ELIZABETH WARREN
MASSACHUSETTS

COMMITTEES:
BANKING, HOUSING, AND URBAN AFFAIRS
ARMED SERVICES
FINANCE
SPECIAL COMMITTEE ON AGING

United States Senate

UNITED STATES SENATE
WASHINGTON, DC 20510–2105
P: 202–224–4543

2400 JFK FEDERAL BUILDING
15 NEW SUDBURY STREET
BOSTON, MA 02203
P: 617–565–3170

1550 MAIN STREET
SUITE 406
SPRINGFIELD, MA 01103
P: 413–788–2690

www.warren.senate.gov

July 26, 2021

The Honorable Janet Yellen
Secretary
United States Department of Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Secretary Yellen:

I am writing to you in your capacity as Chair of the Financial Stability Oversight Council (FSOC) regarding the need for a coordinated and cohesive regulatory strategy to mitigate the growing risks that cryptocurrencies pose to the financial system. FSOC is responsible for identifying and responding to emerging risks to financial stability, and I am pleased to see that the Council has begun devoting more attention to this critical issue.[1] I urge FSOC to act with urgency and use its statutory authority to address cryptocurrencies' risks and ensure the safety and stability of our financial system.

I have become increasingly concerned about the dangers cryptocurrencies pose to investors, consumers, and the environment in the absence of sufficient regulation in the United States.[2] However, as the demand for cryptocurrencies continues to grow and these assets become more embedded in our financial system, the Council must determine whether these trends raise concerns beyond investor and consumer protection and extend to broader systemic vulnerabilities that could threaten financial stability.

As of June 2021, there are estimated to be more than 2,000 cryptocurrencies in global circulation, with a market value that could exceed $2 trillion.[3] There are a number of ways that our financial system has become exposed to these assets to such an extent that material distress

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[1] Financial Stability Oversight Council, "Minutes of the Financial Stability Oversight Council," June 11, 2021, https://home.treasury.gov/system/files/261/FSOC_Minutes_6-11-21_1.pdf; Financial Stability Oversight Council, "Minutes of the Financial Stability Oversight Council," March 31, 2021, https://home.treasury.gov/system/files/261/FSOC_Minutes_6-11-21.pdf.
[2] Letter from Senator Warren to Securities and Exchange Commission Chair Gensler, July 7, 2021, https://www.warren.senate.gov/imo/media/doc/Draft%20SEC%20Crypto%20Exchange%20Letter%2007.7.2021%20clean.pdf; Remarks from Senator Warren to the U.S. Senate Banking, Housing, and Urban Affairs Committee's Subcommittee on Economic Policy, June 9, 2021, https://www.banking.senate.gov/newsroom/majority/at-hearing-warren-delivers-remarks-on-digital-currency.
[3] Written testimony of Sarah Hammer to the U.S. House Committee on Financial Services, June 30, 2021, https://financialservices.house.gov/uploadedfiles/hhrg-117-ba09-wstate-hammers-20210630.pdf.

in the cryptocurrency market could spread throughout the financial sector. Some examples of this exposure include:

- **Exposure to Hedge Funds and Other Investment Vehicles that Lack Transparency:** Hedge funds are "aggressively increasing exposure to blockchain technologies and cryptocurrency,"[4] with a recent survey of "hedge funds managing an average of [$]7.2 billion show[ing] that North American funds expect to have a 10.6% average exposure to cryptocurrency by 2026."[5] According to another survey, 27% of institutional investors in the United States – including hedge funds, pension funds, and family offices – held crypto assets in 2020, up from 22% in the previous year.[6] At the same time as their participation in this market increases, the lack of standardized data reporting requirements makes the exact extent of hedge funds and other institutional investors' exposure to this market a "blind spot for regulators and banks acting as prime brokers to these funds."[7]

- **Risk to Banks:** As the Bank of International Settlements has noted, "the growth of crypto-assets and related services has the potential to raise financial stability concerns and increase risks faced by banks."[8] Some cryptocurrencies are highly volatile, which presents liquidity, credit, market, and operational risks for banks.[9] These risks may be further amplified if cryptocurrency companies are able to gain banking charters without being required to abide by the same safety and soundness regulations to which traditional banks are subject.[10]

- **Unique Threats Posed by Stablecoins:** Stablecoins are a particular type of cryptocurrency pegged to the value of one or multiple assets. Because of the interconnectedness of a potential global stablecoin network, a "poorly designed and unregulated" [11] stablecoin initiative could pose risks to financial stability, particularly in the event there is a run "where many holders attempt to liquidate their stablecoins at the same time…with potentially severe consequences for domestic or international economic activity, asset prices, or financial stability."[12]

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[4] Forbes, "Hedge Funds Invest in Crypto," Carrie McCabe, July 21, 2021, https://www.forbes.com/sites/carriemccabe/2021/07/21/hedge-funds-invest-in-crypto/?sh=5a5558c7570c.

[5] Written testimony of Alexis Goldstein to the U.S. House Committee on Financial Services, June 30, 2021, https://financialservices.house.gov/uploadedfiles/hhrg-117-ba09-wstate-goldsteina-20210630-u1.pdf

[6] Business Insider, "As many as 36% of large investors own crypto assets, and bitcoin is the most popular, Fidelity says," Carmen Reinicke, June 9, 2020, https://markets.businessinsider.com/currencies/news/crypto-assets-bitcoin-owned-large-investors-institutional-fidelity-survey-percentage-2020-6.

[7] *Id.*

[8] Bank for International Settlements, "Discussion Paper: Designing a prudential treatment for crypto-assets," Basel Committee on Banking Supervision, December 2019, https://www.bis.org/bcbs/publ/d490.pdf.

[9] *Id.*

[10] Independent Community Bankers of America, "Cryptocurrencies & Digital Dollar," https://www.icba.org/our-positions-a-z/payment/payments/cryptocurrencies.

[11] Board of Governors of the Federal Reserve System, "Financial Stability Report," November 2019, https://www.federalreserve.gov/publications/files/financial-stability-report-20191115.pdf.

[12] *Id.*

- **Use in Cyberattacks that Can Disrupt the Financial System:** In its 2017 Financial Stability Report, the Office of Financial Research noted that cryptocurrencies "can increase the incentive to conduct malicious cyber activity."[13] Indeed, between 2019 and 2020, the cost of ransomware attacks reported to the Federal Bureau of Investigation grew by more than 200%, a spike cybersecurity professionals partly attributed to the growth of cryptocurrencies, which are "less regulated and harder to trace than other forms of payment, making them attractive to hackers."[14] According to the Office of Financial Research, these cyber incidents can, in turn, threaten financial stability when the affected firm provides a service that cannot be substituted, or there is a loss of confidence among market participants and data integrity is compromised.[15]

- **Risks from "Decentralized Finance" (DeFi):** DeFi refers to a fast-growing and highly opaque corner of the cryptocurrency market which allows users to engage in a variety of financial activities – including lending, borrowing, and trading derivatives to take on leverage – without an intermediary like a bank.[16] Given that participants and project developers may remain anonymous, DeFi could present particularly severe financial stability risks. According to a 2019 Financial Stability Board report, decentralized financial technologies may raise new forms of concentration risks, unclear allocation of liability, and recovery and resolution challenges.[17]

These examples demonstrate the extent to which cryptocurrencies currently touch or can ripple through nearly every corner of the financial system. As such, it is essential that the policy response to the risks posed by these assets is coordinated and holistic, rather than fragmented amongst individual financial agencies. As the body responsible for coordinating amongst U.S. financial regulators, FSOC should take a leading role in developing a comprehensive regulatory regime for cryptocurrencies, especially since "no single regulator inspects cryptocurrency exchanges or brokers," leaving much of the cryptocurrency market outside of regulators' individual jurisdictions.[18]

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[13] Office of Financial Research, "Financial Stability Report," 2017, https://www.financialresearch.gov/financial-stability-reports/files/OFR_2017_Financial-Stability-Report.pdf.
[14] PBS News Hour, "Why ransomware attacks are on the rise – and what can be done to stop them," Lynsey Jeffery and Vignesh Ramachandran, July 8, 2021, https://www.pbs.org/newshour/nation/why-ransomware-attacks-are-on-the-rise-and-what-can-be-done-to-stop-them.
[15] *Id.*
[16] Wall Street Journal, "DeFi is Helping to Fuel the Crypto Market Boom – and Its Recent Volatility," Paul Vigna, June 3, 2021, https://www.wsj.com/articles/defi-is-helping-to-fuel-the-crypto-market-boomand-its-recent-volatility-11622712602.
[17] Financial Stability Board, "Decentralised financial technologies," June 6, 2019, https://www.fsb.org/wp-content/uploads/P060619.pdf.
[18] Wall Street Journal, "Bitcoin Fraud Concerns Draw Scrutiny From Regulators," Dave Michaels and Andrew Ackerman, July 6, 2021, https://www.wsj.com/articles/bitcoin-draws-more-scrutiny-from-regulators-worried-about-fraud-11625576400.

One of FSOC's statutory purposes is "to respond to emerging threats to the stability of the United States financial system".[19] Beyond its ability to serve as a forum for regulators to discuss and coordinate strategies in response to financial stability threats, FSOC was given special authorities to address these risks. In addition to its authority to designate individual institutions as "systemically important," FSOC also has the power to designate certain financial activities to be subject to heightened regulation. Specifically, Section 120 of the Dodd Frank Wall Street Reform and Consumer Protection Act gives FSOC the ability to "provide for more stringent regulation of a financial activity by issuing recommendations to the primary financial regulatory agencies" when the " conduct, scope, nature, size, scale, concentration, or interconnectedness of such activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among bank holding companies and nonbank financial companies, financial markets of the United States, or low-income, minority, or underserved communities."[20]

FSOC should review this matter and determine whether it is appropriate to utilize its statutory authority to contain the systemic risks posed by the growing cryptocurrency market. The longer that the United States waits to adapt the proper regulatory regime for these assets, the more likely they will become so intertwined in our financial system that there could be potentially serious consequences if this market comes under stress.

Thank you for your attention to this important matter.

Sincerely,

Elizabeth Warren
United States Senator

[19] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203.
[20] *Id.*