

BLOG

Stablecoin Regulation: Following MMFs’ Roadmap?

*Collin Berger**

Global investment in stablecoins, a type of cryptocurrency designed to have a stable value relative to something else, has skyrocketed recently.¹ While this growth raises questions about stablecoins’ relationship to the financial regulatory perimeter,² the near term will probably see federal regulators’ stated appetite for policy action exceed coordinated regulatory innovation. The example of the 1970s policy response to money market funds (MMFs)³ has parallels to stablecoins’ potential emergence as private digital money. As was the case with 1970s MMFs, the SEC will likely be stablecoins’ leading federal supervisor but will face substantial constraints on its oversight and limited help from other regulators.

I. BACKGROUND: STABLECOINS

Stablecoins have recently attracted attention for their potential to:

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¹ Gordon Liao & John Carmichael, *Stablecoins: Growth Potential and Impact on Banking* 1 (Bd. of Governors of the Fed. Rsrv. Sys. Int’l Fin. Discussion Papers, Paper No. 1334, 2022), <https://www.federalreserve.gov/econres/ifdp/stablecoins-growth-potential-and-impact-on-banking.htm> (documenting “a more than 500% increase” over the year ending September 2021). The paper also includes a helpful description of stablecoins and the existing market. *Id.* at 2–6.

² “Activities falling within the regulatory perimeter are subject to that regulatory regime and activities outside the perimeter are not.” MICHAEL S. BARR ET AL., FINANCIAL REGULATION: LAW AND POLICY 109 (3d ed. 2021).

³ See *infra* note 28. The 1979 DOJ policy letter about money market funds described there is attached to the end of this blog post.

1. Compete with existing payment systems and banking services and
2. Reach ubiquity rapidly.⁴

Stablecoin issuers maintain coins' value by managing reserves similar to how a central bank could maintain a pegged fiat currency, and reserve management practices are opaque.⁵ The Bank of England published a discussion paper last June describing retail stablecoins' ability to facilitate payments worldwide quickly and cheaply.⁶ The paper also detailed prospective high-level regulatory frameworks for stablecoins.⁷ In July, Secretary Yellen, Fed Chair Powell, and other federal regulators participated in a President's Working Group meeting on stablecoins.⁸ The group's November report called for:

- New legislation,
- Interim measures by agencies like the Department of Justice and Consumer Financial Protection Bureau, and
- Action by the cross-agency Financial Stability Oversight Council (FSOC).⁹

Even before that report's release, the Biden administration expressed an interest in bringing stablecoins into the regulatory perimeter through agency¹⁰ or legislative¹¹ action.

⁴ See, e.g., *id.* at 6–8; *New Forms of Digital Money* § 1.2 (Bank of Eng., Discussion Paper, 2021), <https://www.bankofengland.co.uk/paper/2021/new-forms-of-digital-money>.

⁵ See, e.g., Frances Yue, *Tether Reveals More Details About Its Reserves*, COINDESK (Aug. 9, 2021), <https://www.coindesk.com/markets/2021/08/09/tether-reveals-more-details-about-its-reserves/>.

⁶ *New Forms of Digital Money*, *supra* note 4.

⁷ *Id.*

⁸ Press Release, Dep't of the Treasury, Readout of the Meeting of the President's Working Group on Financial Markets to Discuss Stablecoins (July 19, 2021), <https://home.treasury.gov/news/press-releases/jy0281>.

⁹ PRESIDENT'S WORKING GRP. ON FIN. MKTS. ET AL., REPORT ON STABLECOINS 16–18 (2021), <https://home.treasury.gov/news/press-releases/jy0454>; *id.* at 15 (“Because responsibilities within many of these arrangements are widely distributed, and currently fall within the jurisdiction of different regulatory agencies, or outside of the regulatory perimeter altogether, there is a risk of incomplete or fragmented oversight.”).

¹⁰ Michelle Price, *Explainer: How U.S. Regulators Are Cracking Down on Cryptocurrencies*, REUTERS (Sept. 24, 2021), <https://www.reuters.com/technology/how-us-regulators-are-cracking-down-cryptocurrencies-2021-09-24/>.

¹¹ Andrew Ackerman & AnnaMaria Andriotis, *Biden Administration Seeks to Regulate Stablecoin Issuers as Banks*, WALL ST. J. (Oct. 1, 2021), <https://www.wsj.com/articles>

II. CURRENT REGULATORY PERIMETER

Stablecoins currently occupy a gap between federal regulators' domains.

- Entity-based oversight:
 - The Office of the Comptroller of the Currency (OCC) has explored unconventional charters that would bring companies under its supervision, but that remains controversial (e.g., litigation,¹² academic criticism¹³) and unlikely to expand to stablecoin issuers.¹⁴
 - The Federal Deposit Insurance Corporation (FDIC) might be considering insuring stablecoin issuers,¹⁵ but action is forthcoming.
 - Stablecoin issuers are not Federal Reserve members and are beyond the Fed's oversight unless they seek membership or become important enough that the FSOC pushes them under Fed supervision.¹⁶
- Activity-based oversight:
 - The Commodity Futures Trading Commission (CFTC) monitors all cryptocurrency derivatives and fraud, but this does not cover stablecoin issuers' routine operation.¹⁷

[/biden-administration-seeks-to-regulate-stablecoin-issuers-as-banks-11633103156?mod=latest_headlines.](#)

¹² Pract. L. Fin., *Lacewell v. OCC: Second Circuit Dismisses NYDFS Challenge to OCC Special Purpose National Bank Charter*, PRACT. L. (June 10, 2021), [https://today.westlaw.com/Document/I14e1d786c93711ebbea4f0dc9fb69570/View/FullText.html?contextData=\(sc.Default\)&transitionType=Default&firstPage=true](https://today.westlaw.com/Document/I14e1d786c93711ebbea4f0dc9fb69570/View/FullText.html?contextData=(sc.Default)&transitionType=Default&firstPage=true).

¹³ Howell E. Jackson & Morgan Ricks, *Locating Stablecoins within the Regulatory Perimeter*, HARVARD L. SCH. F. ON CORP. GOVERNANCE (Aug. 5, 2021), <https://corp.gov.law.harvard.edu/2021/08/05/locating-stablecoins-within-the-regulatory-perimeter/> (analyzing stablecoins in light of the Glass-Steagall Act).

¹⁴ See Jesse Hamilton & Akayla Gardner, *Crypto's Road Gets Harder with Biden Pick for Bank Watchdog*, BLOOMBERG (Sept. 28, 2021), <https://www.bloomberg.com/news/articles/2021-09-28/crypto-s-road-gets-even-harder-with-biden-pick-for-bank-watchdog> (describing policy arguments of now-withdrawn nominee for Comptroller of the Currency).

¹⁵ See Nate DiCamillo, *US FDIC Said to Be Studying Deposit Insurance for Stablecoins*, COINDESK (Oct. 7, 2021), <https://www.coindesk.com/policy/2021/10/06/us-fdic-said-to-be-studying-deposit-insurance-for-stablecoins/>.

¹⁶ See *Designations*, DEP'T OF THE TREASURY, <https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc/designations> (last visited Feb. 6, 2022).

¹⁷ CFTC, A CFTC PRIMER ON VIRTUAL CURRENCIES 10–11 (2017), <https://www.cftc.gov/digitalassets/index.htm>; CFTC, DIGITAL ASSETS PRIMER 9, 17, 23–25, 29–33 (2020),

- The SEC supervises some cryptocurrency issuances under a framework ill-suited to stablecoins. That “*Howey*” framework¹⁸ is from a 1940s Supreme Court case that tied SEC oversight to expectations of asset appreciation,¹⁹ which should not occur with dollar-pegged stablecoins. This limitation may explain the SEC’s recent action toward stablecoin lending rather than stablecoin issuers.²⁰
- The recent President’s Working Group report flagged this thorny CFTC-SEC dynamic since, “[a]s an initial matter, and depending on their structure, stablecoins . . . may be [SEC-regulated] securities, [CFTC-regulated] commodities, and/or derivatives.”²¹

III. 1970S MMFS: SEC OVERSAW MODESTLY, OTHERS DEFERRED

With stablecoins emerging as a private form of money, some analyses have drawn parallels between stablecoins and the emergence of MMFs. In the late 1970s, MMFs functioned much like banks with shares that functioned much like deposits. Because of MMFs’ rapid growth outside the regulatory perimeter and advantages over conventional in-perimeter depository institutions, this episode offers stronger parallels to stablecoins than more recent financial innovations. In the context of predicting the regulatory perimeter’s evolution, the MMF example suggests change will occur against the existing legislative backdrop. Although legislators considered their options for MMF oversight in 1980,²² Congress relaxed legislation on depository institutions²³ and did

<https://www.cftc.gov/digitalassets/index.htm>; CFTC, AN INTRODUCTION TO VIRTUAL CURRENCY 2, <https://www.cftc.gov/digitalassets/index.htm> (last visited Feb. 6, 2022).

¹⁸ *Framework for “Investment Contract” Analysis of Digital Assets*, SEC, <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets> (last updated Apr. 3, 2019).

¹⁹ *SEC v. Howey*, 328 U.S. 293 (1946).

²⁰ See Dave Michaels & Paul Vigna, *Coinbase Says SEC IS Investigating Its Crypto Lending Program*, WALL ST. J. (Sept. 8, 2021), <https://www.wsj.com/articles/coinbase-says-sec-plans-enforcement-action-over-crypto-lending-program-11631110478>.

²¹ PRESIDENT’S WORKING GRP. ON FIN. MKTS. ET AL., *supra* note 9, at 11.

²² See *Money Market Mutual Funds: Hearings Before the Subcomm. on Fin. Insts. of the Comm. on Banking, Hous., & Urb. Affs.*, 96th Cong. (1980) [hereinafter *Money Market Hearings*].

²³ Kenneth J. Robinson, *Depository Institutions Deregulation and Monetary Control Act of 1980*, Fed. Rsrv. Hist. (Nov. 22, 2013) (website hosted by the Federal Reserve Bank of St. Louis), <https://www.federalreservehistory.org/essays/monetary-control-act-of-1980>.

not provide meaningful MMF restraints until after MMFs' 2008 crisis.²⁴ Such reactive policy development is consistent with other instances in U.S. financial history.²⁵ That being said, the Administration's recent interest in new legislation suggests it is possible, if unlikely, that Congress will act.

In the absence of new legislation, the MMF example indicates the SEC will emerge as stablecoins' leading regulator even as its oversight faces limitations like those described above. This reflects how agencies encountering MMFs deferred to legal conclusions that placed MMFs under a light SEC regime.

- The MMF question: As MMFs gained traction, some banks argued MMFs violated the Depression-era Glass-Steagall Act by both issuing investment securities and taking supposedly safe deposits.²⁶ The SEC passed this criticism along to the DOJ, which enforced (and still enforces) parts of Glass-Steagall. The relevant legislation remains in effect in 2022.²⁷
- DOJ answered that MMFs receive lighter oversight: The response letter from the DOJ's assistant attorney general of the Criminal Division formed the basis for financial regulators' MMF approach. This was despite his position's comparatively low financial expertise compared to leaders at the SEC, Federal Reserve, or other institutions. In under three pages, the DOJ argued that MMFs did not violate Glass-Steagall for several reasons. Among those reasons, shares of MMFs were equity contracts and not deposits (i.e., debts of the MMFs) even though they shared much

²⁴ Scott Hirst, *Dodd-Frank and Mutual Funds: Alternative Approaches to System Risk*, HARVARD L. SCH. F. ON CORP. GOVERNANCE (Feb. 10, 2011), <https://corp.gov.law.harvard.edu/2011/02/10/dodd-frank-and-mutual-funds-alternative-approaches-to-systemic-risk/>.

²⁵ See, e.g., MICHAEL S. BARR ET AL., *supra* note 2, at 36–37 (describing the First Bank of the United States as “part of a plan to restore the fiscal health of the nation”); *id.* at 38–39 (describing the Second Bank of the United States as a response to the financial pressures of the War of 1812); *id.* at 41–42 (describing the National Banking Acts of 1863 and 1864 as responses to the Civil War's financial pressures); *id.* at 47–48 (describing the “vigorous debate” prompted by the Panic of 1907 that led to the Federal Reserve System); *id.* at 52–54 (describing New Deal reforms in response to the Great Depression); *id.* at 66–67 (describing the Dodd-Frank Act's reforms in the aftermath of the 2008 financial crisis).

²⁶ See *Money Market Hearings*, *supra* note 22, at 472 (letter of Morris D. Crawford Jr. dated Oct. 18, 1979).

²⁷ 12 U.S.C. § 378 (2018); *Glossary: Glass-Steagall Act*, PRACT. L., [https://1.next.westlaw.com/5-507-8468?__lrTS=20201204083055570&transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://1.next.westlaw.com/5-507-8468?__lrTS=20201204083055570&transitionType=Default&contextData=(sc.Default)&firstPage=true) (last visited Feb. 6, 2022).

of contemporary deposit accounts' functionality.²⁸ Under this, MMFs would face some SEC oversight but avoid depository institutions' stricter limits.

- Regulators' alignment to DOJ stance: At congressional hearings a month after the letter, the SEC Commissioner,²⁹ the Comptroller of the Currency,³⁰ and a Federal Reserve governor³¹ all echoed the DOJ letter's message that MMF shares carry risk and are not deposits. Industry testimony at the same hearings also referenced the letter or repeated the message.³² Existing literature describes the DOJ letter and how agencies quickly aligned behind it.³³

IV. MMFs' IMPLICATIONS FOR STABLECOINS

The emergence of coordinated agency positions toward MMFs offer some omens for the regulatory perimeter around stablecoins. Since the DOJ letter on MMFs remains the clearest agency distinction between less-regulated equity contracts and more-regulated debt contracts, one recent paper categorized the most prominent stablecoins as one or the other.³⁴ The authors identified most of the coins they examined as resembling debt contracts, but the leading stablecoin (Tether) was more

²⁸ December 18, 1979 letter from Philip B. Heymann, Assistant Attorney General, Criminal Division, DOJ to Martin Lybecker, Associate Director, Division of Marketing Management, SEC. Academics cite this letter but it has not been published. In it, Mr. Heymann concluded "one who invests in a money market fund is an owner pro tanto of the fund" regardless of the mechanisms for withdrawing funds. *Id.* The letter also argued that, if MMF shares were deposits, the liquidation of the investment by any means would violate Glass-Steagall, thereby destroying MMFs altogether. Glass-Steagall, said the letter, aimed to "sever banks from investment banking, not to put an end to all investment banking business." *Id.* (describing the interplay of sections 16 and 24 of Glass-Steagall). Finally, the letter observed that the nature of the relationship between an investor and a fund does not depend on the fund's type of investment or riskiness. *Id.*

²⁹ *Money Market Hearings*, *supra* note 22, at 7 (prepared statement of Irving M. Pollack, Comm'r of the SEC); *id.* at 15–16 (statement of Irving M. Pollack, Comm'r of the SEC).

³⁰ *Money Market Hearings*, *supra* note 22, at 231, 237 (prepared statement of John G. Heimann, Comptroller of the Currency).

³¹ *Money Market Hearings*, *supra* note 22, at 245 (statement of J. Charles Partee, Member, Bd. of Governors of the Fed. Rsr. Sys.).

³² *Money Market Hearings*, *supra* note 22, at 335 (prepared statement of Edward C. Johnson III, chairman of the bd., Fid. Mgmt. & Rsch. Co.); *id.* at 400 (statement of David Silver, president, Inv. Co. Inst.).

³³ Jackson & Ricks, *supra* note 13; John A. Adams, *Money Market Mutual Funds: Has Glass-Steagall Been Cracked?*, 99 *BANKING L.J.* 4, 26 (1982).

³⁴ Gary B. Gorton & Jeffrey Y. Zhang, *Taming Wildcat Stablecoins* 10 (July 19, 2021) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3888752.

like an equity contract.³⁵ This would mean agencies have a pathway to regulating most of these stablecoins under the more robust standards that apply to debt relationships like those at depository institutions. However, the market leader and new equity-like stablecoins could skirt existing depository institution oversight and might operate under limited SEC oversight. Additionally, recent agency actions toward stablecoins mirror actions around MMFs:

- MMFs: the SEC facilitated DOJ's legal analysis and emerged as the main MMF federal regulator. Other agencies echoed the analysis.
- Stablecoins: the SEC is leading innovations in cryptocurrency regulation.³⁶ Agencies are discussing coordinated action but are highlighting the SEC's and CFTC's roles.³⁷

Agencies' path of least resistance could therefore be to follow the MMF example as the SEC takes sole but legally constrained ownership of stablecoin oversight. This is not guaranteed: another recent analysis argued stablecoins could be subjected to heightened regulation under the DOJ MMF letter and Glass-Steagall.³⁸ However, given the speed with which 1970s regulators settled on their MMF approach and the political tidiness of that settlement, the complexity of creating heightened regulations suggests agencies might again proceed toward a softer SEC-led regulatory strategy.

³⁵ *Id.* at 12, tbl.2. Tether's market capitalization of \$62.5 billion is more than double the total of the other stablecoins the authors examined. *Id.*

³⁶ *See, e.g.*, Sara Morrison, *Biden's SEC Is Ready to Regulate Cryptocurrency*, RECODE (Sept. 9, 2021), <https://www.vox.com/recode/22663312/coinbase-sec-cryptocurrency-bitcoin>.

³⁷ *See, e.g.*, PRESIDENT'S WORKING GRP. ON FIN. MKTS. ET AL., *supra* note 9.

³⁸ Jackson & Ricks, *supra* note 12.

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March 6, 1981

Mr. Randy Miller
Frauds Section
Department of Justice
315 9th Street, N.W.
Washington, D. C. 20350

Dear Mr. Miller:

Enclosed please find a retyped copy referred to in the correspondence of the president of this Association, with the dated February 26, 1981. The enclosure is the Investment Company Institute on Jar and hence, the confusion over its date understanding that the original of the dated in December, 1979.

Please do not hesitate to call me if you have any questions.

Sincerely,



Richard W. Peterson
Legislative Counsel



FAP

212-720-1530



New York Federal
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Enclosure

Attachment I

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ORIGINAL ATTACHED

Mr. Martin Lybecker
Associate Director
Division of Marketing Management
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

Dear Mr. Lybecker:

By his letter of October 19, 1979 to the Attorney General, Mr. Morris D. Crawford, Jr., Chairman of the Board of the Bowery Savings Bank of New York furnished a copy of a letter from him of October 18, 1979, showing the Securities and Exchange Commission among others as an addressee. That letter questioned the propriety in several aspects of money market fund operations, which are, as he notes, regulated principally under provisions of Federal law administered by the Commission. To assist the Commission in that regard and in its evaluation of the issues raised by Mr. Crawford, we are furnishing you herewith our views on Mr. Crawford's allegation that many money market funds violate section 21 of the Glass-Steagall Act, 48 Stat. 189 (12 U.S.C. 378(a)(1) as amended), by their provision of a mechanism that permits a fund investor to write an order to "redeem" (sell) so much of his investment as may be necessary upon presentation of the order to the fund's transfer agent (usually a bank) and for the agent to pay a specified sum to whomever presents the order. According to Mr. Crawford, such orders to sell and pay are generally referred to as checks. Enforcement of the cited statutory provision is a responsibility of the General Litigation and Legal Advice Section of the Criminal Division, Department of Justice.

Under the cited statutory provision, it would be unlawful for a money market fund "...to engage in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt or upon request of the depositor...". Mr. Crawford predicates his allegation upon his conclusion that an investor's interest in a money market fund is a deposit, dismissing at page 6 of his October 18, 1979 letter as worthy only of parenthetical comment, the fact that the value in dollars of an investor's shares in a money market fund is subject to the "risk of market fluctuation...". We note that market fluctuation involves not only the risk of depreciation but also the opportunity for appreciation at least for the serendipitous among the ingenious investors of concern to Mr. Crawford.

It is patent from the quoted statutory language that a depositor is only a creditor of his depository (a debtor in the case of an authorized overdraft, which indebtedness he must liquidate by a "deposit"). It is equally patent that one who invests in a money market fund is an owner pro tanto of the fund

Availability of particular mechanisms for an investor to transfer his ownership is a mere formality and serves in no way to alter the substance of his status as owner. As between him and the fund, the potential for capital gain or loss on his investment remains unaffected by the means he may select to realize his investment, and he is not, by his selection of the mechanism of a combined order to sell and pay over (check) to realize his investment, converted into a mere creditor of the fund with no expectation of capital gain or loss from the fund upon realization. Note, though not relevant to the issue at hand, one may question whether, being payable only from funds to be produced by liquidation of an investment, the instruments here concerned are unconditional orders such that, being drafts drawn on a bank, they are checks. See e.g. 23 I.C. Code 3-104 and 105.

Significantly, the statute here involved encompasses virtually any means a bank's creditor may employ to secure repayment of his deposit, viz: check, presentation of evidence of debt or mere request. Thus Mr. Crawford's argument proves too much. If funds invested in a money market fund are in fact deposits, then the statute is violated as much by liquidation of the investment and repayment on request of the investor as by the investor's use of a "check" for that purpose. This would mean that no pooling of resources by investors to buy and sell money market securities for their mutual advantage would be lawful, for the "...person, firm, corporation, association, business trust, or other similar organization..." for pooling investor resources (section 21, Glass-Steagall Act, *supra*) would necessarily engage in selling money market securities while at the same time receiving "deposits":

In light of the holding in Investment Co. Institute v. Camp, 401 U.S. 617 (1971) that section 16 of the Glass-Steagall Act, 12 U.S.C. 24, as amended, precludes engagement of a national bank in the investment banking business, the proviso in section 21 of the Glass-Steagall Act, *supra*, excluding from that prohibition bank security transactions permitted under section 16 of the Act, will not permit a bank to pool investors' resources for investment on their behalf in money market securities. The cited cases dealt specifically with a stock fund operation, but as the Court said, "...the breadth of the term (securities) is implicit in the fact that the antecedent statutory language (in sections 16 and 21 of the Glass-Steagall Act, *supra*) encompasses not only equity securities but also securities representing debt." Investment Co. Institute v. Camp, *supra*, at 635. The cited opinion makes it clear that the intent of Congress in passing the Glass-Steagall Act was to sever banks from investment banking, not to put an end to all investment banking business.

Reference to stock funds raises a further objection to Mr. Crawford's conclusion that investors in a money market fund are mere depositors. Surely the relationship between a fund and its investors cannot depend upon the character of the res held by the fund. It is probably true that a stock fund investment is generally more speculative than investment in a money market fund, but that distinction has no significance in assessment of the legal nature of the relationship between a fund and its investors. Note that the foregoing has nor and need not involve consideration of permitted transactions of a bank for its own account in investment securities under section 16 of the Glass-Steagall Act, supra.

Inasmuch as investors in a money market fund are, in our view, owners of the fund and not mere depositors, we perceive no violation of section 21(a), Glass-Steagall Act, supra, in permitting an investor in such a fund to realize his investment by means of a check or otherwise. Please call Mr. James Robinson on 724-7526 should you wish to discuss aspects of the foregoing observations informally.

Sincerely,

Philip B. Heymann
Assistant Attorney General
Criminal Division

By:

Lawrence Lippe, Chief
General Litigation and
Legal Advice Section

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