Sound Financial Policy

Principled Recommendations For the 119th Congress

CATO INSTITUTE

Nicholas Anthony, Jai Kedia, Norbert J. Michel, Jennifer J. Schulp, George Selgin, and Jack Solowey • Coeditors: Norbert J. Michel and Ann Rulon

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Cato Institute
1000 Massachusetts Ave. NW
Washington, DC 20001
www.cato.org

Authors are the following Cato Institute Center for Monetary and Financial Alternatives scholars: **NICHOLAS ANTHONY**, policy analyst; **JAI KEDIA**, research fellow; **NORBERT J. MICHEL**, vice president and director; **JENNIFER J. SCHULP**, director of financial regulation studies; **GEORGE SELGIN**, senior fellow and director emeritus; and **JACK SOLOWEY**, policy analyst. Coeditors: **NORBERT J. MICHEL** and **ANN RULON**, outreach associate and research coordinator. The authors thank Jerome Famularo for his research assistance.

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Sound Financial Policy: Principled Recommendations for the 119th Congress

Since Cato published the first edition of this policy guide in 2022, several members of Congress have introduced legislation that would make beneficial reforms to the monetary and financial systems in the United States. Although the House even passed some of this legislation, Congress has failed to enact any meaningful reforms. As a result, there has been no change to the long-term trend of increasing levels of regulation that fail to make financial markets more resilient.

Just as important, Congress and the regulatory agencies have yet to provide much-needed clarity for cryptocurrencies, thus leaving the industry without the well-defined framework it needs. Now more than ever, Americans are losing out as innovation in payments is being driven by developers and customers in other countries.

Yet the Cato Institute's 2022 national survey of Americans' beliefs about the financial sector suggests that Americans broadly oppose the long-term regulatory trends in US financial markets.[1] Based on the survey results, most Americans appear to oppose expanding government regulation, even as government officials have consistently expanded financial regulation. While Congress tends to expand government regulation after a period of financial turmoil, Americans oppose such an approach, even in the wake of a crisis, and seem to be open to the idea that market-based regulation can be a better way to promote the public interest.[2]

Most people want the goods and services they use—including their financial products and services—to meet some set of quality and safety standards, but policymakers rarely contemplate market regulation as a potentially better alternative to government regulation. While many assume that no standards would exist in the absence of government regulation, most companies do set standards for their products and services independently of what government requires because doing so attracts customers and enables the companies to earn profits. Competition also provides incentives for other companies to adopt similar—or better—standards. While governments set standards through centralizing legal rules and requirements, markets set standards and enforce rules through competition.

Yet both markets and governments have made mistakes. A crucial distinction is that markets have the flexibility to analyze and adapt, while government rules are often sweeping and difficult to change. While many Americans believe that there should be stricter oversight of the financial industry, they do not necessarily want the kinds of oversight found in extensive bills such as the 2010 Dodd-Frank Act. Instead, they want regulators to enforce the rules that are already on the books and do not support expanding the number of rules, especially those that dictate which financial decisions people can make.

As the Cato survey shows, Americans believe that regulation should serve two primary functions: to protect consumers from fraud (64 percent) and to ensure that financial institutions fulfill obligations to their account holders (53 percent). Other functions, such as restricting access to risky financial products (16 percent), are a priority among far fewer people. And while public opinion surveys have long reported that Americans have little confidence in Wall Street banks and financial firms, Americans seem to distrust government financial regulators as much as they distrust Wall Street. Nearly half (49 percent) have "hardly any confidence" in either, and only 7 percent say they have a great deal of confidence in either Wall Street or government financial regulators.[3]

These survey results can help inform Congress about developing a better monetary and financial framework for the American people. For decades, Congress has empowered regulators to manage private risks and mitigate private losses to prevent financial-sector turmoil from spreading to the rest of the economy, but most Americans are open to a different approach. For instance, 78 percent of Americans think that regulations too often fail to have their intended effect.[4] Additionally, Americans do not think

that regulators help banks make better decisions generally (77 percent) or, specifically, better decisions about how much risk to take (69 percent).[5] (See Figure 1.)

A smoothly running financial system makes it easier and less costly to buy consumer goods, raise the capital necessary for launching or operating a business, borrow money for buying or building a home, and invest in ideas that improve productivity and increase economic opportunity. Just as in other areas of the economy, excessive government regulation and involvement in financial markets prevent firms from best serving the needs of their customers and, therefore, society. Cato's survey results indicate that Americans are very sympathetic to this view.

For policymakers who want to improve financial markets, this policy guide provides practical solutions to reduce excessive government regulation and involvement in financial markets. Here's a preview of the sections included in this policy guide.

SECTION 1: STRENGTHENING FINANCIAL PRIVACY IN THE DIGITAL AGE TO PROTECT CONSUMERS FROM SWEEPING SURVEILLANCE

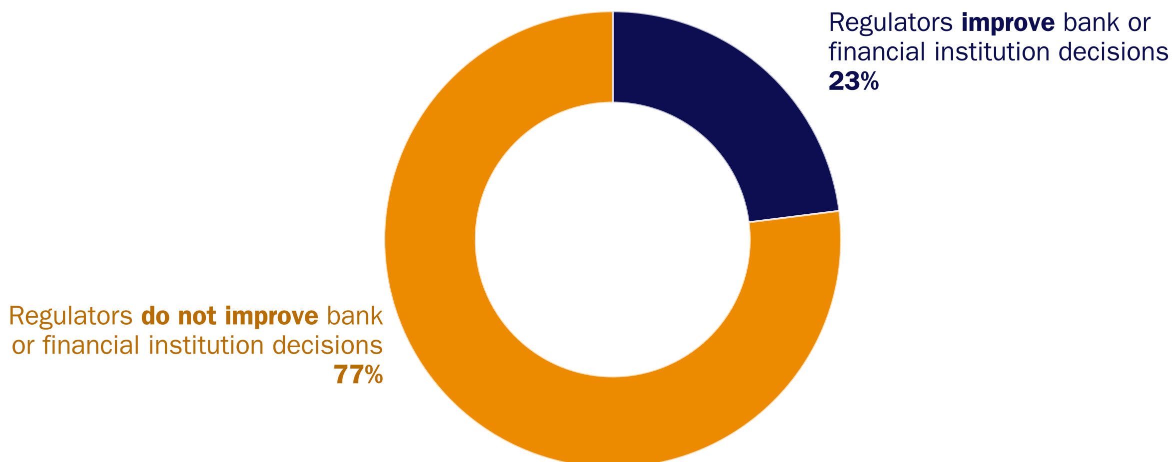
Americans' financial privacy has been eroding for more than 50 years, often hidden in the details of complex policies. Congress can establish stronger financial privacy protections by eliminating many Bank Secrecy Act reporting requirements. If financial records are needed, law enforcement should be required to show probable cause to obtain a warrant—a reform that 83 percent of Americans favor.[6] Shy of eliminating the Bank Secrecy Act or its reporting requirements, Congress could improve financial privacy by enacting inflation-adjusted reporting thresholds for remaining Bank Secrecy Act requirements as well as the Internal Revenue Code, eliminating exceptions in the Right to Financial Privacy Act, and establishing better public oversight for the Financial Crimes Enforcement Network.

SECTION 2: STOPPING THE NEXT EXPANSION BY PROHIBITING THE CREATION OF A CENTRAL BANK DIGITAL CURRENCY

Internationally, governments are increasingly working toward developing and launching central bank digital currencies (CBDCs), which are digital national currencies that are a direct liability of the central bank. But unlike paper dollars, a CBDC would offer neither the privacy protections nor the finality that cash provides to Americans.

Figure 1

Only 23 percent of Americans believe regulators help finance professionals make better decisions



Source: Cato Institute 2022 Financial Regulation Survey.

Launching a CBDC risks ending financial privacy, restricting financial freedom, undermining free markets, and weakening cybersecurity. Congress should prohibit the Federal Reserve and the Treasury from issuing a CBDC.

SECTION 3: OPENING THE DOOR TO CRYPTOCURRENCY INNOVATION BY ELIMINATING UNNECESSARY REGULATORY BARRIERS

Cryptocurrencies remain subject to regulatory uncertainties that hamper their development, along with innovation more broadly. This condition potentially pushes entrepreneurs away from the United States and limits Americans' ability to take advantage of these advances. Congress should create a pro-competitive regulatory framework for stablecoin issuers; provide a clear, practical test for determining whether a crypto project is decentralized; and clarify that securities laws do not apply to decentralized cryptocurrency projects. Congress should also avoid applying punitive tax rules to the crypto ecosystem and, at the very least, remove capital gains taxes applied to alternative currency use.

SECTION 4: POLITICIAN'S ENVIRONMENTAL, SOCIAL, AND GOVERNANCE CONCERNS SHOULD NOT OVERRIDE THE MARKET'S ALLOCATION OF RESOURCES

Congress should ensure that financial regulators do not function as central planners deciding which enterprises are worthy of capital, especially in the name of environmental, social, and governance policy. To achieve this goal, Congress should clarify the scope of mandatory securities disclosures and shrink bank regulators' responsibilities, thus limiting the extent to which environmental, social, and governance policy can politicize financial market regulation without providing clear benefits. Congress should clearly state that disclosures are limited to the type of information relevant to a company's prospects for financial success (as originally contemplated by the 1933 and 1934 securities acts) and repeal the sections of the Dodd-Frank Act that direct the Securities and Exchange Commission to promulgate the conflict minerals and pay-ratio disclosure rules. Congress should also require banking regulators to consider solely economic and financial factors when promulgating regulations, rather than factors that might affect the public's view of a bank, such as the bank's so-called reputational risks.

SECTION 5: MONETARY POLICY THAT HOLDS THE FED ACCOUNTABLE

So long as Congress is inclined to delegate responsibility for conducting monetary policy and limiting financial instability to the Fed, lawmakers should do more to improve the Fed's performance. For instance, Congress can narrow and clarify the Fed's legislative mandate and require that the Fed implement rules-based monetary policy. It can also level the field on which the dollar competes with other potential means of payment so that the Fed faces competitive pressure to preserve, and perhaps enhance, the US dollar's attractiveness as both a domestic and an international exchange medium. A more vibrant financial sector would complement a sounder monetary policy framework, thus providing more economic opportunity for millions of Americans.

SECTION 6: REMOVING BARRIERS TO SMALL BUSINESS CAPITAL FORMATION AND EXPANDING INVESTOR OPPORTUNITIES

Congress should enact an exemption to securities registration for equity offerings that raise funds below a certain threshold, such as $500,000 per year. It should also focus on decreasing the barriers to eligibility for accredited investor status. Congress could, for example, consider investors advised by financial advisers who meet the current accredited investor definition as being accredited themselves.

SECTION 7: OTHER REFORMS TO BOOST COMPETITION AND INNOVATION IN THE FINANCIAL SECTOR

Even if Congress repeals the 2010 Dodd-Frank Act in its

entirety, a dysfunctional regulatory framework would remain. Nonetheless, the legislation represents the most recent large-scale expansion of federal regulatory power, and it solidified the harmful view that federal regulators can and should prevent people from losing money in financial markets. Among its many faults, the Dodd-Frank Act provides a false sense of security by conferring an aura of safety for firms that play by the act's rules. It should be repealed in its entirety.

Congress should also eliminate duplicative federal agencies, narrow Fannie Mae and Freddie Mac's focus to the financing of primary homes, revoke Fannie and Freddie's exemption from the requirement to register their securities offerings, limit the Federal Housing Administration's single-family insurance portfolio to first-time homebuyers, shrink the Securities and Exchange Commission's scope to regulate money market mutual funds, and apply a pro-innovation policy framework for the use of artificial intelligence in financial services.

Section 1: Strengthening Financial Privacy in the Digital Age to Protect Consumers from Sweeping Surveillance

Financial privacy in the United States has been disappearing for more than 50 years. Although many Americans believe that financial information is protected by the Fourth Amendment, that hasn't been the case for decades. Worse yet, much of the surveillance that takes place has been hidden in the weeds of old and complex policies. Recently, the Foreign Intelligence Surveillance Act, or FISA, appeared in headlines across the country as Congress debated whether to reauthorize the government's ability to surveil foreign persons located outside the United States.[1] However, the sweeping surveillance under the Bank Secrecy Act has remained hidden and largely untouched.

Congress should restore financial privacy in the United States. To do so, Congress should establish stronger financial privacy protections by eliminating Bank Secrecy Act reporting requirements, enacting inflation-adjusted reporting thresholds for remaining requirements as well as the Internal Revenue Code, eliminating the exceptions in the Right to Financial Privacy Act, and establishing better public oversight for the Financial Crime Enforcement Network (FinCEN).

THE PROBLEM

The enactment of the Bank Secrecy Act in 1970 was met almost immediately with objections from groups concerned about violations of financial privacy.[2] By forcing banks and other financial institutions to record and report the financial activity of Americans, the Bank Secrecy Act essentially deputized financial institutions as law enforcement investigators. Less than a decade later, Congress enacted the Right to Financial Privacy Act in response to complaints against the regime. Yet, while some progress was made, the Right to Financial Privacy Act was crafted with a list of exemptions to its protections in many situations.

Since then, the Bank Secrecy Act has been officially expanded numerous times as part of both the war on terror and the war on drugs. In addition to being required to file currency transaction reports (CTRs) whenever a customer makes a transaction over $10,000, financial institutions must file suspicious activity reports (SARs) any time a customer's activity might be interpreted as unusual. As it stands, the reasons that SARs are filed appears to have little to do with terrorism and human trafficking. Most often, the issue seems to be suspicions concerning the source of funds or that someone approached the CTR threshold (Figure 2).

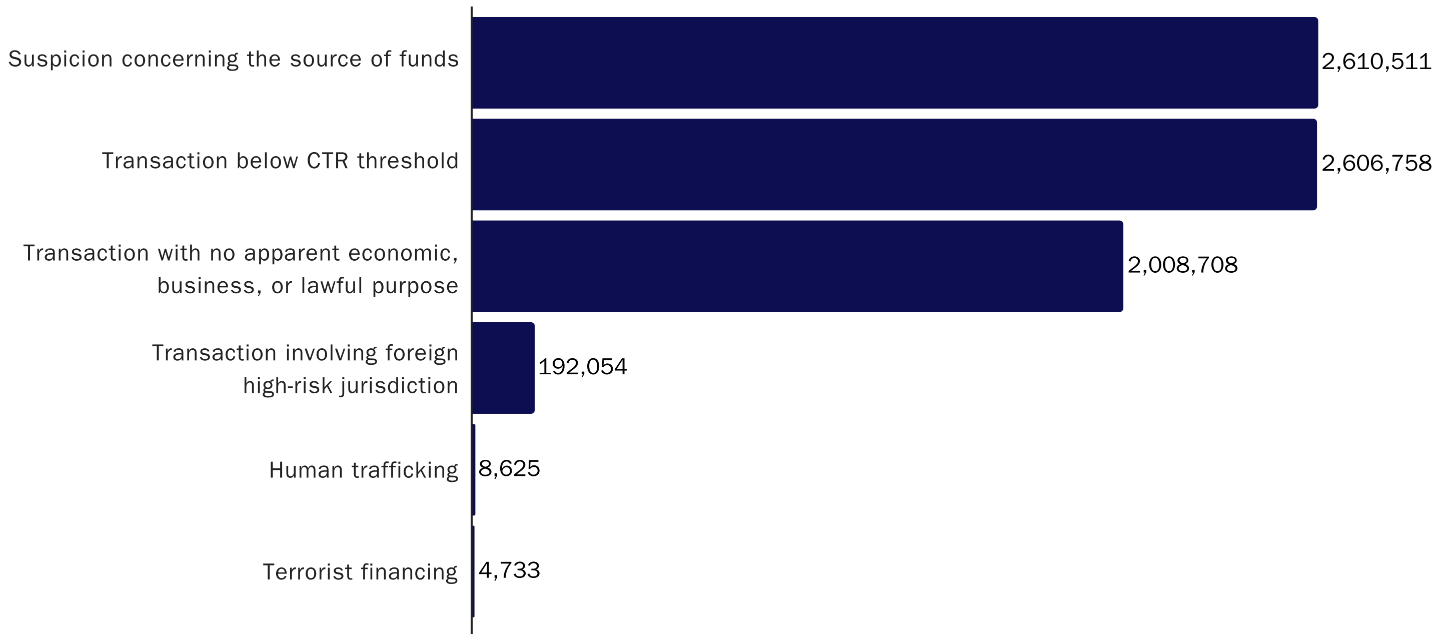
> "Although many Americans believe that financial information is protected by the Fourth Amendment, that hasn't been the case for decades."

Moreover, inflation has effectively increased the scope of activity that banks must report under the Bank Secrecy Act. For instance, the $10,000 threshold for CTRs was set in the 1970s but has never been adjusted for inflation. If it had, the threshold today would be closer to $75,000.[3] Considering that Supreme Court Justices Lewis Powell and Harry Blackmun held in 1974 that the Bank Secrecy Act was constitutional, noting that they felt it was not an undue burden because of its "high" threshold, it's only natural to wonder how they would characterize that burden under today's circumstances.[4]

With such a broad scope, it is little surprise that more than 27 million Bank Secrecy Act reports were filed with FinCEN in 2023.[5] This mass surveillance is conducted without a warrant,

Figure 2

Most suspicious activity reports are filed for relatively mundane reasons



Source: "Suspicious Activity Report Statistics," Financial Crimes Enforcement Network.
Notes: Reports on depository institutions were filed between 2014 and 2022. The currency transaction report (CTR) threshold is $10,000.

Figure 3

Despite tens of millions of reports, Bank Secrecy Act reports only initiated 403 IRS investigations

Sources: "2022 Data Book," Internal Revenue Service; and "Year in Review for FY 2022," Financial Crimes Enforcement Network.

and FinCEN has long resisted calls for statistical information that describes the use of the data it collects. Some information was published in 2024, but it largely showed that while more than 27 million reports were filed with FinCEN, those reports led to only 372 investigations by the IRS (Figure 3).

Worse yet, some government officials seek even larger collections of financial data. In early 2021, the Treasury Department introduced a proposal that, among other things, would require banks and other financial institutions to report on accounts in which $600 or more is moved over the course of a year.[6] In late 2021, Congress largely removed the proposal from consideration after there was widespread backlash from both the general public and the financial industry. Yet an echo of the proposal remained—one that required payments services (e.g., PayPal, Venmo, CashApp) to report on accounts with more than $600 of annual activity—and was ultimately enacted in the American Rescue Plan.[7]

With all these problems in mind, it's no wonder that financial privacy is a serious concern for Americans across the country and across the political spectrum. Both privacy and trust have been cited as top concerns for why millions of Americans are unbanked.[8] Likewise, the Pew Research

Center found that an average of 59 percent of Americans are against the government's monitoring of American citizens.[9] And Reuters found that 75 percent of Americans would not let investigators tap into their internet activity, even in order to combat terrorism.[10] Finally, and most recently, the Cato Institute found that 79 percent of Americans believe it is unreasonable for banks to share their records and transactions with the federal government.[11] Likewise, when asked if the government should need to obtain a warrant to access their financial records, 83 percent of the Americans surveyed said yes.

> "Seventy-nine percent of Americans believe it is unreasonable for banks to share their records and transactions with the federal government."

Privacy may mean different things to different people, but the fact remains that most Americans are concerned about their financial privacy in the wake of this unchecked surveillance. Restoring Americans' constitutional protections is long overdue.

SOLUTIONS

There are several reforms that would help restore financial privacy in the United States, including revising the Bank Secrecy Act; eliminating the exceptions in the Right to Financial Privacy Act; eliminating Section 6050I reporting requirements; requiring inflation adjustments for all Bank Secrecy Act and IRS reporting thresholds; requiring FinCEN to publicly report the number of SARs and CTRs that effectively curb financial crime; protecting peer-to-peer transactions; and prohibiting the Securities and Exchange Commission (SEC) from collecting personally identifiable information in the Consolidated Audit Trail.

- **Revise the Bank Secrecy Act.** Congress should repeal the Bank Secrecy Act. Short of that, Congress should repeal sections of the Bank Secrecy Act that require financial institutions to report on their customers. If law enforcement needs an individual's financial records, law enforcement should be required to show probable cause to obtain a warrant. The basic framework to balance the competing interests of an individual's financial privacy and the government's ability to gather evidence to enforce laws is already present in the Fourth Amendment, so restoring that balance should not be controversial. Congress should amend 12 U.S.C. Sections 3402, 3413, and 3414 as well as 31 U.S.C. Sections 5313–16, 5318(a)(2), 5318A, 5321, 5325, 5326, 5331–32, 5341–5342, and 5351–55.
- **Eliminate the exceptions in the Right to Financial Privacy Act.** Although the Right to Financial Privacy Act was well-intentioned, the list of exceptions included in the act eliminates the bulk of the protections it otherwise offers. For instance, customers are not notified that the government is seeking their financial data, and they are not given the opportunity to object if the information is for Bank Secrecy Act reporting. To offer the protections everywhere except where it really matters is tantamount to offering no protections at all. The Right to Financial Privacy Act should also be strengthened with respect to the formal written requests that it allows government authorities to issue when there is no warrant or subpoena authority available. Congress should strike 12 U.S.C. Section 3408(2), as regulations should not be considered an avenue for circumventing the Fourth Amendment protections this law sought to establish. Likewise, Congress should strike 12 U.S.C. Section 3408(4)(A)2, because Americans should not have to sue the government to have their rights respected when it has already been judged that the authority for a warrant or subpoena does not exist.
- **Eliminate Section 6050I reporting requirements.** No American should be forced by law to report on the activity of another American—especially when that activity is between only two parties and is therefore not subject to the third-party doctrine. Yet for financial transactions using cash or cryptocurrency, the law requires exactly that. Congress should strike 26 U.S.C.

Section 6050I.

- **Require inflation adjustments for all Bank Secrecy Act and IRS reporting thresholds.** If financial reporting requirements remain in effect, they should be updated to reflect the current value of money. Whether it is a CTR or a 6050I report, all reporting thresholds should be adjusted annually for inflation.
- **Require FinCEN to publicly report the number of SARs and CTRs that effectively curb financial crime.** If Congress does not remove the reporting requirements of the Bank Secrecy Act, then FinCEN should be required to publicly report how many reports are received, reviewed, and requested by other governmental agencies. In addition, FinCEN should report how many reports resulted in a conviction, settlement, or additional charges in other investigations. The reports should make a clear distinction between criminal investigations that originated with SARs or CTRs and criminal investigations that merely used existing SARs or CTRs to strengthen existing cases.
- **Protect peer-to-peer transactions.** Congress should enact protections for two-party, or peer-to-peer, transactions. Holding cryptocurrency in a self-hosted wallet is merely the digital equivalent of holding physical cash in a traditional wallet, and it is one of the few ways to escape surveillance under the third-party doctrine. Congress should not allow financial surveillance to be expanded to cover self-hosted wallets and peer-to-peer exchanges.
- **Prohibit the Securities and Exchange Commission's collection of personally identifiable information in the Consolidated Audit Trail.** The Securities and Exchange Commission's consolidated audit trail collects data on every stock and options trade made in the United States and the personally identifying information of the individual who made the trade. The system infringes upon both Fourth and Fifth Amendment rights of investors, whose financial information is collected by the system on the theory that the government might need the information for future law enforcement. Congress should prohibit the Securities and Exchange Commission from collecting investors' personally identifiable information in the consolidated audit trail.

SUGGESTED READINGS

The SEC's Market Surveillance System Implicates the Fourth and Fifth Amendment Rights of Investors by Brent Skorup, Anastasia P. Boden, and Jennifer J. Schulp, *Cato at Liberty* (blog), Cato Institute (February 22, 2024)

The Right to Financial Privacy: Crafting a Better Framework for Financial Privacy in the Digital Age by Nicholas Anthony, Cato Institute Policy Analysis no. 945 (May 2, 2023)

Revising the Bank Secrecy Act to Protect Privacy and Deter Criminals by Norbert J. Michel and Jennifer J. Schulp, Cato Institute Policy Analysis no. 932 (July 26, 2022)

How Inflation Erodes Financial Privacy by Nicholas Anthony, *Cato at Liberty* (blog), Cato Institute (June 10, 2022)

Hearing on Oversight of the Financial Crimes Enforcement Network, 117th Cong., 2nd Sess. (April 28, 2022)(statement for the record, testimony of Nicholas Anthony, Cato Institute)

The Infrastructure Investment and Jobs Act's Attack on Crypto: Questioning the Rationale for the Cryptocurrency Provisions by Nicholas Anthony, Cato Institute Briefing Paper no. 129 (November 15, 2021)

Why Don't Americans Have Stronger Financial Privacy? by Nicholas Anthony, *Cato at Liberty* (blog), Cato Institute (October 28, 2021)

Section 2: Stopping the Next Expansion by Prohibiting the Creation of a Central Bank Digital Currency

Central bank digital currencies, or CBDCs, are on the rise. Around the world, governments are increasingly working toward developing and launching CBDCs. According to the Human Rights Foundation's CBDC tracker, CBDCs have been launched in 11 countries and the 8 islands that compose the Eastern Caribbean Currency Union; CBDCs are being piloted in 39 countries, the Eurozone, and Hong Kong; and CBDCs are being researched in another 70 countries, the Economic and Monetary Community of Central Africa, and Macao.[1] For its part, the United States is currently in the pilot phase. Yet, make no mistake, the United States does not need to launch a CBDC. Rather, Congress should explicitly prohibit both the Federal Reserve and the Department of the Treasury from doing so without authorizing legislation.

THE PROBLEM

Central bankers and other policymakers have increasingly focused on the prospect of CBDCs in recent years. What started as a theoretical concept quickly turned into reality when the central banks of China, Nigeria, The Bahamas, Jamaica, and the Eastern Caribbean Currency Union each launched CBDCs. Yet, these actions should not be replicated by the United States.

In the simplest of terms, a CBDC is a digital national currency that is a direct liability of the central bank.[2] Like paper dollars, a CBDC would be a liability of the Federal Reserve. But unlike paper dollars, a CBDC would offer neither the privacy protections nor the finality that cash provides. In fact, it's precisely this digital liability—a sort of digital tether between citizens and the central bank—that makes CBDCs different from the digital dollars that millions of Americans already use.

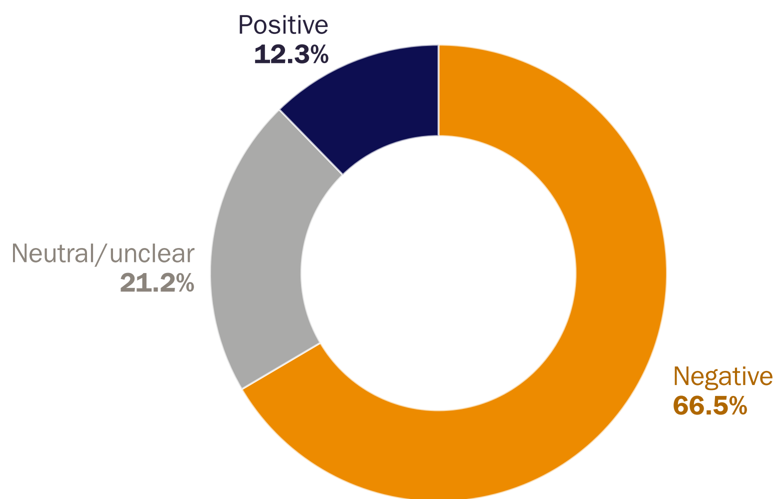
By establishing a direct connection from the government to each citizen's financial activity, CBDCs risk ending financial privacy, restricting financial freedom, undermining free markets, and weakening cybersecurity.[3] Whereas current financial surveillance is done through the private sector under government mandates, a CBDC would put the financial information of Americans on government databases by default. With so much data in hand, a CBDC would then provide countless opportunities for the government to control citizens' financial transactions. Furthermore, with each dollar that is held as a CBDC, the financial system will lose funding that could otherwise be used to issue loans. Finally, with each person that begins to use a CBDC, the system becomes an increasingly lucrative target for cyberattacks.

> "A central bank digital currency would put the financial information of Americans on government databases by default; access to this data would provide countless opportunities for the government to control citizens' financial transactions."

The problems do not end there. Across the jurisdictions that have already launched CBDCs, governments have consistently struggled to increase consumer adoption. For example, in China, The Bahamas, and Jamaica, what little adoption has been gained is largely because the governments have given out money as either stimulus, lotteries, or discounts in CBDC. In Nigeria, the government even went so far as to orchestrate a cash shortage when the

Figure 4

People's attitudes toward a potential launch of a central bank digital currency (CBDC) in the United States is largely negative



Source: Author's calculations based on the responses to the Federal Reserve's request for comment on its CBDC discussion paper.

CBDC adoption rate failed to get above 0.5 percent.[4] Yet even after the resulting protests and riots, CBDC adoption only increased to 6 percent.[5]

The public seems to recognize these problems. Cato Institute research found that 66 percent of respondents viewed CBDCs negatively when the Federal Reserve requested public feedback in 2022 (Figure 4).[6] In fact, when the Cato Institute surveyed a representative sample of 2,000 Americans in 2023, the results were largely the same.[7] After considering the costs and benefits of CBDCs, 74 percent of respondents said that they were opposed to the US government creating a CBDC.

SOLUTIONS

With these problems and the public's concerns in mind, Congress does have several solutions at its disposal. At a foundational level, members of Congress should disregard the idea that there is a race to issue CBDCs. It may be easy to feel a fear of missing out when looking at international headlines, but the strength of the dollar has little to do with the technology that it's moved on. Rather, the dollar's status is owed to the strength of the American economy and its legal protections for private citizens relative to most other countries. Congress should focus on improving those underlying reasons—not on the latest craze in central banking—if it seeks to strengthen the role of the dollar.

- **Prohibit the Federal Reserve and the Treasury from issuing a CBDC.** Limiting the authorities of the Federal Reserve and the Department of the Treasury to explicitly prohibit either agency from issuing a CBDC would prevent the risk that a CBDC would be launched during a time of panic (financial or otherwise).[8] Doing so would therefore prevent the risks to financial privacy, financial freedom, free markets, and cybersecurity that a CBDC would pose.
- **Establish proper oversight of the Federal Reserve.** The 2023 launch of FedNow—a Federal Reserve program for financial institutions to send and receive faster payments on behalf of their clients—showed that the Depository Institutions Deregulation and Monetary Control Act of 1980 lacks sufficient teeth to limit the Federal Reserve's activities with respect to competing with the private sector. The legislation requires neither a formal cost-recovery period nor a third-party audit. In other words, the Federal Reserve—unlike its private-sector counterparts—does not have to worry about recouping costs and can avoid doing so to undercut the market. For example,

the Federal Reserve revealed in late 2023 that it had spent $545 million to create FedNow and would continue to keep participation fees at zero dollars for another year to spur its adoption. To prevent the Federal Reserve from further encroaching on the private sector, Congress should amend the Depository Institutions Deregulation and Monetary Control Act of 1980 to strengthen the explicit requirement for the Federal Reserve to recover its costs when exploring new initiatives. Congress should also require that the Federal Reserve's compliance with the Depository Institutions Deregulation and Monetary Control Act's cost-recovery provisions be subject to regular audits by third parties.

- **Strengthen financial privacy and reform financial surveillance.** Financial surveillance seems to be expanding more each year, and it has some people looking for alternatives to the dollar. Congress should embrace the Fourth Amendment to the US Constitution and reform financial surveillance. To do so, Congress should consider revising the Bank Secrecy Act, eliminating the exceptions to the Right to Financial Privacy Act, strengthening the right to object to surveillance, repealing the surveillance permitted under 26 U.S.C. Section 6050I, requiring inflation adjustments for reporting thresholds, and requiring public reports on how information is used. See Chapter 1 for additional details.
- **Welcome currency competition.** Currency competition offers a much-needed check on government activities and is a source of inspiration for possible future improvements to the dollar. To encourage currency competition, Congress should clarify the application of legal tender laws (31 U.S.C. Section 5103), so people understand that legal-tender status does not require private businesses, persons, or organizations to accept United States coins and currency as payments for goods and services. Congress should also amend 18 U.S.C. Section 486, which forbids counterfeit coins and coins of *original* design. Finally, Congress should, at the very least, remove capital gains taxes where cryptocurrencies and foreign currencies are used for transactions.

SUGGESTED READINGS

There Is No Good Version of a Central Bank Digital Currency by Norbert Michel, *Forbes* (April 23, 2024)

Digital Currency or Digital Control? Decoding CBDC and the Future of Money by Nicholas Anthony, Cato Institute (2024)

CBDC vs. Crypto: What's the Difference? by Nicholas Anthony, *Cato at Liberty* (blog), Cato Institute, (May 31, 2023)

Central Bank Digital Currency: Assessing the Risks and Dispelling the Myths by Nicholas Anthony and Norbert Michel, Cato Institute Policy Analysis no. 941 (April 4, 2023)

Congress Should Welcome Cryptocurrency Competition by Nicholas Anthony, Cato Institute Briefing Paper no. 138 (May 2, 2022)

Central Bank Digital Currencies Are about Control—They Should Be Stopped by Norbert J. Michel, *Forbes* (April 12, 2022)

Section 3: Opening the Door to Cryptocurrency Innovation by Eliminating Unnecessary Regulatory Barriers

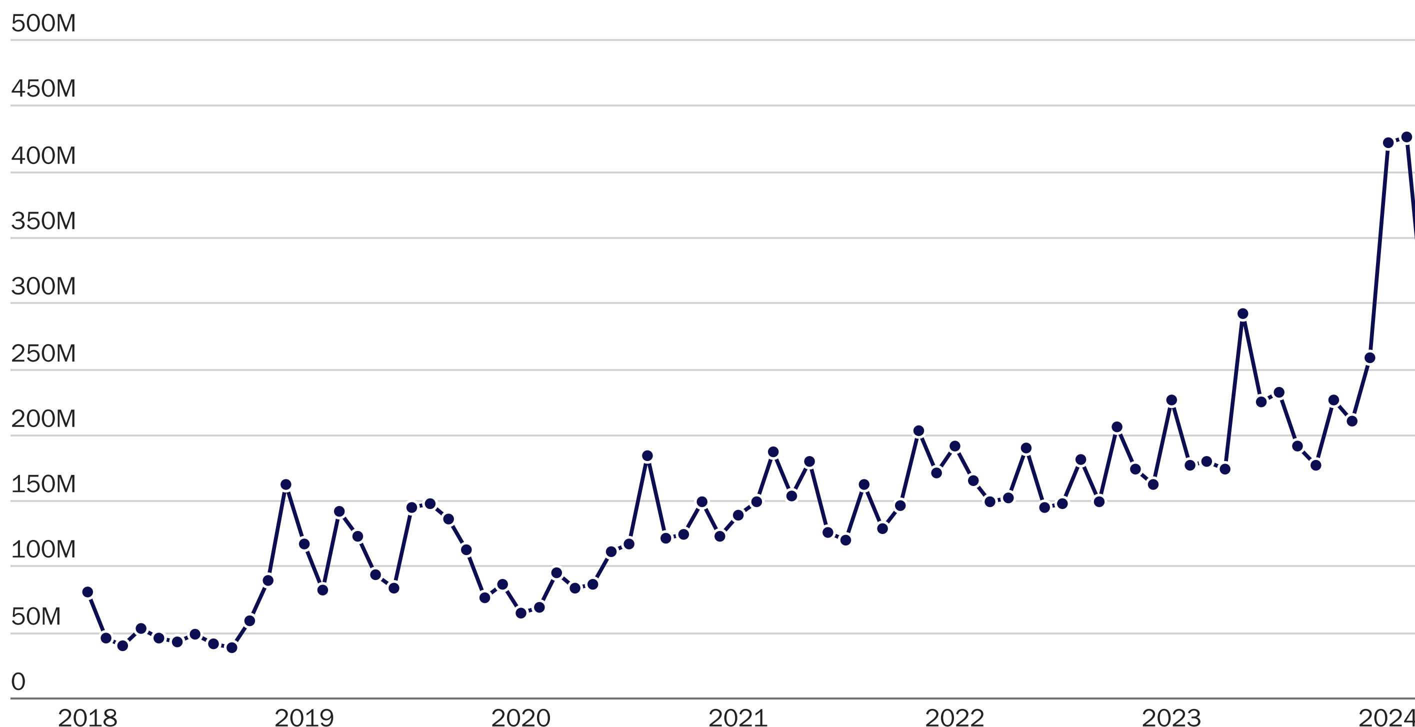
Cryptocurrency is here to stay, if the growing number of on-chain crypto transactions is any guide (see Figure 5).[1] Yet the United States continues to lag other advanced economies by failing to provide clear rules for cryptocurrency and decentralized finance (DeFi). This lack of regulatory clarity should not be mistaken for a light-touch approach, which would be welcome. Rather, regulatory ambiguity has led to an untenable situation where crypto projects eager to comply with US law are offered no practical guidance, are rebuffed by their would-be regulators, and are undermined with high-stakes enforcement actions.

This status quo risks pushing entrepreneurs and developers with key skills (such as applied cryptography) out of the United States, as well as limiting Americans' ability to take advantage of the capabilities of crypto and DeFi. These capabilities include mitigating the traditional risks of financial intermediaries (e.g., theft, fraud, and breach of duty) by replacing those middlemen with self-executing software programs. In addition, the technology underlying cryptocurrencies can be leveraged to build decentralized autonomous organizations (DAOs), as well as a new internet architecture (sometimes called Web3) that provides an alternative to more-centralized platforms. An inhospitable regulatory environment for

Figure 5

On-chain crypto transactions have increased in recent years

Monthly number of on-chain transactions



Source: "The 2024 Crypto Spring Report," Chainalysis, April 2024, p. 28.

cryptocurrencies, therefore, could have far-reaching consequences for new technology pathways. Entrepreneurs, developers, and users should decide whether these pathways are explored, not policymakers and bureaucrats.

Importantly, cryptocurrencies hold promise for liberty, providing individuals with choice in their currency, the potential to protect their financial privacy and property rights, and the ability to engage in quick, cheap, and borderless transactions. Whether these promises are realized depends in part on providing a clear regulatory environment for cryptocurrencies that does not unduly burden their capacity to transform and grow.

THE PROBLEM

Regulatory uncertainty plagues the US crypto ecosystem on multiple fronts.

Crypto tokens. Because a crypto token may be seen as a commodity, a security, a currency, or perhaps something else entirely, the application of existing laws and regulations to crypto projects is not always clear. A legal landscape that is characterized by this uncertainty, or that prioritizes legacy regulatory formalities regardless of their practical relevance to cryptocurrencies, risks becoming inhospitable for both entrepreneurs and users and damaging to technological innovation, capital formation, and consumer welfare.

Resolving whether cryptocurrencies are regulated under securities laws or commodities laws is a prerequisite to addressing other questions about how to regulate the exchange of cryptocurrencies and their general interactions with the financial system, including questions about custody and accounting.

Securities laws evolved, in no small part, to address the risks posed by managerial bodies possessing information that investors do not and those bodies' capacity to act at odds with investors' interests. Cryptocurrency projects seek to transcend the traditional model of centralized enterprises with a corporate form, headquarters, and managerial hierarchy by eschewing, among other things, a managerial body exercising ongoing control over the project. Indeed, a core innovation of decentralized cryptocurrencies is that of mitigating managerial risks through technology.

When a cryptocurrency project does not involve centralized management or control, applying legacy securities laws is both legally inappropriate and practically ineffective at addressing potential harm. But applying securities-law safeguards designed to mitigate certain risks is appropriate when a cryptocurrency project involves managerial control (and when other criteria under securities case law are satisfied).

> "The United States continues to lag other advanced economies by failing to provide clear rules for cryptocurrency and decentralized finance."

Crypto exchanges. Like crypto tokens themselves, the marketplaces over which they trade can be decentralized. These decentralized exchanges (or DEXs) replace centralized exchange services with self-executing software protocols that allow crypto users to transact peer-to-peer, thus mitigating traditional intermediary risks like those related to transaction execution and custody. DEXs are a core component of the broader DeFi ecosystem, allowing, for example, users to trade tokens that enable them to access Web3 services (such as decentralized social networks or file storage systems). Subjecting DEXs to regulations designed for traditional exchanges and broker-dealers does not suit the relevant risks or realities of DEXs and undermines their potential benefits. For example, applying registration requirements to open-source software protocols impedes their core benefits of open access and interoperability because licensing both inhibits the protocols' ability to enter the market and third parties' ability to integrate with them.

Centralized crypto exchanges present standard risks related to financial intermediation. Yet US regulators have not afforded centralized crypto exchanges practical registration pathways with clear and evenly applied rules. This de facto prohibition on lawful onshore crypto exchanges stymies innovation, competition, and entrepreneurship, and it provides little benefit to American crypto market participants.

Stablecoins, currency competition, and payment innovation. Cryptocurrencies can bring the benefits of competition to currencies, which have long been subject to government monopoly. Competition not only has the potential to provide currency that better suits an individual's needs, but lessons learned from competition could also strengthen the dollar and help to preserve its status as the world's reserve currency.

Although digital currency use is growing, to date it has not reached the level of traditional government fiat currencies. Stablecoins—cryptocurrencies designed to maintain a stable value—are one innovation that has seen increasing use and may provide opportunities for faster and more efficient methods of payment under a properly structured regulatory framework.[2]

> "Cryptocurrencies hold promise for liberty, providing individuals with choice in their currency, the potential to protect their financial privacy and property rights, and the ability to engage in quick, cheap, and borderless transactions."

Unfortunately, regulatory barriers, including uncertainty, stand in the way of such new tools and the competition they bring. For example, the Securities and Exchange Commission has made vague assertions that certain stablecoins are securities, leaving issuers unsure about their compliance obligations. In addition, proposals that would subject stablecoin issuers to tight gatekeeping by bank regulators, including frameworks that would prohibit any firm other than a federally insured depository institution from issuing stablecoins, would raise barriers to market entry.[3]

In addition, subjecting cryptocurrencies generally to capital gains taxes impedes their use as money. Because capital gains tax rates are structured to incentivize long-term holding, these taxes penalize people for using cryptocurrencies as money for everyday purchases. They also impose a heavy—and at times impossible—administrative burden both on cryptocurrency users and on those required to report cryptocurrency transactions to the Internal Revenue Service.

Anti-Money Laundering laws and DeFi. The decentralized nature of certain crypto tools, such as DEX protocols and noncustodial crypto wallets (tools for individuals to personally safeguard their own crypto holdings) are a poor fit for the existing Anti-Money Laundering (AML) regime. The current AML regime leans on centralized financial intermediaries to, for example, identify customers and report supposedly suspicious activities. But applying rules designed for financial intermediaries to disintermediated financial technologies can effectively break them. For instance, requiring the operators of computing infrastructure that does not directly interface with customers to nonetheless identify those parties subjects the operators to unmanageable compliance obligations. Similarly, requiring providers of noncustodial crypto wallets to identify their customers is akin to treating manufacturers of physical wallets for cash as if they were banks; it creates both invasive and impractical regulatory burdens.

Taken together, these regulatory obstacles hinder the use of crypto technology as the foundation of new computing infrastructure and work against the use of cryptocurrencies as money.

SOLUTIONS

Congress can undertake several reforms to level the playing field for cryptocurrencies.

- **Create a pro-competitive framework for stablecoin issuers.** Congress should create a pro-competitive regulatory framework for stablecoin issuers. The framework should focus solely on basic reserve requirements and mandatory disclosure of relevant information about those holdings. The regulator overseeing this framework should not be one conflicted by involvement in providing other payment services. Moreover, regulators should not be granted discretionary authority to prevent certain stablecoin issuers from operating based on vague criteria. Additional anti-competitive restrictions that ought to be rejected are those prohibiting certain types of businesses (such as retailers or

networked technology platforms) from issuing stablecoins, as well as mandates that stablecoin issuers be insured depository institutions.[4]

- **Amend the definition of securities to exclude decentralized crypto token projects.** Congress should amend securities statutes to clarify that securities laws do not apply to decentralized cryptocurrency projects by providing a clear, practical test for determining whether a crypto project is decentralized. The key question is whether the cryptocurrency purchaser is expecting profits solely from the efforts of others (i.e., relying on their essential managerial or entrepreneurial efforts). The criterion is whether, in selling a cryptocurrency, the seller, promoter, or developer promises performance necessary to bring the crypto project and its stated benefits to fruition. If so, the cryptocurrency project at issue is centralized. If not, it is decentralized.
- **Establish tailored disclosure for crypto projects on the path to decentralization.** Cryptocurrency projects can take time to achieve decentralization. Some projects may seek to sell their cryptocurrencies to finance their development or place governance tokens in the hands of users as a way to achieve decentralization. Congress should legislate a tailored registration model that prioritizes disclosures related to the specific risks of cryptocurrencies (e.g., fraud, deception, and manipulation by managers) and protections against fraud and misleading statements.
- **Tailor policy to differences between centralized and decentralized crypto exchanges.** Congress should ensure a framework for crypto marketplaces that is sensitive to the key differences between centralized and decentralized crypto exchanges. When exchanges are truly decentralized (i.e., where there is no single party or unified group promising performance or maintaining unilateral discretionary control, but rather an open-source and self-executing software protocol effecting transactions), they do not present the same intermediary risks as centralized exchanges. Bona fide DEXs should not be subjected to inapt regulatory requirements. In addition to averting asset custody risks, DEXs' public transaction histories allow regulators to observe and address market manipulation. DEXs that wish to demonstrate that they comply with standards equivalent to those of centralized exchanges, including through automated controls, should have an option to do so via strictly voluntary registration.
- **Provide clear and practical registration paths for centralized crypto exchanges.** Centralized exchanges should be afforded a clear and practical registration pathway that is focused on intermediary risks. Specifically, crypto commodity exchanges should be offered a tailored, disclosure-based registration pathway. Crypto securities exchanges should be subject to a new crypto-specific alternative trading system rule made possible by Congress through amendments to the Securities Exchange Act.
- **Answer key questions before devising Anti-Money Laundering legislation.** Policymakers seeking to apply AML rules to DeFi applications should answer five key questions.[5] First, does the legislative proposal distinguish centralized actors and decentralized systems? Poorly tailored rules encourage recentralization, reintroducing intermediary risks. Second, does the proposal require reporting information that applications do not have access to? If so, it acts as a de facto prohibition on DeFi infrastructure. Third, does the proposal preserve cash-like treatment for cash-like transactions done digitally? Genuinely peer-to-peer transactions should not be subject to greater surveillance than cash. Fourth, does the solution accommodate technological change? If not, innovations that are useful to users preserving their privacy, as well as the interdiction of bad actors, could be counterproductively left by the wayside. Fifth, is the solution evidence-based? Any proposed solution should have a clear and compelling evidence-backed rationale regarding its efficacy.
- **Do not apply punitive tax rules to the crypto ecosystem.** Congress should remove capital gains taxes, at the very least, where cryptocurrencies are used to purchase goods and services. Tax-reporting standards should not undermine crypto miners and developers by, for example, subjecting them to inapt rules that encompass them within overbroad definitions of covered entities.

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Don't Push Crypto Offshore, Don't Outlaw Disruptive Innovation by Jack Solowey, *Cato at Liberty* (blog), Cato Institute (February 24, 2023)

Practical Legislation to Support Cryptocurrency Innovation by Jack Solowey and Jennifer J. Schulp, Cato Institute Briefing Paper no. 140 (August 2, 2022)

Congress Should Welcome Cryptocurrency Competition by Nicholas Anthony, Cato Institute Briefing Paper no. 138 (May 2, 2022)

A Simple Proposal for Regulating Stablecoins by Norbert J. Michel and Jennifer J. Schulp, Cato Institute Briefing Paper no. 128 (November 5, 2021)

Section 4: Policymakers' Environmental, Social, and Governance Concerns Should Not Override the Market's Allocation of Resources

The US financial system is the means by which capital resources are allocated. At its most basic, borrowers, lenders, and investors exchange funds to finance projects and pursue a return on their financial assets. The market allocates funds based largely on the returns that the parties to the transactions expect to earn on their investments. In this way, "good" projects—those that provide goods or services that are desirable—get funded, and "bad" projects generally do not. While this process is not perfect, over time the incentives and signals provided by the market generally allocate scarce capital resources efficiently.

The market's allocation of capital resources, however, is threatened by the encroachment of regulations and policies that seek to enshrine environmental or social policy into the financial system's framework. This encroachment not only undermines the efficient allocation of capital and risks undermining growth and innovation, but also represents an abuse by financial regulators who are not tasked by Congress (or voters) to implement environmental or social policy and who lack the necessary expertise to create such policy.

Congress can take action to ensure that financial regulators do not function as central planners, deciding which enterprises are worthy of capital, by clarifying the scope of mandatory securities disclosures. Congress should also consider paring back federal regulators' discretion to deal with issues such as reputational risk and even safety and soundness.

THE PROBLEM

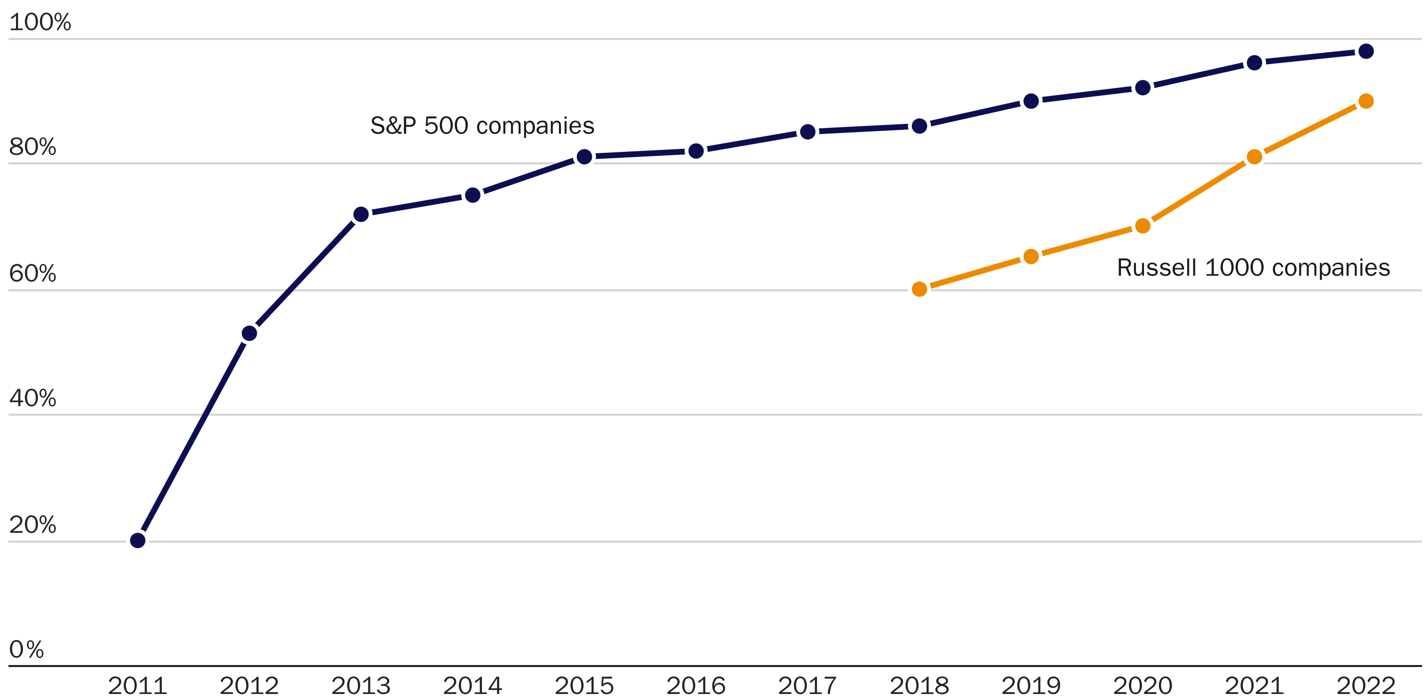
From public company disclosures to the regulation of bank capital, financial regulators have increasingly sought to implement environmental or social policy through the financial system's allocation of capital. Climate change policy was a priority for the Biden administration, which called climate change a "systemic risk to our economy and our financial system," saying that "we must take decisive action to mitigate its impacts."[1] Those actions included Treasury Secretary Janet Yellen's announcement that she would start a climate hub within the Department of the Treasury to coordinate "wide-ranging efforts to fight climate change through economic and tax policies" and "focus on financing for investments needed to reduce carbon emissions."[2] The Securities and Exchange Commission finalized wide-ranging climate-related disclosures for public companies (which have been challenged in federal court) and indicated its intent to prepare proposals on corporate board diversity and human capital management, which may include disclosures related to worker demographics and benefits. These types of regulation can place a drag on the economy by imposing high costs while inappropriately turning financial regulators into universal policymakers.

> "Public companies' mandatory disclosures have expanded in recent years, at times serving as vehicles to promote extraneous policy goals."

Take, for instance, public company disclosures, which are meant to provide investors with information about a company's financial prospects. Public companies' mandatory disclosures have expanded in recent years, at times serving as vehicles to promote extraneous policy goals. The Dodd-Frank Act requires companies to report on the origin of certain "conflict minerals" used in their products and to disclose the ratio of the CEO's pay to the company's median

Figure 6

More than 90 percent of S&P 500 and Russell 1000 companies already publish sustainability reports or disclosures



Source: "2023 Sustainability Reporting in Focus," Governance and Accountability Institute Inc., December 2023.

employee. The SEC has already continued this expansion by finalizing climate-related disclosures and, at least under the Biden administration, was poised to continue by considering new mandatory public disclosures for a wide variety of information related to what is called "ESG" investing [environmental, social, and governance], meaning strategies or theories that take into account a company's environmental, social, and governance factors when making an investment decision. Notably, 98 percent of the largest US public companies and 90 percent of companies on the Russell 1000 Index already publish sustainability disclosures without an SEC mandate (see Figure 6).

Disclosures relating to climate change, board and workforce diversity, and corporate political contributions, among other things, stray far from the existing securities regulation framework of providing information relevant to price discovery by market participants. This expansion is problematic. If the SEC's disclosure regime becomes untethered from its price-discovery function, it can be bent to any purpose. Americans should feel secure that any disclosures the government requires are carefully cabined to encompass only information that is directly related to the legislation's initial intent. These disclosures also often have unintended consequences, particularly when the purpose of the disclosure is to drive non-securities-related policy change.

The banking sector similarly suffers when inappropriate policy aims drive the regulation of banks. Precedent already exists for federal officials using bank regulations to allocate credit to further political goals, including to discourage payday lending and to hinder financing for gun dealers. In January 2023, federal banking regulators even warned banks that certain types of crypto-related activities were "highly likely to be inconsistent with safe and sound banking practices," thus making banks less likely to open accounts for digital asset firms.[3] It is entirely plausible that federal officials could soon expand such actions, disadvantaging those firms in industries that disturb certain political sensibilities (such as fossil fuels and nonorganic agriculture).

Many federal agencies can influence bank activities through the federal regulatory framework, potentially imposing climate change–related regulations through the examination process (among other ways), whether citing

concerns over capital adequacy, reputational risks, or even systemic risks. Regulators have a great deal of discretion in these cases, and banks have very little recourse. For example, the Federal Deposit Insurance Corporation can terminate a bank's status as an insured depository institution if it finds that the bank has engaged in "unsafe or unsound practices," and the agency alone is responsible for determining what constitutes unsafe or unsound practices. Moreover, when regulators determine that an insured depository institution has engaged in an unsafe or unsound practice, they have the explicit legal authority "to place limitations on the activities or functions of an insured depository institution or any institution-affiliated party."[4] Overall, bank regulators have enormous flexibility to develop regulations for anything that they deem a risk factor, including climate change, and banks have been (and will be) very hesitant to push back against these requirements.[5]

SOLUTIONS

Congress should undertake several reforms to protect the market's allocation of capital from distortion introduced by financial regulation of environmental and social causes.

- **Clarify scope of mandatory securities disclosures.** Although the scope of disclosures under the Securities Act of 1933 and the Securities Exchange Act of 1934 has long been understood to encompass information necessary for investors to value securities—primarily a company's financial performance and information about its business—the heated debate about the SEC's authority to promulgate climate risk disclosures indicates that a clear definition of this scope is necessary. Congress should plainly state that disclosures are limited to the type of information relevant to a company's prospects for financial success, as originally contemplated by the 1933 and 1934 acts, and repeal the sections of the Dodd-Frank Act that direct the SEC to promulgate the conflict minerals and pay-ratio disclosure rules.
- **Exercise strong congressional oversight of the SEC.** Even where the agency may have authority to promulgate rules that touch on environmental and social matters, Congress should exercise active oversight to ensure that the SEC is focusing its limited resources on advancing regulation related to its core mission.
- **Shrink and clarify bank regulators' responsibilities.** Congress should require banking regulators to consider solely economic and financial factors when promulgating regulations, rather than factors that might affect the public's view of a bank, including the bank's so-called reputational risks. More broadly, Congress should reassert its control over financial policy and reduce the regulatory authority and discretion of financial regulators. Repealing Title 1 of the Dodd-Frank Act, thus eliminating the Financial Stability Oversight Council, would be one step in a positive direction. Congress should explicitly prohibit banking regulators from considering social or political objectives, including climate change, in the supervision and examination of banks or credit unions regarding asset ratings, capital adequacy, reputational risk, lending limits, "prudential" standards, and financial stability.

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"Securities Regulation" in *Cato Handbook for Policymakers*, 9th ed., by Jennifer J. Schulp, Cato Institute (2022)

Using Financial Regulation to Fight Climate Change: A Losing Battle by Norbert J. Michel, David R. Burton, and Nicolas D. Loris, Heritage Foundation Backgrounder no. 3634 (June 24, 2021)

Section 5: Monetary Policy That Holds the Fed Accountable

Congress created the Federal Reserve (Fed) in 1913 to put an end to financial crises and severe recessions. But some of the nation's worst economic crises have occurred since then, and recessions haven't become shorter or less frequent. The US economy suffered its most severe bout of deflation during the early 1930s. It endured its highest peacetime inflation rates in the late 1970s and early 1980s, as well as abnormally high peacetime inflation rates following the COVID-19 pandemic. Despite the Fed's failures, Congress has tended to further expand its discretionary powers.

So long as Congress is inclined to delegate responsibility for conducting monetary policy to the Fed, there is much it can and should do to improve the Fed's performance. For instance, Congress can narrow and clarify the Fed's legislative mandate and require that the Fed implement rules-based monetary policy. It can also remove the current privileged position that the US dollar holds in competition with other potential means of payment so that the Fed faces competitive pressure to preserve, and perhaps enhance, the dollar's attractiveness as both a domestic and an international exchange medium.

THE PROBLEM

One of the Fed's main responsibilities is to ensure that the economy does not stall because of an insufficient supply of money. Its other main duty is to safeguard against excessive money creation, which increases inflation. To conduct monetary policy responsibly, the Fed should also avoid favoring specific firms, industries, or sectors of the economy over others. If it were to conduct policy in this manner, the Fed would place only the smallest possible footprint on economic activity, avoiding as much as possible any tendency to influence the profits and losses of specific enterprises, to favor government over private investment, to create moral hazard problems, or to transfer financial risks to taxpayers.

Finally, the Fed should conduct monetary policy in a transparent manner, with real accountability to citizens through their elected representatives. Throughout much of its history, the Fed has failed to meet these requirements, and Congress has failed by not compelling it to meet them. In fact, every Fed regime since the 1980s has acted in an increasingly discretionary manner compared to its predecessor. This discretion has worsened significantly since the 2008 financial crisis. Consequently, monetary policy during this period has been divorced almost entirely from clear and understandable rules-based governance.[1]

> "The Federal Reserve should conduct monetary policy in a transparent manner, with real accountability to citizens through their elected representatives."

The so-called dual mandate calls for the Fed to achieve both price stability and maximum employment. Now that the Fed has also become responsible for guarding against financial instability, it really operates under an even broader mandate.[2] Because the Fed's mandates are so ill-defined, the Fed enjoys enormous discretion in interpreting and performing its duties, and Congress often lacks any means for holding the Fed accountable for fulfilling its responsibilities. Furthermore, because both the behavior of the price level and the extent of employment depend not only on the Fed's decisions but also on factors beyond its control, it is unreasonable to blame the Fed for every instance in which these factors vary from some ideal. As the increased inflation after the COVID-19 pandemic demonstrates, for instance, fiscal expenditures can play a significant role, along with the Fed's monetary policy decisions.

More narrowly, the Fed's price stability mandate is problematic because changes in the price level can also reflect

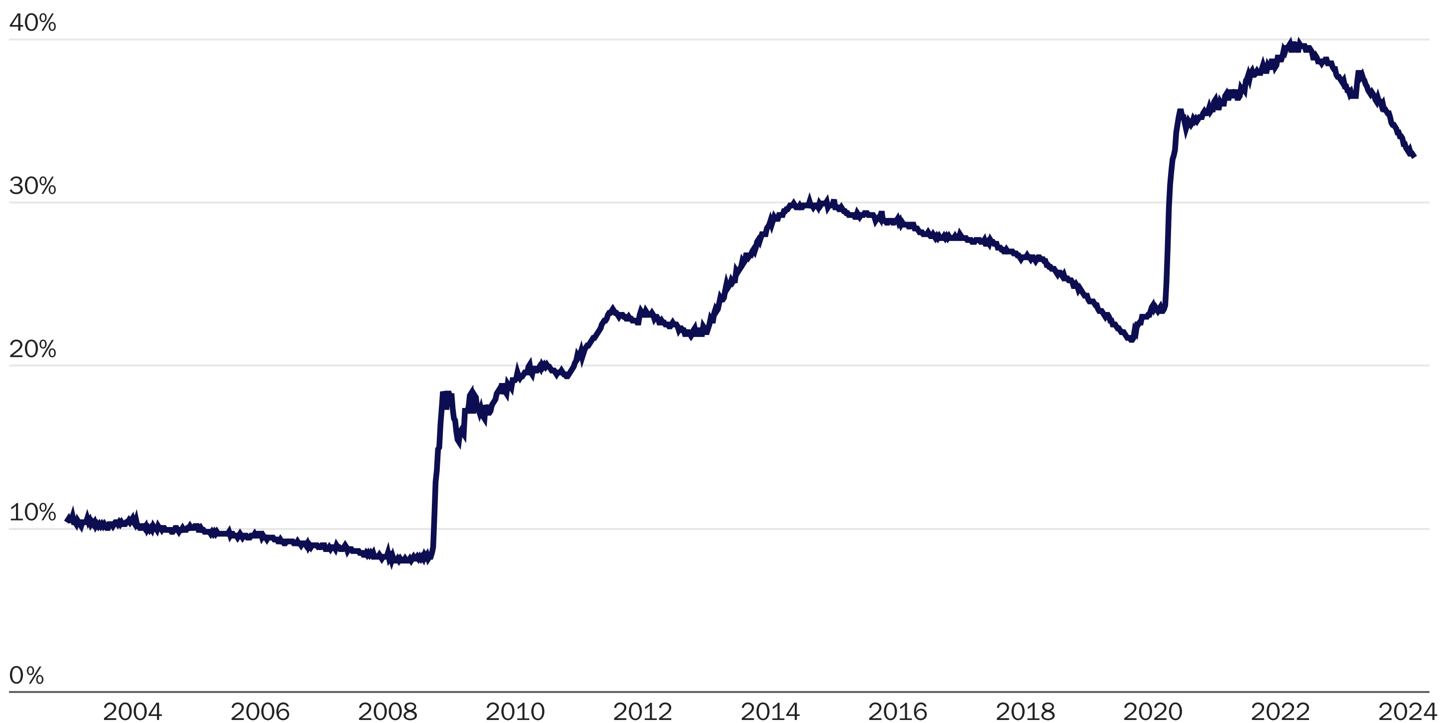
changes in the scarcity of real goods and services. In other words, changes in the price level or in unemployment may not be evidence of good or bad Fed performance. In an economy experiencing long-run productivity growth, for instance, a low (and perhaps even negative) rate of inflation reflects rapidly falling costs and makes it easier for everyone to reap the benefits of those falling costs. In the short run, adverse supply shocks—such as those caused by a war or the COVID-19 pandemic and related government shutdowns—cause prices to rise even when the demand for goods is not growing rapidly. In fact, research by the Cato Institute's Center for Monetary and Financial Alternatives shows that such supply factors overwhelmingly drive inflation in some cases. Across various time periods and a variety of inflation metrics, supply factors account for more than 80 percent of aggregate price changes. Monetary policy usually plays a minor role—accounting for only 5 to 10 percent of US inflation.[3]

Separately, the excessive amount of discretion that Congress has bestowed on the Fed has allowed it to alter its operating framework in a manner that has seen its balance sheet grow to roughly 10 times its pre-2008 size. The Fed is now so large that its assets are greater than 30 percent the size of the entire US commercial banking sector (see Figure 7). Prior to 2008, the Fed's balance sheet was barely 10 percent of the size of the US banking sector, and it had been shrinking in proportion over time. This shift in framework has had serious repercussions for financial markets. Before the 2008 financial crisis, increases in the Fed's balance sheet led to minor *reductions* in market volatility; after the crisis, balance sheet increases are accompanied by large *increases* in market volatility. Research from the Center for Monetary and Financial Alternatives shows that since 2008, a 1 percent increase in assets may cause up to a 6 percent increase in financial market volatility.[4]

The Fed's new operating framework, known as a "floor" system, has provided banks with a new risk-free investment choice at a relatively high rate of return, thus causing banks to hold more funds as reserves. As interest rates rise, the Fed will have to pay larger and larger interest payments to banks

Figure 7

Federal Reserve's balance sheet is larger than 30 percent of the entire US commercial banking sector



Sources: "Assets: Total Assets: Total Assets: Wednesday Level," Board of Governors of the Federal Reserve System, Federal Reserve Bank of St. Louis, 2024; and "Total Assets, All Commercial Banks," Board of Governors of the Federal Reserve System, Federal Reserve Bank of St. Louis, 2024.

to control inflation, an arrangement that increases the Fed's political risk and threatens its operational independence.

The new floor system also divorces the Fed's monetary policy stance from the size of the Fed's balance sheet by allowing it to purchase as many assets as it would like, all while paying firms to hold on to the excess cash that these purchases create. This framework can all too easily allow the Fed to be a pawn of the Treasury Department. Put differently, the Fed's current operating system increases the risk that the Fed's quantitative easing (QE) powers will be abused for nonmacroeconomic purposes, such as the funding of backdoor government spending.

> "Because the Fed's mandates are so ill-defined, the Fed enjoys enormous discretion in interpreting and performing its duties, and Congress often lacks any means for holding the Fed accountable."

Today, thanks to a Standing Repo Facility that the Fed established in 2021, there is no reason why the Fed cannot eventually undo all the post-2008 growth in its balance sheet.[5] Nor is there anything else to prevent it from returning to a "scarce reserves" operating framework. In such a regime, instead of holding substantial reserve balances, banks would strive to economize on reserves while turning more often to either the private repo market or the Fed's Standing Repo Facility to make up for occasional or temporary reserve shortages. The Fed's QE powers would then be correspondingly limited: Although those powers would remain substantial so long as rates are at the zero lower bound—the only circumstance in which QE may be macroeconomically warranted—it would not otherwise possess them.

A scarce reserves regime, therefore, enjoys the distinct advantage over a floor system of avoiding the risk that the Fed's QE powers will be abused for nonmacroeconomic purposes. To compel the Fed to return to a scarce reserves regime, Congress should insist that the Fed follow the 2006 Financial Services Regulatory Relief Act, a law that stipulates that the rate of interest the Fed pays on reserve balances should not exceed the general level of short-term interest rates.

SOLUTIONS

The US dollar has long been the preferred payments medium throughout the United States as well as in many international markets. Congress should do all that it can to preserve that high standing by ensuring that the Fed is a good steward of the dollar by narrowing its statutory mandate, requiring it to follow a policy rule, and shrinking its balance sheet.

- **Narrow the Fed's statutory mandate.** Congress should repeal the financial stability mandates that it gave to the Fed in Title I of the Dodd-Frank Act and remove the Fed's responsibilities as a financial regulator. The Fed's pure regulatory function should be assumed by either the Office of the Comptroller of the Currency or the Federal Deposit Insurance Corporation.
- **Require the Fed to follow a policy rule.** Congress should require the Fed to implement a simple rule that Congress can easily monitor and use to hold the Fed accountable. The rule should provide a clear link between the interest rate target and macroeconomic indicators such as inflation, the output gap, or unemployment. The degree to which the Fed responds to such indicators, as well as other details, might be left to Fed officials to decide. However, it is imperative that once Fed officials decide on a rule, they are required to either follow it or publicly explain any deviations from it.
- **Shrink the Fed's balance sheet and reestablish a scarce reserves regime.** In a scarce reserves regime, instead of holding substantial reserve balances, banks would economize on reserves. To make up for temporary reserve shortages, banks would turn to either the private repo market or the Fed's Standing Repo Facility. To ensure that the Fed returns to a scarce reserves regime, Congress should insist that the Fed follow the 2006 Financial Services Regulatory Relief Act, a law that stipulates that the rate of interest the Fed pays on reserve balances should not exceed the general level of short-term interest rates.[6]

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Ambiguous Economy Is the Latest Result of Fed's Increased Discretionary Behavior by Jai Kedia, *Cato at Liberty* (blog), Cato Institute (June 13, 2023)

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Section 6: Removing Barriers to Small Business Capital Formation and Expanding Investor Opportunities

Small businesses are central to the US economy. Not only are they the primary generator of new jobs, but small businesses are also the incubators of innovation and the pipeline for future large businesses.[1] The ability of small businesses to find capital is critical to their growth and operations. Entrepreneurs financially support their businesses in many ways, including by tapping into their own savings and borrowing on their credit cards. When they turn to outside financing, entrepreneurs may look to banks for loans. But many small businesses do not have the ability to secure a bank loan because they have no stable revenues or few assets for collateral. For those businesses, including ones that rely on intellectual property that is difficult for banks to evaluate, the equity markets are an important source of capital.

> "There is little sense—and there should be little regulatory interest—in imposing the SEC's oversight where entrepreneurs seek to raise exceedingly small amounts of capital."

But tapping the equity markets can be difficult, especially for small businesses that are headquartered outside major coastal cities or led by women or underrepresented minorities.[2] That challenge is made more difficult by the complex web of regulations and exemptions that stand between an entrepreneur and raising capital in a securities market. Those regulations also limit the opportunities of most American investors to support small businesses through equity investment and prevent them from sharing in the potential high growth of startup firms. Taken together, these regulations mean that personal wealth often dictates the starting point for both entrepreneurs' businesses and investors' opportunities.

Congress can take action to support small business growth and individual investor opportunity by creating an exemption for micro offers of equity securities and by increasing the pool of investors that can participate in private offerings.

THE PROBLEM

Many entrepreneurs struggle with navigating the complex equity capital–raising framework. As the Securities and Exchange Commission's Office of the Advocate for Small Business Capital Formation notes:

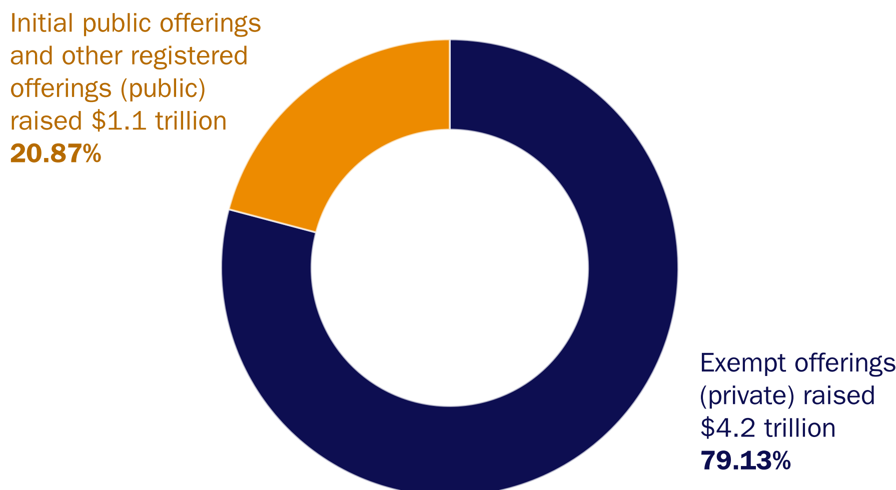
> Even for the most technically sophisticated entrepreneur . . . the language of capital raising and the nuances of our complex rules are often inaccessible. Great entrepreneurial insight does not translate into fluency in almost a century of layered securities laws. . . .
> In other words: entrepreneurs who already find themselves cash-strapped must spend valuable—and often unavailable—resources just to understand their menu of options.[3]

These costs limit small business growth and economic development.

By default, securities offerings must be registered with the SEC, a complex and expensive process that includes detailed disclosures about an issuer's business operations, financial condition, risk factors, and management, as well as audited financials. Most capital is raised pursuant to exemptions from registration (see Figure 8). In theory, those exemptions

Figure 8

More than 75 percent of capital is raised through private offerings



Source: Office of the Advocate for Small Business Capital Formation, *Annual Report for Fiscal Year 2023* (Securities and Exchange Commission, December 2023).

offer a more simplified means of conducting a securities offering. But the exempt offering framework is far from simple. While legislative changes over the years, such as the Jumpstart Our Business Startups (JOBS) Act, have made equity capital–raising more accessible to some investors, each new exemption and its implementing regulations have added another layer of complexity onto an already complicated framework.

While equity crowdfunding, created by the JOBS Act, provided a somewhat streamlined method for entrepreneurs seeking to raise small amounts of equity capital, that process remains burdensome for the smallest entrepreneurs, who must meet a host of regulatory requirements and ongoing reporting obligations to take advantage of this exemption. The average equity crowdfunding capital raise in 2022 was approximately $428,486, and the median raise was $100,000. Crowdfunding is a particularly important source of funding for women, minorities, and companies outside of traditional capital-raising locations.[4] There is little sense—and there should be little regulatory interest—in imposing the SEC's oversight where entrepreneurs seek to raise exceedingly small amounts of capital. This regulatory burden places a drag on small business development that may not be justified by any sort of investor protection interest.

Moreover, small offerings—for instance, in which an aspiring restaurateur or a couple of friends building an app ask their parents, family, and friends to get in on the enterprise with the hope of getting a cut of the profits down the road—still happen outside of regulated crowdfunding, without securities registration, and not pursuant to any existing exemption to registration. The issuer is often unaware of the need for securities registration, and the failure to follow the securities laws only complicates the process when an issuer grows and moves on to more formal methods of raising capital, often resulting in having to unwind those early investments.

The Securities Act of 1933 already recognizes that "the small amount involved or limited character of the public offering" may be an appropriate reason for the SEC to exempt such securities offerings from registration as "not necessary in the public interest."[5] But the SEC has not promulgated such an exemption. A statutory exemption would ensure that the smallest entrepreneurs would be unencumbered by securities regulations that are unnecessary for the protection of investors.

Where entrepreneurs seek to raise larger amounts of capital (i.e., those who typically look to raise money under the exemptions provided by Rule 506 of

Regulation D), the general requirement that their investors be "accredited" harms both small business and investors. Regulation D offerings are popular: More than $3.1 trillion was raised through Regulation D offerings between July 1, 2022, and June 30, 2023, which exceeds the $17 billion raised in initial public offerings.[6] But currently, individual investment in these private offerings is limited to those with more than $200,000 in annual income or assets in excess of $1 million, along with a limited number of individuals who hold certain securities licenses. The SEC is considering recommending updates to the accredited investor definition and is expected to increase the wealth thresholds that an investor must meet to qualify.[7]

> "The accredited-investor definition dampens small business growth by limiting the pool of investors available to entrepreneurs."

The accredited-investor definition dampens small business growth by limiting the pool of investors available to entrepreneurs. That effect is borne disproportionately by would-be entrepreneurs in less wealthy communities, both minority and rural, who have fewer opportunities to recruit investors from the people closest to them.

This limitation on entrepreneurs is not offset by an investor protection benefit. Indeed, the focus on wealth does not protect investors from fraud, and it arbitrarily bars investors from certain offerings. Making the SEC the judge of who is and who is not fit to invest subverts the federal securities laws' disclosure regime that permits any offering to be made to the public if the issuer provides the correct disclosures. In addition, these restrictions—especially when paired with reduced initial public offering volume and longer waits for companies to tap the public markets—may exacerbate wealth inequalities by limiting investment opportunities in potentially higher growth enterprises.

SOLUTIONS

While the entire exempt offering framework would benefit from an overhaul to reduce complexity and to make the equity capital–raising process more friendly for startups and small businesses, there are a few straightforward reforms that Congress can undertake to ease the path for small business capital formation.

- **Micro-offering exemption.** Congress should enact an exemption to securities registration for equity offerings that raise below a certain threshold, say $500,000 per year (indexed for inflation from the time of enactment). Congress should prohibit the SEC from imposing other regulatory requirements on issuers that seek to take advantage of the exemption to ensure that entrepreneurs bear the minimum regulatory burden possible from the securities laws.
- **Accredited investor.** Congress should focus on decreasing the barriers to eligibility for accredited investor status. One way to do this is to consider investors who are advised by financial advisers who meet the current accredited investor definition as being accredited themselves. This would resolve the inconsistency created by the SEC's rules that recognize some advisers as sophisticated but do not permit clients to rely on that sophistication for investment advice. Congress could also consider permitting investors to self-certify their level of sophistication or permitting any investor to make investments up to a certain threshold of their portfolio or net worth.

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Section 7: Other Reforms to Boost Competition and Innovation in the Financial Sector

In the wake of the 2008 financial crisis, proponents of stricter regulation insisted that deregulation of the financial sector—especially nonbank financial firms, those in the so-called shadow banking sector—were the main drivers of the turmoil. According to the conventional narrative, these firms made excessively risky bets with derivatives, then the housing bubble burst and panic ensued. As the story goes, their activity nearly destroyed the financial system, but the federal government stepped in and prevented another Great Depression. The traditional banking sector, on the other hand, supposedly was prevented from taking such risky bets because it was so highly regulated.[1] Therefore, according to this narrative, the best way to guard against future crises is to regulate the nonbanking sector more like commercial banks and to federally back their securities as if they were retail bank deposits backed by the Federal Deposit Insurance Corporation (FDIC).

> "For years, the shortcomings of the regulatory framework have reduced entrepreneurs' investment opportunities, reduced consumers' choices, increased prices, and obscured financial risks."

This narrative is highly misleading. For starters, the 2008 financial crisis was not caused by a reduction in the scale or scope of financial regulations in the United States; rather, the number of financial regulations steadily increased after 1999, long before the 2010 Dodd-Frank Act was even contemplated.[2] Moreover, federal banking regulators approved of much of the so-called shadow banking activity because it took place in partnership with—and in many cases because of guarantees provided by—the traditional banking sector. Overall, the evidence suggests that both banks and nonbank financial firms made carefully targeted risky bets owing, in part, to regulatory and legal requirements. Thus, even if Congress repealed the 2010 Dodd-Frank Act in its entirety, America would be left with an overly burdensome and paternalistic regulatory and monetary system that is filled with harmful incentives. Among other problems, the system infringes on citizens' basic freedom and constitutional rights, increases the likelihood of taxpayer-financed bailouts, limits innovation and competition, and lowers economic opportunities for millions of people.

THE US SYSTEM STIFLES INNOVATION AND COMPETITION

For decades, Congress has passed laws to address regulatory problems in US financial markets. Despite many good intentions, the US financial regulatory framework dampens innovation, protects incumbent firms from competition, and promotes taxpayer-financed bailouts. For years, the shortcomings of the regulatory framework have reduced entrepreneurs' investment opportunities, reduced consumers' choices, increased prices, and obscured financial risks. Moreover, as technology continues to evolve, including through generative artificial intelligence (AI), regulators must employ a technology-neutral approach so as not to undermine the potential of technology to deliver better, cheaper, and more accessible financial services to Americans.

There are many problems spread throughout different sectors of US financial markets. The following section provides a brief overview of the most important issues.

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act

Many government officials, industry participants, and academics endorse an extensive federal role for financial regulation, one that requires regulators to promote financial stability by addressing systemic risks. This approach, embodied in the Dodd-Frank Act, requires regulators to address known threats to financial stability as well as potential threats, typically without specifying any objective definition of these terms. It mandates more regulatory control of bank risk-taking and expands such control to the nonbank financial sector.[3] This approach is based on a mistaken belief that the 2007–2009 crisis stemmed from unregulated financial markets. Quite to the contrary, the government's extremely active role in directing the financial markets—and its promises to absorb the losses of private risk-takers—brought about the financial crisis.

Money Market Mutual Funds

Just as decades of increasingly strict bank regulations have failed to produce financial stability, so too have increasingly strict money market mutual fund (MMF) rules. The increasingly prescriptive regulatory framework for MMFs has also drastically limited investors' options, shrinking the private commercial paper market and pushing more of investors' money into government funds. The failure of the most recent MMF rule amendments even fulfilled one of the harmful scenarios that its advocates insisted the new rules would prevent, directly reducing the funds available to finance private commercial activity as more money flowed into government-backed funds. Rather than acknowledge the failure of this top-down regulatory approach in short-term capital markets, a 2021 Securities and Exchange Commission rule doubled down, with higher liquidity requirements and mandatory liquidity fees.[4]

Housing Finance System

Robust mortgage financing exists in virtually every developed nation in the world without the high degree of government involvement that is found in the United States. While the perceived success of this involvement has helped create the belief that the private housing market cannot properly function without extensive federal involvement, the historical record demonstrates the opposite.

> "Federal intervention in housing finance has done little to measurably increase US homeownership rates."

Most federal intervention in housing finance fuels demand, typically by making it easier to obtain a home mortgage, thus boosting consumer debt and home prices. Federal policies encourage borrowing by supporting the operations of Fannie Mae, Freddie Mac, and Ginnie Mae, and by providing loan insurance through the Federal Housing Administration (FHA), the Department of Veterans Affairs home-lending program, and the Department of Agriculture's Rural Development Program. Prior to the 2008 financial crisis, the federal government controlled a dominant share of the US housing finance system, and that share has since expanded. The operations of Fannie and Freddie and the FHA account for the bulk of this federal intervention. Rather than increase homeownership, this involvement has accelerated purchases by individuals who would otherwise have obtained home loans later in the conventional market, and it has cost taxpayers billions of dollars. It has done little to measurably increase US homeownership rates.[5]

Massive Federal Regulatory Complex

US financial markets have too many regulations and too many regulators. Depending on the activity, at least seven federal regulators could supervise, examine, or otherwise regulate a bank, including the Federal Reserve, the FDIC, the SEC, the Commodity Futures Trading Commission, the Consumer Financial Protection Bureau, the Federal Housing Finance Agency, and various agencies within the US Treasury Department.

Capital markets participants are subject to a similar byzantine regulatory structure, including the SEC and the Commodity Futures Trading Commission, as well as

"self-regulatory organizations," including the Financial Industry Regulatory Authority, which are private not-for-profit organizations that have been delegated regulatory authority.

Banks are more heavily regulated than other financial firms, but virtually all financial companies are subject to extensive restrictions on their activities, capital, and asset composition. It is true that there have been many changes to these rules and regulations in the past few decades and that some of those changes allowed financial firms to engage in activities that they were previously prohibited from doing. However, there has never been a substantial reduction in the scale or scope of financial regulations in the United States. Government rules have increasingly been credited with guaranteeing financial market safety, creating a false sense of security, lowering private incentives to monitor risk, increasing institutions' financial risk, and protecting incumbent firms from new competitors.[6] Yet, as a Cato Institute survey suggests, most Americans still trust the professionals working in the financial industry more than government regulators to understand how much risk financial institutions should take. (See Figure 9.)

Federal Backing of Credit Markets

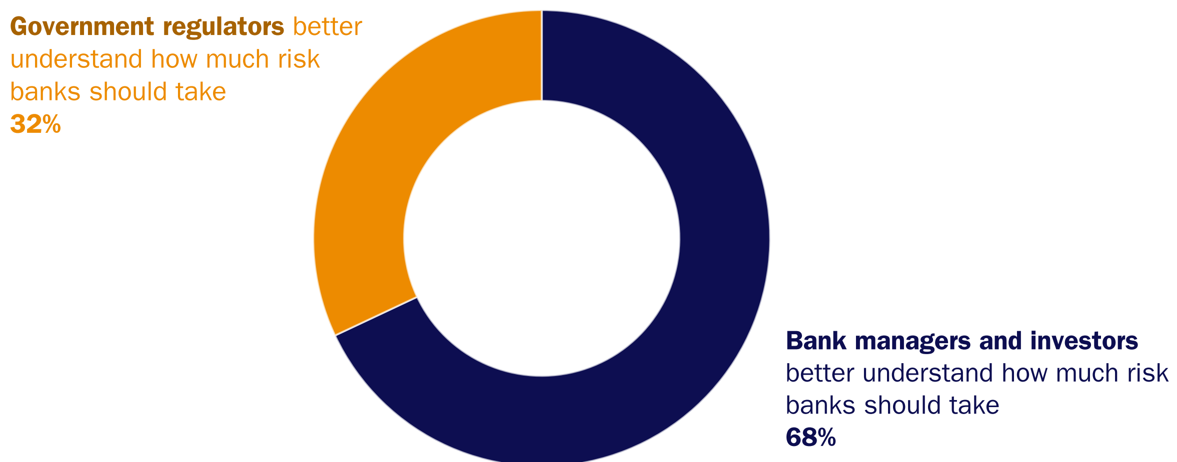
Americans are responsible for trillions of dollars in debt exposure from outstanding federal loans, loan guarantees, and subsidized insurance programs spread over more than 100 federal programs.[7] The government credit portfolio consists of direct loans and loan guarantees for housing, agriculture, energy, education, transportation, infrastructure, exporting, and small business, among other enterprises. Federal insurance programs cover bank and credit union deposits, pensions, flood damage, declines in crop prices, and acts of terrorism. Capital for mortgage lending by banks is provided by the government-sponsored enterprises (GSEs), such as Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. Taxpayer backing in the current framework also comes indirectly from the Federal Reserve, which has a long history of using its emergency lending and discount-window loan policies to support failing firms, as well as directly from deposit insurance provided by the FDIC. This redistribution of taxpayers' money erodes the nation's entrepreneurial spirit, increases financial risk, and fosters cronyism and corruption.

Financial Artificial Intelligence

Artificial intelligence and finance have been intertwined for decades, from algorithmic trading to payment fraud detection systems and beyond. But the arrival of generative

Figure 9

68 percent of Americans trust finance professionals over regulators on risk



Source: Cato Institute 2022 Financial Regulation Survey.

AI—artificial intelligence capable of generating text, images, and other data after having learned patterns from training data—has sparked newfound regulatory interest in AI. Financial regulators, including cabinet-level departments, bank regulators, and capital markets regulators, have been active in warning of AI-related risks and promulgating rules and guidance to address them.[8] Notably, the risks typically flagged by regulators—such as those related to fraud, cybersecurity threats, unlawful discrimination, and breaches of fiduciary duties—usually are already covered by existing laws and rules. Whereas some regulators have used this moment to reiterate the applicability of existing obligations, others have treated AI advances as manifesting entirely new kinds of risk requiring new (and expanded) regulations.

"Congress and federal agencies can implement many reforms to improve the overly burdensome and paternalistic regulatory and monetary systems."

The conclusion that financial AI may not merely affect (positively or negatively) the *degree* of long-understood financial conduct risks, but rather poses inherently novel risks, is often based on fundamental misunderstandings of the nature of AI and its application to finance.[9] Making policy based on these erroneous conclusions is the opposite of the technology neutrality that financial regulators should observe and undermines the vast potential of AI to deliver better, cheaper, and more accessible financial services to American consumers.

SOLUTIONS

Congress and federal agencies can implement many reforms to improve the overly burdensome and paternalistic regulatory and monetary systems, thus strengthening citizens' basic rights, reducing the likelihood of taxpayer-financed bailouts, expanding innovation and competition, and increasing Americans' economic opportunities.

- **Repeal Dodd-Frank.** The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act is among the most inappropriately named laws ever enacted in the United States. It neither reformed Wall Street nor protects consumers, and it imposed massive new regulations on banks far from Wall Street. Congress should repeal the law.
- **Fix money market mutual fund rules.** A better alternative to the current MMF rules would use the 1983 regulatory framework for MMFs as a baseline. From there, the SEC should pare down the prescriptive rules to the bare minimum so that they include little more than an average maturity restriction. The rules should not provide incentives for holding specific types of short-term assets, including government securities, in MMFs. Rather than trying to improve financial markets by saddling MMFs with more operating restrictions, the SEC should allow fund managers and investors to figure out what works best for them. This approach would foster more competition in short-term credit markets and make them more resilient by decreasing the uniformity of investment options. If the SEC refuses to adjust the MMF rules, Congress should rewrite the statute.
- **Shrink the Federal Housing Authority's role.** Congress should limit the FHA's single-family insurance portfolio to first-time homebuyers, without any refinance eligibility (through the FHA) over the tenure of the loans in force. Additionally, the FHA should decrease the value of loan limits eligible for FHA single-family mortgage insurance to (at most) the first quartile of home prices.
- **Wind down the government-sponsored enterprises.** Congress should shut down Fannie Mae and Freddie Mac and all their subsidiaries. Any legislation to close the GSEs should avoid creating a smaller version of the companies under a new name. While the GSEs still exist, the Federal Housing Finance Agency should raise Fannie and Freddie's mortgage guarantee fees, eliminate the geographic price differentials for the GSEs'

conforming loan limits, narrow the GSEs' focus to the financing of primary homes, and gradually reduce conforming loan limits. Congress should also require the Federal Housing Finance Agency to enforce the excessive use provisions in the GSEs' charters, and revoke Fannie and Freddie's exemption from the requirements to register their securities offerings under the Securities Act of 1933. Banking regulators should adjust risk-weighted capital rules so that financial institutions cannot treat GSE debt and mortgage-backed securities as if they are US government obligations.

- **Reform the regulators.** Congress should eliminate duplicative federal agencies. There is no objective reason to have three federal banking regulators and two federal capital markets regulators. Congress should also improve the financial regulatory framework by taking an entirely different approach to regulating banks and capital markets. This reform program should reduce impediments to capital formation and market efficiency, reduce unwarranted regulatory costs, and eliminate policies that socialize private investors' losses. Moreover, the main purpose of financial regulations should be to provide reasonable, scaled disclosure; enforce contracts; and deter fraud. The Fed's primary responsibility is monetary policy, and it does not need to be a regulator. Congress should also eliminate the Fed's ability to provide emergency lending and discount-window loans directly to firms, thus limiting the Fed to providing system-wide liquidity.
- **Provide new financial firm charters.** Congress should create a new federal charter for financial institutions, broadly defined, that ensures the owners will absorb their own financial risks with higher equity stakes. Congress could pair these charters with regulatory off-ramps so that scaled regulatory relief is provided for firms that agree to hold higher equity funding.
- **Stop federally backing credit.** Unconstrained spending, unfettered losses, and rampant cronyism are only part of the cost of the government's vast credit-backing system. Proponents say that such backing is necessary to spur economic growth or to mitigate market imperfections, but government credit is a poor substitute for private financing where (to the contrary) great care is taken in lending decisions under the threat of loss. Well-intentioned or otherwise, there is abundant evidence that government-backed financing produces more harm than benefit for the nation as a whole and that these programs should be eliminated.
- **Avoid counterproductive overreach on artificial intelligence.** Policymakers should apply a pro-innovation policy framework to financial AI. This framework involves making three key assessments to avoid inappropriate regulation of the application of AI tools to financial services.[10] First, determine whether AI is, in fact, introducing greater or novel risk based on validated evidence. Second, determine whether the AI-related risk is already covered by laws and rules regarding unlawful conduct before layering on novel or redundant regulatory obligations. Third, consider the lost benefits of applying a new or existing policy to AI and take an outcome-oriented approach. Notably, where existing policies relevant to an AI-related risk contain prescriptive obligations that are not suited to the operation of new AI tools, such prescriptions ought to be revised so that a comparable risk-mitigation outcome can be achieved without undermining consumers' access to AI tools.
- **Embrace decentralized policy responses to decentralized financial artificial intelligence.** Where AI tools achieve sufficient degrees of autonomy (i.e., the ability to operate with limited ongoing human intervention), policy responses should look to long-standing legal principles, such as those enshrined in the common law of agency, as a guide instead of devising new and prescriptive regulations.[11] Generally, where AI tools decentralize access to financial services, such as investment advice, policy responses themselves should be decentralized in nature—for example, based in common-law principles that incentivize appropriate care—as opposed to being reliant on centralized gatekeeping and licensing regimes.

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About the Cato Institute

Founded in 1977, the Cato Institute is a public policy research foundation dedicated to broadening the parameters of policy debate to allow consideration of more options that are consistent with the principles of limited government, individual liberty, and peace. To that end, the Institute strives to achieve greater involvement of the intelligent, concerned lay public in questions of policy and the proper role of government.

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Despite the achievement of the nation's Founders, today virtually no aspect of life is free from government encroachment. A pervasive intolerance for individual rights is shown by government's arbitrary intrusions into private economic transactions and its disregard for civil liberties. And while freedom around the globe has notably increased in the past several decades, many countries have moved in the opposite direction, and most governments still do not respect or safeguard the wide range of civil and economic liberties.

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