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National Association of Federally-Insured Credit Unions

July 5, 2022

International Trade Administration
U.S. Department of Commerce
1401 Constitution Avenue NW
Washington, DC 20230

Re: Developing a Framework on Competitiveness of Digital Asset Technologies
Docket ITA-2022-0003; RIN 0625-XC04

Dear Sir or Madam:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the request for comment (RFC) on establishing a framework for enhancing U.S. economic competitiveness in, and leveraging of, digital asset technologies, including central bank digital currency (CBDC). NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 130 million consumers with personal and small business financial service products.

In little more than five years, the cryptocurrency market's value rose from roughly $14 billion in November 2016 to $3 trillion in November 2021. In June 2022, the market receded to a total value of just under $1 trillion. Although the volatility of cryptocurrencies has long been recognized as a risk, the magnitude of recent market fluctuations should lend urgency to federal agency efforts to develop an appropriate regulatory framework for digital assets. In the context of promoting American competitiveness, such a framework should emphasize several key principles:

1. a level playing field for credit unions, banks, and other financial companies seeking to engage with digital asset technologies;
2. the application of consumer protection laws to entities facilitating consumer engagement with digital assets; and
3. support for responsible innovation within the credit union industry.

With respect to the possible introduction of a CBDC, NAFCU believes the cost of pursuing such an initiative would far outweigh any of the hypothesized benefits. As noted in NAFCU's comments to the Federal Reserve, administration of a CBDC would distract from the Federal Reserve's dual mandate of achieving both stable prices and maximum sustainable employment, while risking significant disruption to the stability and role of credit unions and other depository institutions.[1]

General Comments

[1] *See* NAFCU, Letter to Board of Governors of the Federal Reserve System re: "Money and Payments: The U.S. Dollar in the Age of Digital Transformation," (May 20, 2022), available at https://www.nafcu.org/comment-letter-federal-reserve-central-bank-digital-currency-File.

Section 8(b)(iii) of the Executive Order on "Ensuring Responsible Development of Digital Assets" (the Executive Order) directs the Secretary of Commerce, in consultation with the Secretary of State, the Secretary of the Treasury, and the heads of any other relevant agencies, to establish a framework for enhancing U.S. economic competitiveness in, and leveraging of, digital asset technologies. NAFCU supports a competitive framework for digital assets that preserves credit unions' ability to compete with other financial institutions and companies on a level playing field.

Historically, credit unions have served a unique function in the delivery of financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was recognized as a way to promote provident credit and to make financial services available to people, many of whom otherwise would have no access to affordable credit. Credit unions are not-for-profit cooperatives owned and governed by their members who elect volunteer boards of directors under a principle of "one member one vote."

Federally-insured credit unions (FICUs) are subject to a comprehensive framework of federal prudential and consumer financial protection regulation and are regularly examined either by the National Credit Union Administration (NCUA) or their appropriate state supervisory authority (SSA). The largest credit unions (those with $10 billion or more in total assets) are also supervised by the Consumer Financial Protection Bureau (CFPB). An equivalent system of safety and soundness oversight and consumer protection supervision does not always apply to other companies offering digital asset products to consumer or investors. In some cases, unregulated or underregulated entities may be operating in areas where the application of consumer protection law to a particular business model is unclear. In other cases, such as those involving decentralized organizations, structural gaps in the current landscape of financial regulation frustrate efficient supervision and enforcement activity, a fact acknowledged by federal banking regulators in the President's Working Group Report on Stablecoins.[2]

FICUs seeking to facilitate member engagement with digital assets may only do so by following all applicable laws and regulations, which can impose significant restraints on activity that the broader digital asset marketplace takes for granted. For example, the authority of FICUs to provide digital asset custodial services remains an unanswered question, whereas banks supervised by the Office of the Comptroller of the Currency (OCC) have benefited from affirmative clarification in this area and others.[3] NCUA guidance has, however, acknowledged the existing authority of FICUs to provide digital asset related services by engaging a registered broker-dealer and has informed FICUs that they may utilize distributed ledger technology, provided its use conforms with applicable law and regulation.[4]

To the extent that the marketplace for digital assets is inherently global, the International Trade Administration (ITA) and Department of Commerce (Commerce) should ensure that U.S. financial

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[2] See President's Working Group on Financial Markets, Report on Stablecoins, 2 (November 2021), available at https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.
[3] See e.g., OCC, Interpretive Letter #1170 (July 22, 2020) (providing cryptocurrency custodial services is permissible in both non-fiduciary and fiduciary capacities); OCC, Interpretive Letter #1172 (September 21, 2020) (banks may hold dollar deposits serving as reserves backing stablecoin in certain circumstances); OCC, Interpretive Letter #1174 (January 4, 2021) ("banks may buy, sell, and issue stablecoin to facilitate payments.").
[4] *See* NCUA, LCU 22-CU-07 "Federally Insured Credit Union Use of Distributed Ledger Technologies," (May 25, 2022) ; NCUA, LCU 21-CU-16 "Relationships with Third Parties that Provide Services Related to Digital Assets" (January 7, 2022).

institutions are able to operate on a level playing field relative to foreign banking organizations and other entities that may be offering digital asset products or services. For the credit union industry, this objective can be supported by encouraging the NCUA to support responsible innovation and regulation that is responsive to the changing financial habits of American consumers.

In September 2021, NAFCU submitted comments to the NCUA that described in detail how the agency might pursue these objectives.[5] Included in NAFCU's recommendations was the principle of a form-agnostic approach and common taxonomy for assessing digital assets and the application of related technologies. NAFCU has also encouraged the NCUA to support a credit union sandbox and pilot program to permit structured engagement with digital assets without the fear of uncertain compliance risks. Similar programs and initiatives extended to credit unions at other federal agencies that may be charged with regulating digital asset activities would also have value. Accordingly, NAFCU encourages the ITA and Commerce to encourage collaboration among federal banking regulators to ensure that experimental pilot programs and regulatory sandboxes are broadly accessible to credit unions and that participation in these programs is not cost prohibitive or contingent on the size of a particular institution.

A framework aimed at fostering U.S. competitiveness should also seek to mitigate the potential for regulatory arbitrage by emphasizing the applicability of appropriate prudential oversight (e.g., safety and soundness compliance for entities seeking access to the Federal Reserve's payment system), and the application of consumer financial law to entities engaged in providing digital asset services to consumers. Additionally, an effective framework for promoting competitiveness at home and abroad should aim to eliminate arbitrary regulatory distinctions within the U.S. financial sector that might favor one type regulated financial institution over another as the preferred vehicle for providing digital asset related services. More specifically, future laws and frameworks that address the digital asset activities of federally insured depositories as a class of financial institutions should be broadly inclusive of credit unions.

CBDC Does Not Represent the Best Method for Achieving Financial Inclusion Objectives

The President's Executive Order envisions a whole of government approach to support development of a CBDC; however, NAFCU believes that federal administrative resources could be put to better use, particularly in the domain of financial inclusion, by prioritizing existing financial sector infrastructure and community development programs.

NAFCU continues to support increased funding for the Community Development Financial Institutions (CDFI) Fund and the Community Development Revolving Loan Fund (CDRLF). These programs have proven to be an invaluable means of providing financial services to underserved areas and demonstrated their worth during the pandemic. Programs such as the CDFI Fund or the CDRLF help credit unions invest directly into communities. By contrast, the upfront technology expenditures necessary to operationalize a CBDC would be unlikely to provide the same type of immediate and tangible impact for underserved communities.

[5] *See* NAFCU, Letter to NCUA re: Digital Assets and Related Technologies RFI, (September 27, 2021), available at https://www.nafcu.org/system/files/files/9.27.21%20Letter%20to%20NCUA%20re%20Digital%20Assets%20and%20Related%20Technologies%20RFI.pdf.

There are nearly 500 CDFI credit unions today, and that number has grown over the last two years. In addition to increased funding, NAFCU has shared with Congress the need for a modernized and streamlined application process. Even in the most optimistic scenario, a CBDC offers only an attenuated method for achieving financial inclusion by modifying the operation of payment channels, whereas supporting the CDFI Fund's operations would directly address practical obstacles (i.e., cumbersome application processes and application backlogs) that stand in the way of immediate assistance to underserved communities.

A CBDC could, theoretically, yield greater payments efficiency in a country that currently lacks mature payment systems and in these jurisdictions the appeal of a CBDC as a financial inclusion tool is understandably greater. However, the United States is not such a country and American consumers have access to a mature and reliable payments system. In this regard, hypothesized improvements to domestic and cross-border payments would likely be marginal, especially when real-time payments can already be made, and the improvements needed to reduce international remittance costs are largely dependent upon legal harmonization efforts which do not depend on the technical infrastructure of a CBDC.

Supporting Credit Union Efforts to Reach Underserved Population Will Advance Financial Inclusion Objectives More Efficiently Than a CBDC

Credit unions, like many community institutions, have strong relationships with their members and strive to provide affordable financial products and services that are tailored to individual needs. While the products offered by credit unions can vary based on particular fields of membership, the credit union industry as a whole has embraced new technology over the past twenty years, such as remote deposit capture (RDC) and mobile banking, to improve access to financial services.[6]

Credit unions have also demonstrated a commitment to maintaining a physical presence in the communities they serve. A 2019 Federal Reserve study demonstrated a recent dramatic decline in bank branches in rural areas.[7] More specifically, the study showed that 7 percent of rural bank branches were closed between 2012 and 2017 and that number grew to 11 percent through 2019. Credit unions were the only financial institution that added branches in both rural and urban areas, demonstrating credit unions' commitment to their members and to serving underserved communities.

Investment in physical branches located in rural areas shows that credit unions are expanding into underserved areas. This type of brick-and-mortar presence provides tangible evidence of financial inclusion and participation in the affairs of a community; whereas a CBDC provides simply another means of executing electronic payments. To the extent that there are other, theoretical cost savings that can be associated with the introduction of a new CBDC payments rail, these can be realized through existing public and private efforts. Within the credit union industry, there is already significant attention to payments innovation. In surveys conducted between 2019 to 2021,

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[6] NAFCU, 2020 Report on Credit Unions, 19 (2020), available at https://www.nafcu.org/sites/default/files/2020%20NAFCU%20Annual%20Report%20on%20Credit%20Unions.pdf.
[7] *See* Federal Reserve, Perspectives from Main Street: Bank Branch Access in Rural Communities (2019), available at https://www.federalreserve.gov/publications/november-2019-bank-branch-access-in-rural-communities.htm.

more than half of NAFCU-member credit unions indicated that they expected to invest in payments processing over the next three years.[8]

To accomplish broader financial inclusion objectives that payments improvements alone may not fully address, NAFCU encourages the ITA and Commerce to support legislative proposals to grant all federal credit unions the ability to include underserved areas in their fields of membership. Bills such as the "Expanding Access for Underserved Communities Act" would complement existing credit union efforts to provide low-cost loans and accounts to populations in need and simultaneously fill the gap left by departing bank branches in rural and underserved areas.[9]

Introduction of a CBDC Would Significantly Disrupt Credit Union Operations and Pose Financial Stability Risks

As NAFCU has noted in its comments to the Federal Reserve, soliciting input on hypothetical models of CBDC without clear regulatory parameters or potential design choices to consider frustrates the public's ability to consistently evaluate costs and benefits. Yet even in the absence of a formal proposal, any government policy favoring CBDC must demonstrate that CBDC is superior to alternative methods for promoting financial inclusion, protecting consumer privacy, guarding against criminal activity, and ensuring financial stability. Based on the limited information presented in the RFC, NAFCU anticipates that the costs and risks associated with introducing a CBDC will outweigh any potential benefits.

Given that the RFC does not describe how a CBDC might be issued, NAFCU assumes that the ITA and Commerce do not have a specific policy preference for either a direct model of issuance or an indirect model. Although NAFCU is generally skeptical of any type of CBDC, a direct model would be the most disruptive to credit unions and other depository institutions.

Offering CBDC directly to consumers through government accounts would constitute a radical expansion of the Federal Reserve's mission and involvement in the economy, and NAFCU strongly discourages any model for issuing CBDC that relies upon such an arrangement. While an intermediated CBDC is preferrable to a disintermediated (i.e., direct) model of issuance for the purpose of avoiding the most acute destabilizing effects on the U.S. financial system, significant risks are still present. NAFCU is concerned that the only meaningful benefit of intermediation relates to the government's ability to avoid the compliance costs associated with providing direct banking services by allocating those costs to private account hosting institutions.[10]

To the extent the RFC contemplates an intermediated form of CBDC that relies upon existing financial sector compliance infrastructure to facilitate issuance to the public, there is little evidence

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[8] NAFCU, Report on Credit Unions, 21 (2021).
[9] H.R.7003, "Expanding Access for Underserved Communities Act," 117th Congress (2021-2022), https://www.congress.gov/bill/117th-congress/house-bill/7003/all-actions?s=1&r=1&overview=closed. *See also* NAFCU Letter re: Bank Attacks on H.R. 7003 – Expanding Financial Access for Underserved Communities Act (April 25, 2022), available at https://www.nafcu.org/system/files/files/4-25-22%20NAFCU%20Letter%20on%20Banking%20Deserts%20and%20HR%207003.pdf.
[10] *See* Federal Reserve, Money and Payments: The U.S. Dollar in the Age of Digital Transformation, 14 (2021). "An intermediated model would facilitate the use of the private sector's existing privacy and identity-management frameworks; leverage the private sector's ability to innovate; and reduce the prospects for destabilizing disruptions to the well-functioning U.S. financial system."

to support the view that either the public or financial institutions would benefit from such an arrangement.

As an initial matter, the RFC omits any practical details regarding how financial institutions might cover the costs associated with verifying CBDC accounts, managing Bank Secrecy Act (BSA) compliance and addressing anti-money laundering (AML) risks, not to mention other consumer compliance obligations related to payments. In general, these functions are expensive for credit unions to perform and the RFC does not posit any method for avoiding or recovering these costs under intermediated model of CBDC.

Estimating the precise magnitude of CBDC-related compliance costs is also difficult because the RFC does not offer any indication of how privacy interests will be balanced. The degree of anonymity provided to CBDC payments and how related policy frameworks will address AML compliance or counter terrorist financing (CFT) activities are open-ended questions.

A CBDC might also put strain on credit unions' ability to secure liquidity and support lending activity during times of economic stress. In periods of crisis, a flight to safety would favor CBDC and credit unions would have limited ability to compete rate-wise against interest-bearing CBDC or CBDC accounts with no end-user limits. Even a non-interest bearing CBDC could be attractive if consumers or businesses prefer absolute safety or have urgent liquidity needs. Precedent suggests that when these conditions materialize, money will move rapidly to the least risky asset, as it did when Treasury yields spiked in March 2020.[11]

A flight to safety that involves commercial deposit substitution could profoundly alter mechanisms for maturity transformation and make it more difficult for credit unions to recover after periods of crisis.[12] If credit unions were to experience a sharp decline in deposit balances as members shifted their money to CBDC, the negative impact on lending activity could simultaneously constrain efforts to increase rates on insured shares. These effects could impair the important role credit unions have played in their communities as dependable and affordable lenders.

If outflows from commercial deposit accounts into CBDC occur during a crisis, the Federal Reserve's management of resulting liquidity stress could also result in greater balance sheet risk. As the Federal Reserve provides more liquidity to commercial banks as deposits are substituted for CBDC, the Federal Reserve would assume the risks associated with acceptance of new bank collateral. If the demand for liquidity is very great, the Federal Reserve might need to accept less liquid assets or riskier securities.[13] In this regard, a CBDC's potential negative effects on the stability of the broader U.S. financial system could impair the financial sector's overall competitive strength.

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[11] *See* Annette Vissing-Jorgensen, The Treasury Market in Spring 2020 and the Response of the Federal Reserve, NBER Working Paper No. 29128 (August 2021), available at http://www.nber.org/papers/w29128.
[12] *See* J. Fernández-Villaverde, D. Sanches, L. Schilling et al., "Central bank digital currency: Central banking for all?", Review of Economic Dynamics 41, 227, 234 (2021), available at https://economics.smu.edu.sg/sites/economics.smu.edu.sg/files/economics/pdf/Seminar/2022/FERNAN~1.PDF.
[13] *See* BIS, Committee on Payments and Market Infrastructures, "Central Bank Digital Currencies," 14 (March 2018), available at https://www.bis.org/cpmi/publ/d174.pdf.

Payments Innovation Does Not Depend on the Introduction of a CBDC

In general, the existing alternatives to CBDC already provide a robust payments ecosystem and are capable of supporting future innovation. On the public side, the Federal Reserve maintains several services to facilitate wholesale and retail payments. These include a check-processing service, FedACH, which supports credit transfers and direct debits, the Fedwire Funds and National Settlement Services, which support wholesale payments, and in 2023, the FedNow Service, which will support real-time transfers of interbank payments. On the private side, there is ample evidence that payments innovation is a priority for credit unions as well as other payment system stakeholders.[14]

NAFCU expects that future enhancements to cross-border digital payments will be driven by industry-led investments. For example, in April 2022, The Clearing House, EBA CLEARING, and SWIFT announced that they would launch a pilot service for immediate cross-border (IXB) payments. Separately, the BIS is pursuing its own cross-border payments improvement project, Nexus, which proposes to streamline the process of linking national banking systems.

To the extent that cross-border payments improvement features significantly in the ITA's vision for future American global competitiveness, a more targeted inquiry that considers existing public and private sector initiatives would likely identify other alternatives to CBDC. The ITA should also recognize the Federal Reserve's existing work to enhance the messaging standard it uses for Fedwire, which will eventually support greater interoperability with global settlement systems.[15] By comparison, a wholesale CBDC would only offer an alternative and unproven technical approach without addressing other major barriers to cross-border payments efficiency, such as the need for regulatory harmonization.

Conclusion

Given the lack of clarity regarding specific CBDC parameters and design features, NAFCU does not believe that sufficient evidence exists to justify development of a CBDC, particularly when better alternatives for achieving the same purported benefits already exist. Credit unions are well positioned to improve underserved populations' access to affordable financial products and their efforts do not depend upon the introduction of a CBDC.

With respect to fostering U.S. competitiveness in the broader arena of digital asset related activities, NAFCU encourages the ITA and Commerce to support a level playing field, the consistent application of consumer financial protection law, and the encouragement of responsible credit union innovation.

NAFCU and its members appreciate the opportunity to comment on the RFC. Should you have any questions or require any additional information, please contact me at amorris@nafcu.org or (703) 842-2266.

Sincerely,

[14] For example, The Clearing House already offers real time payments through its RTP service.
[15] *See* Federal Reserve, "New Message Format for the Fedwire® Funds Service," 86 Fed. Reg. 55600 (October 6, 2021).

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