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# Stablecoin Markets and Mitigating Illicit Finance

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## I. Executive Summary

The stablecoin market is rapidly evolving, presenting both opportunities and challenges for the financial system. This paper focuses on fiat-backed stablecoins, highlighting their growth, potential for illicit use, and the current U.S. regulatory environment. The Trump Administration's positive approach to crypto asset regulation contrasts with the previous Biden Administration's more risk-averse focus, and is joined by new legislation and the prospect of a more formalized stablecoin market that will expand usage and invite larger financial players to leverage the technology. While current anti-money laundering regulations cover stablecoin companies, vulnerabilities in the secondary market and the prevalence of over-the-counter transactions pose significant risks. To mitigate these risks, it is recommended that the U.S. improve law enforcement officials' digital asset investigative capacity, crack down on international over-the-counter crypto asset markets, and use persuasive negotiation to encourage global implementation of Financial Action Task Force (FATF)'s virtual asset guidance. These actions are crucial to ensure the responsible growth and security of the stablecoin market.

## II. What are Stablecoins?

A stablecoin is a crypto asset minted on a blockchain and designed to maintain a specified value in relation to a particular asset or a pool of assets.<sup>1</sup> In principle, stablecoins cause greater price stability since they are pegged to real-world currencies or backed by liquid collateral rather than most crypto assets, whose price value is based on supply and demand of the token. Stablecoins are lauded by advocates for having the same technological benefits of crypto assets, such as 24/7 availability, transaction transparency and auditability, and smart contract programmability, while not having the common drawback of price volatility. Two distinct types of stablecoins are central to the stablecoin ecosystem:

- Fiat-backed stablecoins aim to maintain value with a national fiat currency and are supposed to be backed by reserves of cash or cash equivalents. Fiat-backed stablecoins constitute 94% of the current stablecoin market<sup>2</sup> and 99% of these types of stablecoins are pegged to the US dollar.<sup>3</sup> The most popular USD stablecoins currently are issued by the El Salvador-based<sup>4</sup> company Tether, whose stablecoin known as USDT has a market capitalization of \$145 billion, followed by U.S.-based Circle, whose USDC coin (USDC) has a market cap of \$60 billion.<sup>5</sup>

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<sup>1</sup> Fanusie, Yaya J., ed., and Melina Ramirez. "Decrypting Crypto: Central Bank Digital Currencies and Stablecoins." Georgetown University Center for Financial Markets and Policy, April 2025. <https://finpolicy.georgetown.edu/wp-content/uploads/2025/04/CBDCs-Explainer.pdf>

<sup>2</sup> CCI. "What Traditional Banking Reveals About Stablecoins." *Crypto Council for Innovation*, 26 December 2024, <https://cryptoforinnovation.org/what-traditional-banking-reveals-about-stablecoins/>.

<sup>3</sup> Treasury Borrowing Advisory Committee. "Digital Money." US Department of the Treasury, April 30, 2025. <https://home.treasury.gov/system/files/221/TBACCharge2Q22025.pdf>.

<sup>4</sup> "Tether Licensed in El Salvador, Strengthening Focus on Emerging Markets and Innovation." *Tether.io*, 13 January 2025, <https://tether.io/news/tether-licensed-in-el-salvador-strengthening-focus-on-emerging-markets-and-innovation/>.

<sup>5</sup> Treasury Borrowing Advisory Committee. "Digital Money." US Department of the Treasury, April 30, 2025. <https://home.treasury.gov/system/files/221/TBACCharge2Q22025.pdf>.

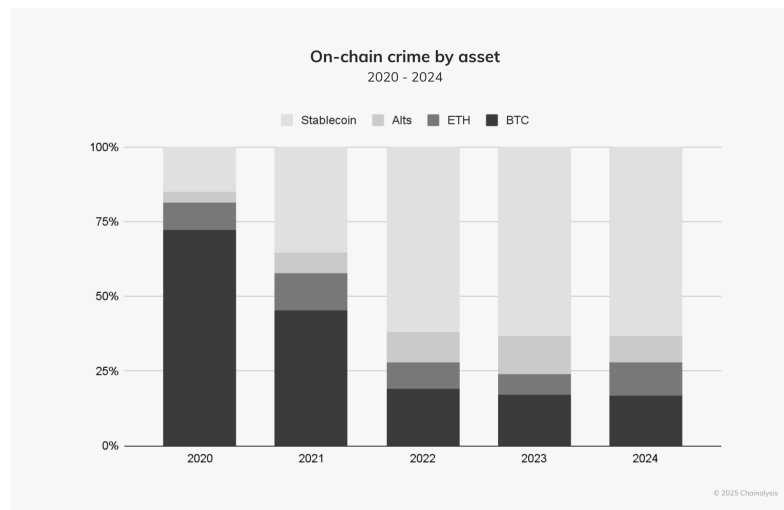
- Algorithmic stablecoins use algorithmic programming that adjusts the supply and demand of the asset or set of assets in reserve, typically crypto assets, in order to maintain a stable value. These types of stablecoins are widely used in decentralized finance (DeFi) applications and services.

This paper and its policy recommendations focus solely on fiat-backed stablecoins.

### III. Current Stablecoin Environment and Crypto Illicit Finance Trends

Stablecoins are growing as part of the financial landscape. As of early 2025, there was approximately \$208 billion worth of stablecoins in global circulation, according to the World Economic Forum.<sup>6</sup> The market grew an estimated 28.4% year-over-year, up from \$162 billion in 2024.<sup>7</sup> Trends indicate stablecoin use will likely sustain growth, impacting traditional banking and requiring more formal regulatory frameworks and compliance enforcement.

In January 2025, Chainalysis, a leading blockchain analytics firm, projected that 2024 could show the highest volume of crypto illicit finance transactions.<sup>8</sup> An estimated 2024 illicit financing transactions via crypto networks were anticipated to amount to over \$51 billion, contrasted with \$46 billion in 2023, and \$54.3 billion in 2022; the 2022 figure includes over \$8 billion from the FTX creditor claim, however.<sup>9</sup> Also, Chainalysis noted that it is common for the previous year's figures to rise dramatically during the subsequent year as the firm identified illicit addresses connected to earlier transactions.



*Figure from Chainalysis. Accessed April 21, 2025.*

<sup>6</sup> "Stablecoin surge: Reserve-backed cryptocurrencies are on the rise." *The World Economic Forum*, 26 March 2025, <https://www.weforum.org/stories/2025/03/stablecoins-cryptocurrency-on-rise-financial-systems/>. Accessed 17 April 2025.

<sup>7</sup> IBIT.

<sup>8</sup> "2025 Crypto Crime Trends from Chainalysis." *Chainalysis*, 15 January 2025, <https://www.chainalysis.com/blog/2025-crypto-crime-report-introduction/>. Accessed 18 April 2025.

<sup>9</sup> IBIT.

The price stability of stablecoins, which attract everyday crypto users, also attracts criminals who want to preserve the value of their illicit earnings. In recent years, stablecoins have comprised a large chunk of all blockchain (“on-chain”) transactions that are known to connect with illicit addresses, according to Chainalysis figures. But the observed illicit on-chain transactions are lower-bound estimates. The above graph, for example, only accounts for on-chain crime. In practice, however, many illicit activities occur in non-crypto asset funds (off-chain) and are converted to stablecoins but may never get flagged as “illicit.”

## IV. U.S. Stablecoin Environment

The current political and policy-making environment under the Trump Administration signals a hastening effort to regulate and expand stablecoin markets. The Trump Administration has quickly adopted a proactive approach to digital assets, describing stablecoins as vital for global dollar dominance.<sup>10</sup> This orientation diverges from the Biden Administration's more risk-averse approach, which did not acknowledge any potential benefits of cryptocurrencies or their underlying technology.<sup>11</sup>

On January 23, 2025, President Trump signed an Executive Order (E.O.) prioritizing national stablecoin regulation and innovation. The order directed the Secretary of the Treasury Department “to immediately revoke The Department of the Treasury’s Framework for International Engagement on Digital Assets” developed under the Biden Administration and to create the President’s Working Group on Digital Asset Markets to coordinate interagency stablecoin efforts.<sup>12</sup> The Biden Administration framework in 2022 emphasized consumer protection; global cooperation to mitigate illicit financing transactions; and the exploration of central bank digital currencies (CBDCs), digital assets that could potentially be issued by central banks, including by the Federal Reserve in the United States.<sup>13</sup> The Trump Administration altered the policy posture, pushing a forward-leaning narrative on digital assets that emphasizes domestic private sector development and citing CBDCs globally as a threat to U.S. sovereignty and personal privacy.<sup>14</sup> The formalization of the U.S. stablecoin market is a key priority under the Trump E.O., with the President aiming to sign stablecoin-related bills into law by August 2025.<sup>15</sup>

Congressional support for stablecoin legislation is at a historical peak. The GENIUS Act in the U.S. Senate and the STABLE Act in the House of Representatives reflect current congressional

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<sup>10</sup> “Strengthening American Leadership in Digital Financial Technology – The White House.” *The White House*, 23 January 2025, <https://www.whitehouse.gov/presidential-actions/2025/01/strengthening-american-leadership-in-digital-financial-technology/>. Accessed 21 April 2025.

<sup>11</sup> Fanusie, Yaya J. “America Is Missing a Big Opportunity on Blockchain.” *Foreign Policy*, 17 July 2023, [https://foreignpolicy.com/2023/07/17/cryptocurrency-blockchain-us-digital-finance-technology-regulation/?download\\_pdf=true](https://foreignpolicy.com/2023/07/17/cryptocurrency-blockchain-us-digital-finance-technology-regulation/?download_pdf=true).

<sup>12</sup> IBIT.

<sup>13</sup> “President Trump Issues Executive Order to Establish Digital Assets Regulatory Framework.” *O’Melveny*, 10 February 2025, <https://omm.com/insights/alerts-publications/president-trump-issues-executive-order-to-establish-digital-assets-regulatory-framework/>. Accessed 22 April 2025.

<sup>14</sup> “Strengthening American Leadership in Digital Financial Technology – The White House.” *The White House*, 23 January 2025, <https://www.whitehouse.gov/presidential-actions/2025/01/strengthening-american-leadership-in-digital-financial-technology/>. Accessed 1 June 2025.

<sup>15</sup> Kelley, Alexandra. “Trump aims to sign two stablecoin bills by August, officials say.” *Nextgov*, 27 March 2025, <https://www.nextgov.com/emerging-tech/2025/03/trump-aims-sign-two-stablecoin-bills-august-officials-say/404103/>. Accessed 28 May 2025.

support. To date, both have received widespread, rare bipartisan affirmation during the legislative process. The GENIUS Act passed the Senate Banking Committee with margins of 68-30 and the STABLE Act smoothly passed through the House Financial Services Committee.<sup>16</sup> Senator Kirsten Gillibrand (D-NY), co-sponsor of the GENIUS Act with Senator Bill Hagerty (R-TN), reiterated the urgency of representatives to encourage stablecoin integration into the economy. “Unfortunately, when it comes to Web3 – the next generation of the internet built on blockchain, digital assets, and cryptocurrencies – we are trailing and are at risk of falling further behind,” warned Gillibrand in an op-ed for Coindesk.<sup>17</sup> Senator Gillibrand called for a regulatory framework that begins with stablecoins. The two bills will predictably be changed in the coming months, but one notable potential result of the GENIUS Act is the allowance for stablecoins to be used for interbank settlement.<sup>18</sup> This would be a significant innovation for the infrastructure of the banking sector. The Clearing House Network (CHIPS), the largest private USD clearance and settlements company in the world, clears and settles approximately \$1.8 trillion in domestic and international transactions daily, per its website.<sup>19</sup> Because stablecoins possess the features of blockchain software programmability, 24/7 access, and transparency/auditability, using stablecoins for interbank settlement could, in theory, accelerate such processes, which for decades have been facilitated by multiple organizations tasked with crediting, debiting, and reconciling accounts between financial institutions.<sup>20,21</sup> This has led to longstanding information silos, friction, and inefficiencies in banking payments.

In the private sector, financial institutions are increasingly focused on incorporating stablecoins into their business models. Banks like JPMorganChase and Bank of America recently introduced their own stablecoins or signaled future plans to do so. JPMorganChase developed the JPM Coin in 2019 and when it came to functional fruition in late 2023,<sup>22</sup> the firm reported its daily transaction value amounted to \$1 billion.<sup>23</sup> The JPM Coin is, from the firm’s perspective, “a blockchain-based bank account rather than a tokenized deposit,” per a 2024 *Ledger Insights* article. It runs on JPMorgan’s private blockchain network, not on an open, permissionless blockchain like the stablecoins issued by Tether and Circle. Still, large users of the firm’s JPM Coin include the German company Siemens,<sup>24</sup> demonstrating the potential of stablecoins for industrial cross-border transactions. Bank of America CEO Brian Moynihan mirrored JPMorgan’s shift to using stablecoins, affirming that Bank of America will launch a stablecoin in

<sup>16</sup> Wong, Scott, and Julie Tsirkin. "Senate passes landmark crypto regulation bill on a bipartisan vote, sending it to the House." NBC News, 17 June 2025, <https://www.nbcnews.com/politics/congress/senate-passes-landmark-crypto-regulation-bill-bipartisan-vote-sending-rcna213437>.

<sup>17</sup> "Financial Services Committee Advances Five Bills During Full Committee Markup." US House Committee on Financial Services, 2 April 2025, <https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=409683>.

<sup>18</sup> Gillibrand, Kirsten. "Why We Need a Bipartisan Stablecoin Bill." Office of U.S. Senator Kirsten Gillibrand, 10 February 2025, <https://www.gillibrand.senate.gov/news/press/release/icymi-gillibrand-op-ed-in-coindesk-why-we-need-a-bipartisan-stablecoin-bill/>.

<sup>19</sup> "Changes in latest Genius Act bill – applies to non-interest bearing stablecoins." *Ledger Insights*, <https://www.ledgerinsights.com/senate-banking-committee-passes-bill-for-non-interest-bearing-stablecoins-2/>. Accessed 26 April 2025.

<sup>20</sup> "CHIPS." *The Clearing House*, accessed 10 June 2025, <https://www.theclearinghouse.org/payment-systems/chips>.

<sup>21</sup> Merle-Huet, Alexandra. "Overview of the U.S. Payments, Clearing and Settlement Landscape." Federal Reserve Bank of New York, 11 May 2015. [https://www.newyorkfed.org/medialibrary/media/banking/international/03 Overview-US-PCS-landscape-Merle.pdf](https://www.newyorkfed.org/medialibrary/media/banking/international/03%20Overview-US-PCS-landscape-Merle.pdf).

<sup>22</sup> "JP Morgan says JPM Coin transactions have 'exploded' because of programmability." *Ledger Insights - blockchain for enterprise*, 30 May 2024, <https://www.ledgerinsights.com/jp-morgan-says-jpm-coin-transactions-have-exploded-because-of-programmability/>. Accessed 25 April 2025.

<sup>23</sup> "JPMorgan Says JPM Coin Now Handles \$1 Billion Transactions Daily." *Bloomberg*, <https://www.bloomberg.com/news/articles/2023-10-26/jpmorgan-says-jpm-coin-now-handles-1-billion-transactions-daily>.

<sup>24</sup> IBIT.

2025, pending legislative approval. Moynihan informed business leaders at a public forum in Washington, D.C. that, “If they make that legal, we will go into that business,” likening regulated stablecoins to new versions of money market funds or typical bank accounts.<sup>25</sup>

Further, non-banking financial institutions (NBFIs) are among market participants aiming to increase digital asset exposure. Bain and Company reports that a growing number of NBFIs are developing partnerships to back stablecoins with investment funds and launching digital asset trading platforms, as Citadel did in 2022 with its EDX Markets for cryptocurrencies. Pantera Capital, a California-based hedge fund and venture capital firm, wrote a 2025 blog post calling stablecoins “the ‘killer app’ of crypto.”<sup>26</sup> In short, many institutional investors view stablecoins as the safer, more practical manifestation of cryptocurrency technology. Funds like Citadel and others are likely to increasingly focus on stablecoin opportunities and integrate them into ongoing cryptocurrency initiatives.

Lastly, payment infrastructure companies like PayPal and Visa have also started using stablecoins. PayPal introduced the PYUSD, a coin which is convertible 1:1 with the US dollar, on its platforms in 2023.<sup>27</sup> Its company website states that users can buy and sell the PYUSD, use it for payments, or convert it to other cryptocurrencies that PayPal offers. Similarly, Visa first announced on its website that it would allow for stablecoin payments, specifically in Circle’s USDC, in 2020. Since then, the level of stablecoin transactions done via the Visa platform has skyrocketed. According to its internal reports, in the 30 days prior to April 26, 2025, users’ stablecoin transaction value totaled \$2.3 trillion with an adjusted transaction volume of \$722.4 billion.<sup>28</sup>

The presidential, congressional, and private sector support for integrating stablecoins into the financial system is at an unprecedented high in the United States.

Internationally, a few other countries have instituted preliminary stablecoin regulation. For example, Europe’s MiCA, which stands for Markets in Crypto-Assets Regulation, created baseline rules for stablecoins, which it formally refers to as e-money tokens. According to MiCA, all issuers of stablecoins must be EU-approved, must be backed 100 percent by reserves, and 30 to 60 percent of stablecoin reserves must be stored at a credit institution.<sup>29</sup> In regard to auditing, the EU requires independent audits semi-yearly. MiCA’s regulatory framework wades only lightly into the regulation of the retail market of stablecoins.<sup>30</sup> MiCA directly addresses the issuance and public offerings in institutional markets and skims over accessibility to the retail

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<sup>25</sup> “Bank of America Plans To Launch Stablecoin Once U.S. Legislation is Passed, CEO Says.” *Yahoo Finance*, 27 February 2025, <https://finance.yahoo.com/news/bank-america-plans-launch-stablecoin-081305207.html>.

<sup>26</sup> Lowe, Erik. “THE ‘KILLER APP’ OF CRYPTO IS THE DOLLAR.” Pantera Capital, <https://panteracapital.com/blockchain-letter/a-new-frontier-for-crypto-exposure/>.

<sup>27</sup> “PayPal Launches U.S. Dollar Stablecoin.” *PayPal*, 7 August 2023, <https://newsroom.paypal-corp.com/2023-08-07-PayPal-Launches-U-S-Dollar-Stablecoin>.

<sup>28</sup> “Stablecoin Transactions.” *Visa Onchain Analytics Dashboard*, <https://visaonchainanalytics.com/transactions>. Accessed 26 April 2025.

<sup>29</sup> “Stablecoin Regulation Gains Global Momentum.” *S&P Global*, 10 February 2025.

<sup>30</sup> <https://www.spglobal.com/ratings/en/research/articles/250210-stablecoin-regulation-gains-global-momentum-13400761>. Accessed 28 May 2025.

<sup>30</sup> IBIT.

market, signaling future challenges for retail market regulation.<sup>31</sup> Standard and Poor's also highlights the progress of proposed regulations in the U.K., Hong Kong, and the UAE. Both the U.K. and Hong Kong have been focusing on fiat-backed stablecoins and have signaled a desire to ensure that all stablecoins are 100% backed by reserves. UAE stablecoin regulation requires the maintenance of a 100% reserve backing requirement with a preference for cash, but the country's legislation scope extends beyond fiat-backed stablecoins to asset-backed stablecoins that could include a variety of financial assets.<sup>32</sup>

## V. The State of AML/CFT Regulation of Stablecoin Markets

Although stablecoins have not been formally included under the safety and soundness and consumer protection regulatory requirements that cover banks, businesses that facilitate trading of stablecoins, and cryptocurrencies generally, already fall under anti-money laundering and countering the financing of terrorism (AML/CFT) regulation. Dating back to 2013, the Financial Enforcement Crimes Network (FinCEN), a bureau under the U.S. Department of Treasury, classified virtual currency exchanges and those who administer centralized repositories for issuance and redemption of such tokens as money service business (MSBs), making them subject to the Bank Secrecy Act (BSA) of 1970.<sup>33</sup> The BSA vests powers in FinCEN to ensure MSBs are following AML/CFT laws.<sup>34</sup> In 2019, FinCEN released updated guidance, expounding upon the variety of activities and business models that had evolved over a decade since the birth of Bitcoin.<sup>35</sup> Stablecoin issuers (companies that create stablecoins and make them initially available) in the United States have looked to the BSA and FinCEN's virtual currency guidance as the blueprint for how to manage the illicit finance risks involved in issuing stablecoins. Broadly, this indicates that U.S. stablecoin issuers must register with FinCEN and comply with AML/CFT measures. Issuers must perform Know Your Customer (KYC) verifications, customer due diligence, and transaction monitoring of clients, who are commonly large organizations, not individuals. Other responsibilities for stablecoin issuers include maintaining a formal risk-based compliance program, having a compliance officer, keeping certain administrative and operational records, and filing suspicious activity reports with FinCEN; such tasks are also expected for traditional financial services.<sup>36</sup> Stablecoin issuers are also bound by U.S. sanctions and must screen customers to ensure they are not on the Treasury's list of Specially Designated Persons, with whom transactions are prohibited.

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<sup>31</sup> "EU MARKETS IN CRYPTO-ASSETS (MICA) REGULATION EXPECTED TO ENTER INTO FORCE IN EARLY 2023." *Mayer Brown*, 14 December 2022, <https://www.mayerbrown.com/en/insights/publications/2022/12/eu-markets-in-crypto-assets-mica-regulation-expected-to-enter-into-force-in-early-2023>.

<sup>32</sup> "Stablecoin Regulation Gains Global Momentum." *S&P Global*, 10 February 2025, <https://www.spglobal.com/ratings/en/research/articles/250210-stablecoin-regulation-gains-global-momentum-13400761>. Accessed 28 May 2025.

<sup>33</sup> Financial Crimes Enforcement Network. "Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies." FIN-2013-G001. US Department of the Treasury, 18 March 2013. [https://www.fincen.gov/statutes\\_regs/guidance/pdf/FIN-2013-G001.pdf](https://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2013-G001.pdf).

<sup>34</sup> Hylton, Megan. "Blockchain & Cryptocurrency Laws & Regulations 2025 | USA." *Global Legal Insights*, 13 October 2024, <https://www.globallegalinsights.com/practice-areas/blockchain-cryptocurrency-laws-and-regulations/usa/>. Accessed 27 April 2025.

<sup>35</sup> Financial Crimes Enforcement Network. "Application of FinCEN's Regulations to Certain Business Models Involving Convertible Virtual Currencies." FIN-2019-G001. US Department of the Treasury, 9 May 2019.

<https://www.fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf>.

<sup>36</sup> "Shielding Against Money Laundering: AML Regulations for Stablecoins Uncovered." *Financial Crime Academy*, 18 March 2025, <https://financialcrimeacademy.org/aml-regulations-for-stablecoins/>.



The international community has also established that stablecoin markets fall under the current framework of AML/CFT rules. In 2019, the Financial Action Task Force, the intergovernmental body that sets AML/CFT standards, released guidelines which emphasized that “[i]n general terms, both global ‘stablecoins’ and their service providers would be subject to the FATF standards either as virtual assets and virtual asset service providers or as traditional financial assets and their service providers. They should never be outside the scope of anti-money laundering controls.”<sup>37</sup> This framework is a foundational model for countering illicit finance in stablecoin markets, but it does not necessarily address the entire scope of transactional activity that arises. This is due to the existence of two distinct types of stablecoin trading environments.

Stablecoins can be acquired in two different types of markets.<sup>38</sup> The primary market is where stablecoin issuers provide tokens by selling them in large batches to customers who will typically then make them available to a wider range of users. The everyday retail user today typically can not purchase a stablecoin on the primary market, directly from the issuer. A secondary market consists of the platforms where the stablecoin issuer’s customers—typically entities with much liquidity—sell stablecoins to the broader public, including individuals buying smaller quantities. It also includes informal trading, which could occur between individuals who exchange stablecoins for other cryptocurrencies directly or through decentralized exchange platforms where users trade via smart contract-based software and where an intermediary is not involved. The most critical distinction from a regulatory perspective is that the customers and users on the secondary market are *not* customers of the stablecoin issuer. Under AML/CFT regulations, the issuer has no formal obligation to do KYC identification, transaction monitoring, or suspicious activity reporting on those secondary customers. This distinction is practical from a legal perspective since the issuer has no direct relationship with the secondary market customers and has no reasonable way to identify them.

**Primary Market:**

- Initial **issuance** of stablecoin tokens for **institutional clients**
- Created by registered money service businesses
- Most commonly pegged 1:1 with USD or other currency
- Smaller market and often limited time frame

**Secondary Market:**

- Stablecoin receivers can **trade their stablecoin** for other cryptocurrencies, currencies
- Traders can exploit primary and secondary market differentials; this arbitrage can **help maintain token peg**
- No involvement from issuer
- Larger market and on-going

<sup>37</sup> “Money laundering risks from “stablecoins” and other emerging assets.” FATF, 18 October 2019, <https://www.fatf-gafi.org/en/publications/Fatfgeneral/Statement-virtual-assets-global-stablecoins.html#:~:text=In%20general%20terms%2C%20both%20global,stable%20coins%20and%20other%20emerging%20assets.>

<sup>38</sup> Watsky, Cy, Jeffrey Allen, Hamzah Daud, Jochen Demuth, Daniel Little, Megan Rodden, and Amber Seira. “Primary and Secondary Markets for Stablecoins.” *FEDS Notes*. Board of Governors of the Federal Reserve System, 23 February 2024. <https://www.federalreserve.gov/econres/notes/feds-notes/primary-and-secondary-markets-for-stablecoins-20240223.html>.



Many of the primary market customers are themselves MSBs who, because they exchange stablecoins and other cryptocurrencies as a business, must follow AML/CFT rules for servicing the secondary market users who are their direct customers. A cryptocurrency exchange platform (which would be a stablecoin primary market customer) conducts KYC on its customer that is part of the secondary market, monitors transactions, files suspicious activity reports\ to mitigate illicit finance risks. The secondary market is not free from AML/CFT coverage but like the broader financial system, it does have vulnerabilities that can be exploited by illicit actors.

The secondary market offers a wider array of opportunities to acquire stablecoins from a variety of formal and informal traders, given the ease with which tokens can transfer between users on blockchain networks. The majority of tokens' users and individual traders access them via the secondary market. Often, stablecoins are traded for other decentralized, non-fiat-backed cryptocurrencies, potentially complicating the links between their purchase at a regulated exchange and their eventual transfer to a new user. If someone uses a decentralized exchange to swap a non-stablecoin cryptocurrency for a stablecoin, decentralized exchanges without centralized intermediaries have no way to implement formal AML/CFT requirements on those trades. This general ease of acquisition plausibly allows for bad actors to purchase stablecoin not only outside the purview of issuing firms like Circle or Tether, but also away from the regulatory compliance of regulated crypto exchanges.

The wide array of acquisition touchpoints in the global secondary market is heightened by the presence of over-the-counter (OTC) crypto brokers who often provide access to tokens with little or no KYC hurdles. As of 2021, Circle estimated that “anecdotal evidence suggests that the crypto OTC market sees 2x to 3x the amount of trading volumes that [regulated] crypto exchanges process on a daily basis.”<sup>39</sup> OTC exchanges are essentially gray markets and proliferate in countries that have not implemented FATF's guidance on virtual assets and have weak or no formal AML/CFT regulation of their cryptocurrency sector.

Stablecoin issuers have found a way to support counter-illicit finance efforts in the secondary market, particularly when it comes to enforcing sanctions. However, their compliance with these efforts has been inconsistent across jurisdictions. As mentioned, U.S. stablecoin issuers must abide by U.S. sanctions restrictions. Because fiat-backed stablecoin tokens have a centralized issuer, their design typically allows for the issuer to freeze, block, or destroy tokens they have minted. The U.S. has sought for issuers to freeze stablecoins possessed by sanctioned entities. Tether, whose annual profits soared exponentially and previously surpassed those of BlackRock, particularly, has come under scrutiny regarding sanctions compliance.<sup>40</sup> The El Salvador-based company, which previously was headquartered in the British Virgin Islands, reports that it complies with AML and CFT rules. In a conversation with The Wall Street Journal, the firm

<sup>39</sup> "Crypto OTC Trading and Stablecoins: Why Institutional Market Participants Increasingly Choose USDC." *Circle*, 19 January 2021, <https://www.circle.com/blog/crypto-otc-trading-and-stablecoins-why-institutional-market-participants-increasingly-choose-usdc>.

<sup>40</sup> Berwick, Angus, and Ben Foldy. "The Shadow Dollar That's Fueling the Financial Underworld Cryptocurrency Tether enables a parallel economy that operates beyond the reach of U.S. law enforcement." *The Wall Street Journal*, [https://www.wsj.com/finance/currencies/tether-crypto-us-dollar-sanctions-52f85459?gaa\\_at=eafs&gaa\\_n=ASWzDAiAi5Rf1BsfDzR9UJVd8H59Dv6FwCrCIWMBzhpt9AyxwPDJMI7SxEYBPcmPDi8%3D&gaa\\_ts=683756bc&gaa\\_sig=esoXtce9YxkHKpELZDuDUJKVj4npf\\_tiw7nG\\_i6L9xcPgonSgkX\\_kRewpMN](https://www.wsj.com/finance/currencies/tether-crypto-us-dollar-sanctions-52f85459?gaa_at=eafs&gaa_n=ASWzDAiAi5Rf1BsfDzR9UJVd8H59Dv6FwCrCIWMBzhpt9AyxwPDJMI7SxEYBPcmPDi8%3D&gaa_ts=683756bc&gaa_sig=esoXtce9YxkHKpELZDuDUJKVj4npf_tiw7nG_i6L9xcPgonSgkX_kRewpMN).

stated it can freeze accounts like traditional banks. WSJ reports indicate, though, that from 2018 to June 2024 “Tether blacklisted 2,713 wallets on its two most popular blockchains that had received a total of about \$153 billion, according to crypto data provider ChainArgos. Of that massive sum, Tether could only freeze \$1.4 billion because the rest of the funds had already been sent on.” Due to the increased speed of transfer on blockchains, law enforcement authorities and stablecoin issuers have to act quickly to stop stablecoin-holding sanctioned actors before they can cash out into fiat currency or convert to a decentralized cryptocurrency that can not be frozen by a centralized issuer.

The international use of U.S. dollar stablecoins has emerged as a national security issue. Currently, one of the dominant use-cases for USD stablecoins is outside the United States, born out of a mix of economic necessity and opportunity. Many individuals in other parts of the world seek to preserve financial value by exchanging highly inflationary local currency for USD stablecoins. Also, stablecoins have become a more convenient and cheaper way to pay for international trade directly between buyers and merchants, without having to go through the conventional banking system. These features benefit general users but also get exploited by those facing the most restrictions from global banking and who seek alternative channels: individuals and entities designated under U.S. sanctions.

A variety of sanctioned actors have been able to circumvent the AML/CFT and sanctions safeguards of both the conventional banking system and the regulated digital asset space by moving monetary value in stablecoins. The Wall Street Journal has reported that Russian oligarch networks, Iranian financial networks, the terrorist group Hamas, the Maduro regime in Venezuela, and international drug cartels have evaded sanctions restrictions by using stablecoins to conduct cross-border transactions that would be much more difficult, if not impossible, through conventional banking channels.<sup>41</sup> Tether’s USDT, the stablecoin with the greatest global circulation, has been prominent in these types of activities. Blockchain analysis firm TRM Labs noted in early 2025 that a significant share of illicit crypto activity has been occurring in recent years through Tether stablecoins minted on the TRON blockchain.<sup>42</sup> The TRON protocol is known for fast confirmation times and low transaction fees,<sup>43</sup> which are highly prized by illicit actors looking to move and launder funds quickly, just as they would be attractive to legitimate users. In response to such concerns about illicit use of USDT on TRON, Tether has formed a partnership with TRON and TRM Labs and developed an industry financial crime unit to investigate illicit activity and collaborate with law enforcement.<sup>44</sup>

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<sup>41</sup> Berwick, Angus, and Ben Foldy. “The Shadow Dollar That’s Fueling the Financial Underworld Cryptocurrency Tether enables a parallel economy that operates beyond the reach of U.S. law enforcement.” The Wall Street Journal, [https://www.wsj.com/finance/currencies/tether-crypto-us-dollar-sanctions-52f85459?gaa\\_at=eafs&gaa\\_n=ASWzDAiAi5Rf1BsfdZr9UJvD8H59Dv6FwCrCIWMBzhpt9AyxwPDJMI7SxYBPemPDi8%3D&gaa\\_ts=683756bc&gaa\\_sig=esoXtXe9YxkHKpELZDuDUJKVj4npf\\_tiw7nG\\_i6L9xcPGonSgkX\\_kRewpMN](https://www.wsj.com/finance/currencies/tether-crypto-us-dollar-sanctions-52f85459?gaa_at=eafs&gaa_n=ASWzDAiAi5Rf1BsfdZr9UJvD8H59Dv6FwCrCIWMBzhpt9AyxwPDJMI7SxYBPemPDi8%3D&gaa_ts=683756bc&gaa_sig=esoXtXe9YxkHKpELZDuDUJKVj4npf_tiw7nG_i6L9xcPGonSgkX_kRewpMN).

<sup>42</sup> “Report Teaser: Proportion of Illicit Volume of Crypto Dropped 51% in 2024.” TRM Labs, 15 January 2025, <https://www.trmlabs.com/resources/blog/report-teaser-proportion-of-illicit-volume-of-crypto-dropped-51-in-2024>.

<sup>43</sup> Deer, Marcel. “What is Tron, and how does it work? A beginner’s guide.” Cointelegraph, 4 October 2024, <https://cointelegraph.com/learn/articles/what-is-tron-trx-and-how-does-it-work-a-beginners-guide>.

<sup>44</sup> “TRON, Tether and TRM Labs establish first-ever private sector financial crime unit to combat crypto crime.” Blockworks, 11 September 2024, <https://blockworks.co/news/tron-tether-and-trm-labs-establish-financial-crime-unit>.

Although centralized stablecoin issuers are technically able to freeze the tokens circulating in the secondary market, compliance with U.S. sanctions has not always been readily implemented by non-U.S.-based firms. For example, when the Treasury's Office of Foreign Asset Control (OFAC) sanctioned the decentralized crypto mixing service Tornado Cash in 2022,<sup>45</sup> entities under U.S. jurisdiction became obligated to freeze any assets that they had in Tornado Cash's sanctioned wallets.<sup>46</sup> However, a Tether executive said at the time that the firm would only freeze specific Tether wallets if the U.S. government contacted it directly about which wallets to freeze.<sup>47</sup> Tether posted on its blog that it considered its company to be outside U.S. jurisdiction because it is not based in the U.S., and even though people in the U.S. use USDT in the secondary market, Tether's customers (primary market firms) are non-U.S. companies.<sup>48</sup>

The existence of a leading USD stablecoin issuer that does not clearly fall fully under U.S. oversight and thus may not be unquestionably cooperative with U.S. law continues to be a major concern for U.S. lawmakers engaged in current stablecoin legislation. One of the key provisions negotiated in the GENIUS Act deals with how to treat foreign issuers of USD stablecoins in U.S. markets and how to ensure that they comply with U.S. lawful orders and freeze or block stablecoin tokens when requested by the U.S. government.<sup>49</sup> In addition, the bill calls for FinCEN to issue guidance or rulemaking that will establish best practices for stablecoin issuers to deter illicit financial activity.<sup>50</sup>

Although the final details of a U.S. stablecoin regulatory framework are not yet settled, the U.S. will likely implement some regime that brings stablecoins within the U.S. regulatory perimeter. It will become even more critical for U.S. policymakers, law enforcement, and national security officials to approach the stablecoin environment with a clear-eyed vision for how to combat illicit finance in a potentially wider primary and secondary market and to address the current vulnerabilities that threat actors are exploiting in the digital asset ecosystem.

## **VI. Recommended Actions to Improve Illicit Finance Risk Management in the Stablecoin Environment**

Illicit finance can not realistically be reduced to zero, but some policy and investigative strategies would significantly reduce the illicit use of stablecoins globally. The following are three action items that U.S. officials and international partners should consider:

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<sup>45</sup> Office of Foreign Assets Control. "U.S. Treasury Sanctions Notorious Virtual Currency Mixer Tornado Cash." US Department of the Treasury, 8 August 2022, <https://home.treasury.gov/news/press-releases/iy0916>.

<sup>46</sup> The OFAC designation of the Tornado Cash protocol was controversial in the crypto industry and was later overturned. A federal court in 2024 ruled that the decentralized, immutable smart contracts of Tornado Cash could not legally be designated because, technically they could not be controlled or owned by any individual or entity and, thus, could not be considered property which could be blocked. OFAC removed the sanctions designation in early 2025.

<sup>47</sup> "Tether Won't Freeze Sanctioned Tornado Cash Addresses Without Authorities' Request." *Blockworks*, 24 August 2022, <https://blockworks.co/news/tether-wont-freeze-sanctioned-tornado-cash-addresses-without-authorities-request>.

<sup>48</sup> "Tether Explains Its Decision On Tornado Cash Addresses, Awaits Law Enforcement Instruction." *Tether.io*, 24 August 2022, <https://tether.io/news/tether-holds-firm-on-decision-not-to-freeze-tornado-cash-addresses-awaits-law-enforcement-instruction/>.

<sup>49</sup> "Myth vs. Fact: The GENIUS Act." US Senate Committee on Banking, Housing, and Urban Affairs, 8 May 2025, <https://www.banking.senate.gov/newsroom/majority/myth-vs-fact-the-genius-act>.

<sup>50</sup> Guiding and Establishing National Innovation for U.S. Stablecoins (GENIUS) Act. 119th Congress (2025-2026). S. 1582. Introduced by Sen. Bill Hagerty (R-TN), 1 May 2025. <https://www.congress.gov/bills/119th-congress/senate-bill/1582/text>.

**Advance digital asset investigative capacity at the international and local level.** Successful prosecution of criminals using cryptocurrencies requires robust digital asset investigations. This begins with having expertise in blockchain tracing and forensics analysis, but does not end there. Law enforcement and intelligence officials need blockchain analysis software in order to track transactions, identify wallets and funds used by illicit actors, and build maps of the on-chain laundering networks and tools. They also need expertise in an array of investigative techniques for gathering off-chain evidence relating to crypto-related crime. This includes knowing what to look for in the hardware and software used by bad actors, such as seed phrases linked to private keys, various types of cold storage devices, website domains typically used by scammers, as well as awareness of legal strategies like adapting traditional finance asset forfeiture for digital asset forfeiture and how to maintain digital chain of custody for crypto.

Currently, digital asset investigative skills are not widely dispersed in law enforcement. Typically, national-level police departments that have significant resources for cyber investigations tend to be the most adept at responding to crypto-related crime. There is also unevenness between countries. Some countries with high levels of illicit stablecoin use do not have commensurate digital asset expertise in their law enforcement. Internationally, U.S. legal attaches in U.S. embassies should help set up digital asset investigative exchanges in regions where cryptocurrency use is high, but local country law enforcement capacity is low. These should be periodic meetings (2 to 4 times a year) in a central regional location where investigators could learn from digital asset expert investigators and acquaint themselves with methodologies and tools for crypto-related investigation, analysis, and prosecution.

Within the United States, digital asset expertise needs to be dispersed down to the local level. The Federal Bureau of Investigation, the Internal Revenue Service's Criminal Investigative Division, and the Department of Homeland Security's Homeland Security Investigations should set up quarterly digital asset investigative exchanges with state and local officials to help seed and expand the investigative know-how that currently is skewed toward national-level law enforcement. These sessions could draw on private sector blockchain software firms to provide training on analytic software and include briefings on successful investigations and prosecutions. The objective of both this international and global strategy is to build informal interpersonal networks and relationships that officials can call on to improve their capacity to work on crypto cases and support successful interdictions and prosecutions.

**Crack down on OTC markets similar to how hawala networks were addressed in the 2000s.**

Over-the-counter crypto brokers operate in environments where there is high demand for their informal but trusted services. These brokers will continue to exchange fiat currency for stablecoins and vice versa as long as local customers seek the benefits of stablecoin transactions. In many cases, illicit exploitation of stablecoins is more a function of the broker's general disregard of KYC procedures rather than witting coordination with specific illicit actors, although the end result may be the same. After the September 11 attacks, U.S. law enforcement and national security officials put more scrutiny on informal value transfer systems known as

hawalas, which are common in Asia and Africa for transferring money overseas. Terrorists and drug networks had been exploiting the lack of AML/CFT measures in this informal, but popular, system operating outside conventional banking infrastructure. However, discussion with law enforcement experts indicates that the crackdown on hawalas led to improved AML/CFT practices, and they are generally better regulated than they were prior to September 2001.<sup>51</sup> OTC brokers should be approached similarly.

U.S. law enforcement officials should conduct a joint campaign with foreign partners to confront OTC brokers known to be offering services to sanctioned individuals and illicit finance networks. This requires doing analysis on blockchain transactions transiting to known or presumed OTC brokers' wallets, and also conduct investigations on off-chain to identify their physical locations and broader in-person networks. As with hawaladars, not all of these brokers are members of the illicit groups they service and visits by local and U.S. law enforcement officials, along with the threat of being potentially designated by OFAC (for those with high levels of servicing to U.S. national security threats) is likely to reduce much of the permissive illicit activity happening in these markets. Although it would be unlikely for the U.S. to do this in hostile environments such as Iran, this strategy could be undertaken in countries with friendlier governments, such as the Philippines, Vietnam, Thailand, the United Arab Emirates, Turkey, Iraq, Pakistan, and now, potentially in Syria.

**Encourage Other Nations To Fully Implement FATF's Virtual Asset Guidance.** Even if the U.S. implements stablecoin legislation that bolsters the AML/CFT practices, bad actors will still have access to international secondary markets that might not sufficiently regulate the exchange of digital assets. The only way to reduce the regulatory arbitrage is to have more nations pass necessary AML/CFT legislation for digital assets and implement appropriate regulation and enforcement that bring crypto exchange services into the formal sector. FATF published an assessment in 2024 stating that many countries with materially significant crypto activity had not implemented FATF's virtual asset guidance.<sup>52</sup> This gap still exists.

The U.S. Treasury's Office of Terrorism and Financial Intelligence (TFI), which oversees U.S. engagement with FATF, should take a more assertive approach to hold countries accountable for their progress in virtual asset regulation. One bold strategy would be to make these countries' performance a factor for potentially reducing tariffs being negotiated between Washington and its foreign counterparts. As a starting move, the Treasury Department should provide the U.S. Department of Commerce and the U.S. Trade Representative, in particular, with a regularly updated list of the foreign jurisdictions with significant digital asset activity—especially with OTC markets—that also have poor AML/CFT regulation of the digital asset sector. Although FATF's mutual evaluations do not happen often or quickly enough for FATF to formally assess jurisdictions' real-time progress, this pressure should produce noticeable changes from the view

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<sup>51</sup> Author discussion with experts at the 11th Virtual Currency Conference at the Europol Headquarters in The Hague, June 6, 2025.

<sup>52</sup> Financial Action Task Force. "Status of implementation of Recommendation 15 by FATF Members and Jurisdictions with Materially Important VASP Activity." FATF-GAFI, March 2024, <https://www.fatf-gafi.org/content/fatf-gafi/en/publications/Virtualassets/VACG-Snapshot-Jurisdictions.html#accordion-f4c9813e10-item-b956d9cb6f>.

of U.S. law enforcement and national security officials. For example, nations wanting to demonstrate stronger AML/CFT enforcement could do so by collaborating with the U.S. on the above two recommendation items.

## **Conclusion**

The stablecoin market represents a rapidly evolving landscape that is likely to shift the payment infrastructure of the global financial system. While stablecoins offer advantages such as efficiency and accessibility, their potential for illicit use, particularly in the secondary market and via over-the-counter transactions, necessitates proactive regulatory frameworks and international cooperation. The U.S. is taking proactive steps to regulate stablecoins, but global harmonization of AML/CFT measures, bolstered by enhanced investigative capabilities and targeted interventions against informal exchanges, is crucial to mitigate risks and ensure the integrity of the digital asset ecosystem.