Stablecoins, The Genius Act: Some Historical Cautionary Tales

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Introduction

- The Genius Act of July 2025 sets out a framework to regulate and promote stablecoins as a digital money that incorporates the advantages of new digital technologies such as the blockchain
- The Genius Act opens a number of issues on the implementation of a safe private currency from a century ago
- The Act ignores some potential flaws that should be revisited before it leads to a satisfactory outcome
- I discuss how successful private currency was implemented in the US and Canada long before the establishment of central banks
- My focus is primarily on SC as a possible form of domestic retail currency and less on its wholesale and international possibilities

Introduction

- Digital currencies must satisfy the basic functions of money as a unit of account, medium of exchange and a store of value
- Digital currencies are a financial innovation nearly 250 years after Adam Smith compared bank notes to specie coins in 1776
- " The gold and silver which circulates ..may very properly be compared to a highway, which, while it circulates and carries to market all the grass and corn of the country, produces itself nota single pile of either. The judicious operations of banking, by providing **..., a sort of wagon-way through the air**, enable a country to convert..., a great part of its highways into good pastures and cornfields, and thereby to increase very considerably the annual produce of its land and labor...."

The Genius Act July 2025

- The act allows banks, non banks and other institutions including state chartered entities to issue stable coins
- SCs backed 100% by cash, Treasuries uninsured bank deposits, repo…
- Large issuers with issue >$10B to be regulated by the Fed and OCC
- Small issuers ,<&10B regulated by states
- Features: SC redeemable on demand; not legal tender; no bailouts

Stablecoin: Lessons of Earlier Private Currencies

- Problem was to create No Questions Asked currency (Gorton and Zhang 2017)
- Will the note always be equal to face value?
- Not the case in the U.S. Free banking experience
- Successful in the U.S. National banking era
- Also successful with chartered banks in Canada
- Genius Act has elements of all 3 regimes

Free banking 1837 -1863

- FB did not satisfy NQA
- State regulations: easy to set up a bank; bank note issue backed by the security of state bonds (par and market value; redeemable on demand, regulated by state bank examiners)
- Bank notes circulated at different discounts reflecting distance to redemption, quality of the backing -- despite counterfeit detectors
- ***FB episode experience: widespread counterfeiting, frequent bank failures; panics, financial instability***
- Depended on state governance
- Genius Act by allowing smaller issues to be state regulated opens up the same problems as under FB

National Banking 1864-1914

- National Banking System established to remedy failings of the FB era
- National banks issued notes more than 100% backed by UST bonds, redeemable on demand in lawful currency, double liability; regulated by the OCC
- But it took 10 years to become NQA
- Government intervention overcame problems
- 1. Making NB notes accepted everywhere at par required UST redemption centers
- 2.UST insured NB notes against insolvency
- 3. UST set up gross clearing mechanism “National Bank Note Redemption Agency” 1874
- Each NB to deposit 5% of notes in lawful M

National Banking 1864-1914

- Key lesson from NB era: it took government establishment of enforceable rules to solve the problems of acceptance at par; rapid redeemability; and insurance against default
- The Genius Act does not detail how exactly similar problems would be solved
- The UST solved the problems in NB era
- What will happen when significant defaults occur because of similar issues?

IV. Canadian Chartered banking 1867-1935

- Canada had a private chartered banking system without a central bank longer than the U.S.
- It provided a uniform safe NQA currency
- CDN chartered banks could issue notes backed by specie, bonds and capital
- CDN nationwide branch banking system had zero banking panics while U.S. had many
- Like the U.S. it took a long time to reach an NQA currency

IV. Canadian Chartered banking 1867-1935

- Problems preventing NQA overcome by the CDN Bankers Association and the Federal Government
- 1. a note insurance scheme
- 2. clearing mechanism like the US
- 3. mechanism to prevent systemic effects of bank failures-designated banks absorbed putative insolvent banks
- Unlike the US, Canada maintained monetary and financial stability , lessening the case for a central bank (Bordo and Redish 1987)
- Key lesson from CDN experience , like US NB era, is for government regulators along with stable coin issuers to work out the pressing problems of par convertibility on demand, redemption and insurance

Three Policy Lessons

- 1. A safe uniform NQA stable coin is possible with enforceable rules for good behavior
- But problems leading to systemic risks will inevitably require Federal Reserve (and other monetary and regulatory) intervention
- eg shocks to the value of backing of stable coins coming from global and U.S. policy mistakes as happened in the NB era
- 2. In all 3 eras banks failed because of fraud and malfeasance as well as shocks to the real economy leading to contagion and panics

Policy Lessons

- 3. Shocks coming from other parts of the global financial system could spill over into stable coin space and vice versa.
- The Genius Act as it stands has no provision for dealing with them
- A key lesson from the global history of private banking/ currency systems is that at some point they failed to maintain the NQA principle and even broke down in the face of systemic shocks
- This led to the creation of central banks
- It would not surprise me that yet to be revealed flaws in the Genius Act, combined with totally unknown shocks, could lead to introduction of CBCD, even the U.S.

Appendix

- Wilkins (2025)

Category	GENIUS Act (USA)
Law	*Guiding and Establishing National Innovation for U.S. Stablecoins Act* (S.1582), signed July 18, 2025. Effective Jan 18, 2027 or 120 days after final regs.
Scope	Creates first federal framework for **payment stablecoins**.
Definition	Digital asset used for payments/settlement; redeemable 1:1 for monetary value; expected to maintain stable value. Excludes securities, deposits, national currency.
Permitted Issuers	Subsidiaries of insured depositories, OCC-chartered nonbanks/uninsured nat'l banks, Fed-approved foreign bank branches, state-qualified issuers (<$10B), foreign issuers from comparable regimes.
Regulators	OCC for federal nonbank issuers; banking agencies for banks; states if certified "substantially similar." Treasury oversees via Stablecoin Certification Review Committee (SCRC).
Issuer Activities	Limited to issuing, redeeming, managing reserves, custody of reserves/keys, and related support.
Reserves	Full backing with cash, Fed balances, bank deposits, short-term Treasuries, or certain repos/MMFs.
Transparency	Monthly public reserve disclosures; audits by registered accountants.
AML/CFT	Full BSA compliance (AML/KYC, sanctions). Foreign issuers must meet U.S. standards.
Financial Stability	State issuers must convert to federal charter if >$10B outstanding (unless waived).
Yield	Issuers barred from paying interest/yield. (3rd-party rewards not banned but debated.)
Capital/Liquidity	No fixed rules; regulators to design tailored standards.
Consumer Protection	Holders prioritized in bankruptcy; prohibited misleading claims of gov't backing.
Non-Compliant Coins	Unpermitted stablecoins lose "cash equivalent" status after July 18, 2028.