Stablecoins, the Genius Act: Some Historical Cautionary tales

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I Introduction

The Genius Act (Public Law 119-27, 119th Congress) passed in July 2025 sets out a framework for regulations for U.S.payment stable coins—a digital currency to be provided by the private sector. The rationale for this legislation is to promote stable coins as a form of digital money which will take on the advantages of new digital technologies such as the blockchain. An alternative form of digital money is central bank digital currency, which is being developed across the world but not in the U.S.

The Genius Act opens up a number of issues on the implementation of a safe private sector issued currency that were dealt with successfully over a century ago and which may need to be revisited before it leads to a satisfactory outcome. In this paper I analyze how a safe, successful private sector currency was implemented in the US and Canada long before the establishment of central banks. The lessons from 3 earlier eras of private currency have resonance for the Genius Act. My focus will be primarily on stable coins as a possible form of domestic currency and less on its wholesale and international possibilities.

Digital currencies must satisfy the basic functions of money as a unit of account, store of value and medium of exchange. Digital currencies are a financial innovations bank notes were over specie coins as pointed out in 1776 by Adam Smith.

'… "The gold and silver which circulates in any country 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 not a single pile of either. The judicious operations of banking, by providing, if I may be allowed so violent a measure, a sort of wagon-way through the air, enable a country to convert as it were, 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…." (Smith [1776] (1981) WN II.ii.86:321)

Proponents of stable coins argue that stable coins would provide instant and costless access to the payment system which would be a significant saving especially for merchants whose cost at present to access the payments system is considerable , would be a unit of account as stable coins, unlike cryptocurrencies like bitcoin , are defined in terms of dollars and safely backed by dollar assets . It would also serve as a store of value (especially if were interest bearing (Friedman 1969). Other advantages claimed for stable coins include greatly reducing the costs of international transactions, and financing the crypto space (also of course, funding the black sector).

II. The Genius Act July 2025

Figure 1 . Summary Table. Source C. 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.

The key feature of the Genius Act is that it allows banks like JP Morgan, qualifying state chartered entities, Non-bank financial institutions, Crypto companies like Tether and Circle ,US branches of foreign banks to issue digital stable coins defined as currencies backed 100% by US short -term Treasury securities, cash, uninsured bank deposits, reserves at the Federal Reserve and MMFs and repos based on government securities.

The Act distinguishes between 2 types of issuers: large issuers with more than 10 billion dollars in notes and small issuers with less than 10 billion dollars.

The large issuers would be regulated by the Office of the Comptroller of the Currency (OCC) , the Federal Reserveand the FDIC, the smaller issuers by State authorities.

Key features of the Genius Act include that 1. Stable coins would be fully redeemable on demand, 2. that they would not be legal tender ,3. They would not bear interest 4.the issuers would not be bailed out by US monetary authorities should they become insolvent.

The framework for payment stable coins has great resonance to other such arrangements in the monetary history of the U.S. and foreign countries, The issue in the past was to create a safe uniform currency for which the 'No Questions Asked 'principle would be upheld, i.e that the face value of the currency would always be equal to what it would be accepted for in exchange. (Gorton and Zhang 2017). Earlier legislation in U.S. history to create NQA private currency either was unsuccessful—Free banking 1837-1863, or it took a lengthy process of learning by doing to become successful—The National banking era 1864 -1914. The Genius Act has elements of both. Canada's experience with private bank notes also went through a similar learning process.

Free banking in the U.S. 1837-1864

Financial innovation in Europe in the 18tth century led to the use of paper bank notes as a low cost substitute for specie. The First and Second Banks of the U. S . from 1791 to 1836 issued bank notes convertible on demand into specie, which along with specie coin, were moving the country in the direction of a safe uniform currency. States also chartered note issuing bank whose notes often circulated at a discount but which by forced redemptions of the two central banks also moved towards NQA currency status.

In the Free Banking era the states regulated note issuing banks. Free banking had several important features;1. It took minimal capital and red tape to set up a bank ,in contrast to the earlier chartering process; 2.Free banks could issue notes backed by the security of state bonds(some states stipulated the bonds valued as at par and some at market value); the notes were to be immediately redeemable on demand in specie 3. The banks were regulated and supervised by state authorities

Figure 2: state bank notes.

The Free banking era did not satisfy the NQA principle (Gorton and Zhang 2017, Weber 2014). Bank notes circulated at various discounts reflecting the quality of the bond backing, the soundness of the bank, the quality of the state regulations and supervision and the distance of the note from the issuing bank. Valuing the myriads of different bank nots was not costless, despite the wide use of counterfeit detectors---magazines that listed fraudulent and broken notes as well as discount rates on others.

In the Free Banking era counterfeiting was widespread, many banks failed, and the subsequent financial instability was manifest in two severe bank panics which involved runs from bank notes into specie. Not all states were problematic however, the variance of performance ranged from good e.g. New York and Massachusetts with sound regulations and supervision and bad, Michigan and other frontier mid-west states with less than stellar governance had instances of wildcat banking.

This experience represents a cautionary tale for the small issue stable coins to be regulated and supervised by the states under the Genius Act.

III. The National banking era 1864-1914

The National Bank Act of 1864 passed during the Civil War when the Confederate states (opposed to Federal power) were absent. It was designed to create an NQA currency and overcome the flaws of the FB era i.e to create a national uniform safe currency to be perfectly convertible into government issued (lawful) currency (Greenbacks and specie) It also was designed to raise revenue for war finance.

Figure 3: A National bank note.

Under the NB Act, agents could provide capital to establish a national bank anywhere in the U.S. The highly capitalized unit banks could issue national bank notes up to 90% of the value of US government bonds deposited with the Treasury. Issuing these non-interest-bearing notes was a profitable source of seigniorage revenue (Luck 2025). These notes were to be perfectly redeemable into specie or other lawful money on demand. The shareholders of the national banks were subject to double liability. National banks were required to hold reserves in specie and lawful money; the reserve requirement depended on their location in large or small centers. The national banks were to be regulated and supervised by the Office of the Comptroller of the Currency (OCC), a branch of the US Treasury.

As described by Weber (2015), it took a number of years to establish a safe and uniform currency that satisfied the NQA principle. Many innovations were required, almost all involving government regulation. Notable problems overcame included:1. Making national bank notes issued by a myriad of individual banks acceptable at par at every national bank in the country. This required the Treasury setting up note redemption centers in every major city; 2. Treasury provision of insurance against losses to note holders when national banks failed (5% failed over the whole period); 3. The Treasury setting up a gross clearing mechanism "The National Bank Note Redemption Agency" in 1874. To fund it each NB was required to deposit in lawful money 5 % of its note circulation with the Treasury"

With these innovations national bank notes became perfect substitutes for other forms of currency (Friedman and Schwartz 1963) and the U.S. had an NQA monetary system.

The lesson from the National banking period for the Genius Act regime is that it took government establishment of enforceable rules for good behavior to prevent free riding and the incentive to cut corners, to solve the acceptance at par, redeemability and insurance problems which plagued that era. There is little in the Genius act detailing how exactly similar problems will be solved. In the case of the national banks, it was the Treasury that solved these problems. It will be interesting to see what happens when significant defaults occur because of such issues, possibly spilling over to the real economy.

Moreover, a safe currency in the National banking era did not mean overall monetary and financial stability. The National banking system, in addition to providing safe bank notes also engaged increasingly in deposit banking as interest bearing deposits were a more profitable source of business and the expansion of the national bank note issue was limited, in part because of the convenience yield of Treasuries (Gorton and Zhang 2017). A key flaw of that system was that the deposit based fractional reserve banking system was prone to banking panics as depositors fearful for the safety of their deposits attempted en masse to convert them into currency (regardless of whether they were national bank notes or lawful money of any type). Also, the U.S. in this period was on the gold standard and financial shocks from abroad could severely impact the banking and financial system and hence the real economy. Other well-known flaws of the national banking system were: the inverted pyramid of credit(with most of the nation's bank reserves concentrated in New York City and invested in the call loan market thereby linking stock market crashes to banking panics) and the absence of a mechanism to stabilize seasonal shocks (Friedman and Schwartz 1963). The Federal Reserve System was established to overcome these problems although it took another 70 years for it to learn how to be a successful central bank (Meltzer 2005).

IV Canadian chartered banks 1867 to 1935

Canada had a private chartered banking system without a central bank until 1935 which, like the national banks in the U.S. provided a uniform safe NQA currency. The bank shareholders were also subject to double liability. Like in the U.S. the chartered banks could issue banknotes backed by specie, bonds and capital. The banks were initially regulated by the provinces and then after Confederation in 1867, by the Federal government.

Figure 4: Canadian chartered bank notes. Source Fung, Hendry and Weber (2017) page 11, figure 1.

The Canadian nationwide branch banking system had no banking panics in its entire history and fewer bank failures than in the U, S. (Bordo, Redish and Rockoff 2015) but like the U.S., it took a long time to acquire a NQA. The requisites for creating an NQA involved both the banks working through the Canadian Bankers Association (its cartel) and the Federal Government via a series of decennial Bank Acts to create a note insurance scheme, a clearing mechanism very similar to the 1874 US version, and a mechanism to prevent bank failures from having systemic consequences -- designated banks would take over troubled banks before they became insolvent). Unlike the US, Canada maintained monetary and financial stability, lessening the case for a central bank (Bordo and Redish 1987). The lesson from the Canadian experience for US stablecoins, like for the national banking era in the U.S, is for government regulators along with the stable coin issuers to work out the pressing problems of convertibility, redemption and insurance in a framework with enforceable rules to avoid systemic spillovers.

v. Policy Lessons

The policy lessons to be taken from the historical comparisons to US stable coins under the Genius Act include:

First It is possible to have a safe uniform NQA stable coin system with enforceable rules for good behavior. But problems leading to systemic risks will inevitably require Federal Reserve (and other monetary and regulatory) intervention.

These include shocks to the backing of stable coins coming from global and self-induced U.S. policy mistakes on the value of the bond backing. This happened in the NB era. Second in all the three eras examined, banks failed because of fraud and malfeasance as well as shocks to the real economy. This led to contagion and considerable financial stress including systemic panics.

Third, shocks coming from other parts of the global financial system could spill over into the stable coin space and vice versa. The Genius act as it stands has no provision for dealing with them.

One lesson from the history of private currencies in virtually every country of the world is that private banking/currency systems failed at some point 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 even the US introducing a CBDC.

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