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RFA Update: Digital Assets

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OUR VIEW	In 2008, the enigmatic Satoshi Nakamoto sent a comprehensive nine-page white paper to a group of cryptographers outlining a peer-to-peer electronic cash system called Bitcoin. Over a decade later, Bitcoin and the greater digital assets market stand at an outstanding market capitalization of over $2 trillion. It is estimated that around 16% of adult Americans, or roughly 40 million people, have invested in, traded, or used cryptocurrencies, according to the White House. While the meteoric rise of digital assets has created fierce policy debate, discussions, and ongoing workstreams in Washington, it remains clear that legislators and regulators are playing catch up. There have been numerous Congressional hearings on digital assets, as well as statements from all financial regulatory agencies. From there, we have seen regulators and lawmakers form varying views on the emerging technology – critics, skeptics, advocates, and everything in between – but all seem to agree that greater regulatory oversight over the crypto ecosystem is warranted. While the agreed-upon goal is greater regulatory clarity, there are conflicting views on how to best achieve this, and it seems a stretch at this point to expect substantial legislative or regulatory action in the cryptocurrency space in 2022. That said, decision-makers in Washington will continue working towards a regulatory solution. Below, we examine the various legislative and regulatory workstreams in the digital assets space, as well as discuss President Biden's recent Executive Order on digital assets. Stablecoins will be discussed in our Payments State of Play, which will be released in the coming days.
CRYPTO& CONGRESS	***Congress*** While there are certainly lawmakers with expertise in this space, broadly speaking it is clear that a majority in Congress remain in an educational phase as it relates to digital assets. Numerous hearings have been held in key committees, including in the House Financial Services Committee (HFSC), Senate Banking Committee (SBC), and Senate Agriculture Committee, with an additional hearing in SBC scheduled for this month. Committees without clear jurisdiction in the digital assets space have also held hearings on the topic, especially as it relates to the recent slew of ransomware attacks. During these hearings, one common theme continued to emerge: lawmakers and industry alike agree that additional regulatory clarity is needed, particularly around asset classification. What is less clear, is whether this rare instance of bipartisanship, combined with the push from industry and external pressures as this new asset class increases in popularity, will be enough to enact legislation this year – but we believe Congress is inching closer towards a regulatory solution that involves a role for both the SEC and CFTC. • Most lawmakers across the political spectrum see the value in digital assets, albeit Democrats, in general, have remained warier about a lack of consumer protections and vulnerabilities to fraud and other illicit activity. This includes SBC Chair Brown (D-OH) who has referred to crypto as "shady," "funny money," and a "mirror of the same broken [banking] system." Rep. Sherman (D-CA), Chair of the HFSC Subcommittee on Investor Protection, Entrepreneurship & Capital Markets, is arguably the greatest opponent of crypto on HFSC – repeatedly calling for banning digital assets altogether. Other lawmakers, like Sen. Warren (D-MA), have echoed sentiments expressed by SEC Chair Gensler that the digital assets space is the "wild west" and ripe with opportunities for waste, fraud, and abuse. • Critics have also been quick to point to the enormous amount of energy consumption used by blockchain technology and digital assets like Bitcoin. The House Energy and Commerce Committee even held a hearing on the topic in January, with many Democrats on the

Committee arguing that the inherent benefits of blockchain need to be balanced with environmental and pollution concerns.

- Conversely, digital assets have also found vocal advocates in Congress on both sides of the aisle. Lawmakers, such as Reps. McHenry (R-NC), Soto (D-FL), Hill (R-AR), Davidson (R-OH), and Gottheimer (D-NJ), among others, have introduced legislation to study or provide more regulatory clarity on digital assets. Upwards of 40 bills have been introduced this Congress focused on Blockchain and crypto policy, with more in the works. Below we outline some of the more prominent pieces of legislation.
  - **H.R.1628, the Token Taxonomy Act (Rep. Davidson (R-OH))**: specifies that virtual currencies should not be regulated as securities, thus providing regulatory certainty and clarity for tax treatment for related businesses and investors.
  - **H.R. 1602, the Eliminate Barriers to Innovation Act (Rep. McHenry (R-NC))**: directs the CFTC and SEC to jointly establish a digital asset working group and report respective findings to Congress.
  - **H.R.4451, the Securities Clarity Act (Rep. Emmer (R-MN))**: seeks to clarify that an investment contract asset (i.e., a digital token) is separate and distinct from a securities offering.
  - **H.R.6006, the Keep Innovation in America Act (Rep. McHenry (R-NC))**: seeks to amend the definition of a "crypto broker," in the Infrastructure Investment and Jobs Act.
  - **H.R. 7441, the Digital Asset Market Structure and Investor Protection Act (Rep. Beyer (D-VA)):** seeks to create statutory definitions for digital assets and incorporate digital assets products into existing SEC and CFTC regulatory frameworks, among other things.
  - **The Stablecoin Innovation and Protection Act (Rep. Gottheimer (D-NJ))**: designates certain digital currencies as "qualified" stablecoins if they can be redeemed on a one-for-one basis for U.S. dollars. This bill has yet to be formally introduced.
  - **Digital Commodity Exchange Act of 2021 (Rep Thompson (R-PA)):** fills gaps between the CFTC and SEC regarding the digital assets market, as well as creates a voluntary registration framework to regulate trading venues that list digital commodities such as bitcoin for public trading, among other things. The bill has yet to be formally introduced.
  - Perhaps the most talked-about bill as of late is one that has yet to be introduced. Sen. Lummis (R-WY) is expected to drop a robust, wide-ranging bill to regulate digital assets in the coming weeks. The bill will be the most comprehensive legislation we've seen thus far and may even have bipartisan support.
  - It is our understanding that the Senate Agriculture Committee may also be working on legislation to grant the CFTC more authority in the digital assets spot and cash markets. We discuss the growing calls for additional CFTC authority below.
- In addition to legislation, we have also seen the creation of new working groups and caucuses focused on fostering innovation and ensuring investor protection in the space. We outline the most prominent groups below.
  - Sens. Lummis (R-WY) and Sinema (D-AZ) led the creation of the bipartisan Financial Innovation Caucus, which launched in May 2021 and focuses on several issues including blockchain, digital assets, AI and ML, and central bank digital currencies, among other things. Lummis has described the goal of the Caucus as to educate lawmakers and their staff on the benefits of crypto and present it as a productive tool for both investors and underbanked individuals, as opposed to an apparatus for criminal activity. The formation of the Caucus exemplifies the growing interest in the space by a diverse set of Senators.
  - In 2019, lawmakers launched the bipartisan Blockchain Caucus to focus solely on cryptocurrency policy. The Caucus is made up of thirty-seven Members of Congress and co-chaired by Reps. Emmer (R-MN), Schweikert (R-AZ), Soto (D-FL), and Foster (D-IL). Like in the Senate, the Blockchain Caucus serves as an educational body for House lawmakers interested in understanding the potential opportunities and implications of blockchain technology and facilitating collaboration as Congress deliberates legislation. The group holds educational briefings for Members and staff but has not been particularly active as of late.
  - HFSC Chairwoman Waters (D-CA) launched the Digital Assets Working Group in June of last year for Democratic members of the House Financial Services Committee. The group features both crypto advocates and critics and focuses on "responsible innovation" in the cryptocurrency space, as well as legislation and policy solutions. Given the focus of Chair Waters and the makeup of the Digital Assets Working Group, we expect this group

	will primarily look to ensure any developments in the digital assets space provide protections to the most financially vulnerable individuals. Despite the abundance of Congressional activity in the digital assets' ecosystem, we continue to believe that it will be challenging to pass comprehensive legislation into law in 2022. That said, we saw a dramatic uptick in legislative activity last year and we expect this trend to continue into this year.
DIGITAL ASSETS REGULATION	***SEC and CFTC*** Despite general agreement that the current patchwork of federal and state regulations is insufficient, there is not a clear consensus at this point as to which agency will take the leading role in regulating crypto markets. Also, given that cryptocurrencies do not fit neatly into one framework over another, this becomes all the more challenging and has created what seems to be a turf war between heads of the SEC and CFTC. • SEC Chair Gensler has publicly argued that he believes most cryptocurrency products, including stablecoins, function as securities and should be regulated as such, citing the asset's fulfillment of the Howey Test. He has reiterated this belief in various speeches, hearings, and even recently at the annual retreat for Democratic members and legislative staff of the HFSC. Gensler has been somewhat of a crypto skeptic, recognizing it as the "Wild West," and many in Congress on both sides of the aisle have criticized his assertive approach to regulating the industry. • Meanwhile, CFTC Chair Behnam has underscored that the CFTC is prepared to and should take an expanded role in regulating digital asset spot markets. However, this additional authority (plus greater funding) would first need to be provided by Congress. He has pointed to the CFTC's proven experience regulating similar markets and cited that 60% of digital assets currently are considered commodities (this includes major market players, Bitcoin and Ethereum). Senate Agriculture Committee leaders agree, as laid out in this letter, and industry seems to generally favor a regulatory regime that does not have the SEC as the sole or leading regulator. This was also laid out in a recent hearing for the four nominees to be CFTC Commissioners – all members in attendance discussed the CFTC's role in the digital assets space to some extent, and all nominees exerted the same belief that the CFTC is ready and able (with additional resources and authority from Congress) to play the leading regulatory role here. The Chair and Ranking Member of the House Agriculture Subcommittee on Commodity Exchanges, Energy, and Credit, Reps. Delgado (D-NY) and Fischbach (R-MN), respectively, also recently sent a letter to President Biden urging him to ensure the CFTC plays a forthcoming role in his recently released Executive Order (more below). • It is important to note that members on both sides of the aisle have generally agreed with this sentiment from the CFTC and have called for one lead federal regulator (albeit not the only regulator) for digital assets. The back and forth between the SEC and CFTC will persist for the immediate future, presenting pressure for Congressional action to provide clarity for both the cryptocurrency industry and regulators. ***Prudential Regulators*** In November 2021, the banking regulators (Federal Reserve, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency) released a joint statement on their series of interagency "policy sprints" focused on digital assets. Agency staff researched matters related to digital assets and analyzed the plethora of ways banks may want to engage in crypto-asset activities, such as crypto-asset custody, facilitation of customer purchase and sales of crypto, loans collateralized by crypto, activities involving payments like stablecoins, and activities that may result in the holding of crypto-assets on a bank's balance sheet. The joint statement details that in 2022, the agencies plan to provide greater regulatory clarity on whether activities that involve banks and digital assets are legal and expectations for consumer protection, compliance with existing laws and regulations, and safety and soundness implications. • *FDIC:* Acting FDIC Chairman Gruenberg said the evaluation of the risks associated with cryptocurrency is a top priority for the agency to analyze in 2022.

	• *Federal Reserve*: Chair Powell has stated that he doesn't view cryptocurrencies as a financial stability concern at the moment and has called them "really speculative assets." Additionally, he advocated for a cryptocurrency regulatory framework to deter criminal behavior at a recent House Financial Services Committee hearing. • *OCC:* The OCC published a letter in November confirming that national banks and federal savings associations must "demonstrate that they have adequate controls in place before they engage in certain cryptocurrency, distributed ledger, and stablecoin activities." The statement clarifies that banks should not engage in any activity regarding crypto unless it receives a non-objection from their supervisory office. ***Industry*** President Biden signed an executive order on cryptocurrencies last week (more below), and certain aspects drew widespread applause from the greater crypto industry. For years, crypto companies have been calling for regulatory clarity to ensure innovation can remain in the United States instead of shifting abroad, and in a major win for the industry, the Biden Administration has now recognized the promise and opportunity the emerging technology holds. This signals that the White House and other decision-makers in Washington will continue to engage with the private sector as they work towards a regulatory solution that enables innovation in the industry. • That said, various crypto exchanges, trade groups, and other industry stakeholders have already been highly engaged in Washington prior to the President's EO, generally embracing regulation and calling on Congress to act. This includes various appearances in Congressional hearings and frequent meetings with key regulators and lawmakers and their staff. Similarly, we have seen major industry players release proposals, guiding principles, and frameworks to help steer policymakers in the debate around market regulation. The proposals come in varying forms, with differing levels of detail, but are comprised of similar elements. These include things like prioritizing definitional clarity/asset classification; dedicating one federal primary market regulator; establishing a new, separate framework for digital assets, separate from existing banking system rules; and ensuring a regulatory apparatus that is not overly restrictive and enables innovation and introduction of new products. Industry continues to warn that the cost of regulatory inaction in the digital assets' space may prove detrimental and push innovation abroad. As the cryptocurrency market continues to grow in market capitalization and as its use becomes more widespread, regulators will need to start assessing viable policy recommendations to foster responsible growth in the sector.
CRYPTO EXECUTIVE ORDER	**Executive Order on Digital Assets** On March 9th, President Biden signed an Executive Order (EO) titled "Ensuring Responsible Development of Digital Assets". The long-awaited directive calls on the government to examine the risks cryptocurrencies pose to the economy, national security, and climate, while also noting their possible benefits. While the EO marks the first time the White House has formally weighed in on cryptocurrency, advocates welcomed the absence of any imminent federal action in the order and its acknowledgment of the positive elements of the industry, such as fostering innovation and financial inclusion. That said, the EO also raised some serious concerns about the financial risks posed by cryptocurrency. • The EO focuses on six key priorities: consumer and investor protection; financial stability; illicit finance; U.S. leadership in the global financial system and economic competitiveness; financial inclusion; and responsible innovation. • The Administration calls on the Treasury Department, in coordination with agency partners, to develop policy recommendations on digital assets and encourages regulators to ensure proper oversight and safeguard against systemic risks posed by the emerging technology. 13 of the 23 Cabinet departments will plan a role in carrying out this EO. • Another key area that Biden's executive order focuses on is rooting out illegal activity in the crypto space, where he called for an "unprecedented focus of coordinated action" from federal agencies in mitigating illicit finance and national security risks posed by cryptocurrencies.

	• The Biden administration also wants to explore a digital version of the dollar. While central bank digital currencies (CBDCs) could rapidly speed up the settlement of payments, policymakers are evaluating several issues around financial stability and privacy. • The Administration has said it will continue to work across agencies and with Congress to establish policies that guard against risks and guide responsible innovation, and with the private sector to study and support technological advances in digital assets. • Stablecoins were not addressed in the White House's announcement. While the President's Executive Order doesn't provide the regulatory clarity that is desperately needed in the cryptocurrency sector, it does move the needle substantially and starts a long-overdue dialogue. In six months, the Secretary of the Treasury, in consultation with other agency heads, will submit a report to the President on the future of the money and digital currencies. We eagerly anticipate this report and will continue to update you as we learn more.