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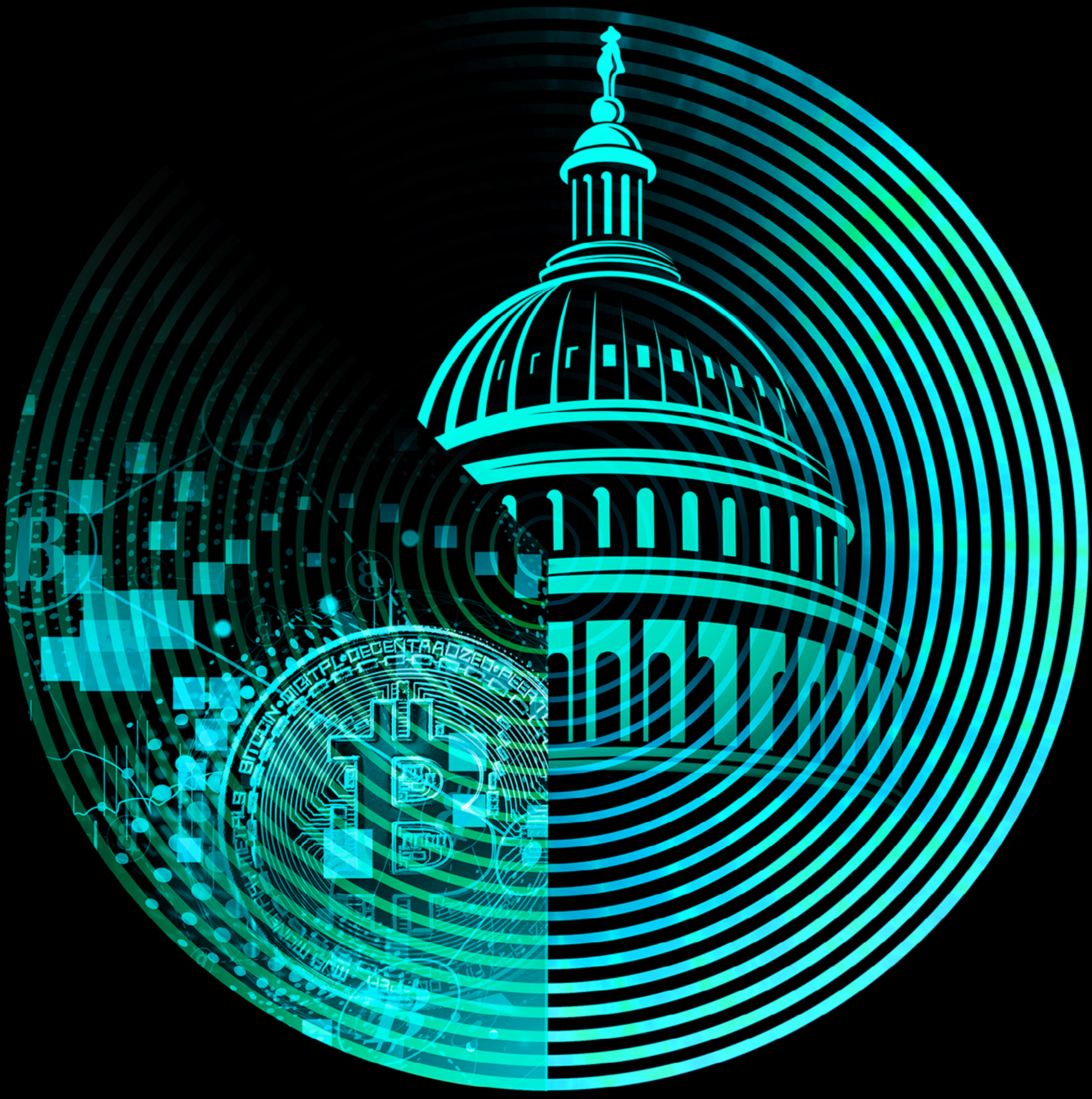

Digital Assets Banking and Capital Markets Regulatory Digest: October 2023

Center *for* Regulatory Strategy US

Contents

1. Introduction

From a policy and regulatory perspective, 2023 continues to be a challenging year for blockchain and digital assets in the United States. Federal regulators have taken decisive actions to confront the industry with little response from Congress. Businesses navigating the complex policy environment are forced to "take sides" in the debate over how the existing regulatory framework applies to their products or business. Some would-be market entrants are waiting in the wings for more clarity while others forge ahead. Still others are locked in near-existential legal battles that may ultimately provide the industry more clarity. Meanwhile, regulated entities struggle to square new applications of blockchain with their regulatory framework, and supervisory scrutiny has expanded beyond crypto assets to applications of blockchain technology more broadly.

Despite the clouds lingering as technology grates against existing law, signs of progress glimmer on a distant horizon. At the end of July, the House Financial Services Committee (HFSC) sent four separate pieces of legislation out of committee. In the Senate, major bipartisan legislation was reintroduced earlier this summer. As the standoff over regulation versus legislation continues, we are monitoring developments across the federal government, which are summarized on the following pages.

2. Classification, reporting, and registration

2.1 IOSCO Policy recommendations for crypto and digital asset markets

<table>
<tr><th colspan="2">IOSCO policy recommendations for crypto and digital asset markets</th></tr>
<tr><td>Agency: International Organization of Securities Commissions (IOSCO) Board</td><td>Date: May 2023</td></tr>
<tr><td>Key summary points</td><td>Implications</td></tr>
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• IOSCO issued a report detailing 18 recommendations regarding crypto and digital assets and their markets.

• The 18 recommendations are designed to tackle a wide swath of issues and establish new norms and "standards" for the digital asset space, according to a press release.[1]

  · "The time has come to put an end to the regulatory uncertainty that characterises crypto activities," Jean-Paul Servais, IOSCO chairperson, said in a statement. "Today's consultation paper received unanimous support from the IOSCO Board and is the outcome of an intense period of regulatory risk analysis, information sharing and capacity building."

• Specifically, the recommendations are designed to "cover six key areas, consistent with the IOSCO Objectives and Principles for Securities Regulation and relevant supporting IOSCO standards, recommendations, and good practices." These include:

1. Conflicts of interest arising from vertical integration of activities and functions,
2. Market manipulation, insider trading and fraud,
3. Cross-border risks and regulatory cooperation,
4. Custody and client asset protection,
5. Operational and technological risk, and
6. Retail access, suitability, and distribution.

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• This effort was led by a working group within IOSCO, which was led by the United Kingdom's Financial Conduct Authority (FCA) as part of the global body's fintech task force.

• These recommendations from IOSCO follow a trend of similar concern, regulation, and legislation around the world regarding the custody and trading of digital and crypto assets following upheaval over the past year.

• The recommendations are aimed in part at unifying digital asset regulation around the world, as many countries have thus far taken diverging approaches to regulation, with some attempting to ban them outright while others have looked to establish regulatory and licensing regimes.

  · Many in the crypto and digital asset space have praised this and other similar pieces of legislation for at least attempting to standardize and unify regulation surrounding digital assets. In a series of interview with Coindesk, several industry executives praised the organization for helping "regulators worldwide move towards a more harmonized system."[2]

  · The 18 currently proposed recommendations do not, however, address decentralized finance (DeFi). DeFi is currently set to be examined separately as part of a different IOSCO working group.

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<tr><td colspan="2">Regulatory references/other materials: IOSCO Policy Recommendations for Crypto and Digital Asset Markets</td></tr>
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2.2 Blockchain Regulatory Certainty Act

Blockchain Regulatory Certainty Act	
Agency: House Financial Services Committee (HFSC)	**Date:** July 26, 2023
Key summary points	**Implications**
• Approved by the HFSC on July 26, the bill would codify in law certain definitions critical to the industry, including blockchain developer, blockchain network, blockchain service, control, and digital asset.	• Legal definitions would be a critical step forward for the industry. • As drafted, the bill largely scopes DeFi out of existing regulatory regimes.
Regulatory references/other materials: Blockchain Regulatory Certainty Act	

2.3 Financial Technology Protection Act of 2023

Financial Technology Protection Act of 2023	
Agency: House Financial Services Committee (HFSC)	**Date:** July 26, 2023
Key summary points	**Implications**
• The bill, which would establish an independent technology working group for combatting terrorism and illicit finance, was unanimously approved by the HFSC on a bipartisan basis.	• The bill mirrors parallel efforts in the Senate to curb the illicit finance risks of digital assets.
Regulatory references/other materials: Financial Technology Protection Act	

2.4 Digital asset market structure proposal

Digital asset market structure proposal	
Agency: US House of Representatives	**Date:** June 2023
Key summary points	**Implications**
• Patrick McHenry (NC-10), HFSC chair; Glenn "GT" Thompson (PA-15), House Committee on Agriculture chair; and French Hill (AR-02), Subcommittee on Digital Assets, Financial Technology and Inclusion chair, released a draft bill that would provide "a statutory framework for digital asset regulation intended to provide clarity, fill regulatory gaps, and foster innovation, while providing adequate consumer protections." • This bill is aimed at providing clarity to the ongoing question of whether digital and crypto assets are considered commodities or securities. The bill would provide clarity by first creating an exemption for digital assets that would help provide a road map for whether a given asset should be a security. • The bill would also look to provide clarity regarding the standards for judging whether or not a given blockchain network is "decentralized." • Other elements of the proposed bill include providing a definition of fungible versus non-fungible assets, the classification of software or other tools that create digital assets.	• The passage of this bill could have significant impacts on the digital and crypto asset industry by finally providing clarity on whether given assets are securities or commodities. • Providing clarity on this issue would have major impacts in the digital asset space and allow many companies in the space to further engage with digital and crypto assets while ensuring they can remain in compliance with relevant regulation. • Based on the definition of "decentralized" and "fungible" assets in this bill, many crypto-related assets would not be included, such as non-fungible tokens (NFTs) or other similar assets. • This bill faces a long process to becoming law, as this discussion draft is still in the early stages of the legislative process.

Regulatory references/other materials: Digital Asset Market Structure Proposal[3]

3. Regulating exchanges

3.1 Financial Innovation and Technology for the 21st Century Act

Financial Innovation and Technology for the 21st Century Act	
Agency: US House of Representatives	**Date:** July 2023
Key summary points	**Implications**

• The US House Committee on Agriculture and HFSC each advanced the Financial Innovation and Technology for the 21st Century Act.
 	
• The bill, a first draft of which was released in June of this year, seeks to provide an overarching regulatory framework for the classification, registration, and trading of various digital assets, providing clear rules regarding various digital assets.
  · This edition of the bill would give the Commodity Futures Trading Commission jurisdiction over digital commodities and would create a process for digital assets originally deemed securities to be sold as commodities.
  · It also clarifies the jurisdiction of the Securities and Exchange Commission (SEC).
 	
• Perhaps most crucially, this latest version of the bill is also designed to create and standardize a regulatory approach for crypto exchanges to register with the SEC.
  · The bill would enable exchanges to trade digital securities, commodities, and stablecoins all in one place, helping to clarify the role of exchanges in these transactions.
 	
• The bill would also aim to create a pathway for blockchains to be certified as decentralized.
 	
• In one of the larger departures from the original bill, this new draft excludes a range of traditional securities such as stocks, bonds, "transferable share[s], … certificate[s] of interest or participation in any profit-sharing agreement," and others from the definition of "digital assets."[4]
	• According to information released by the US House Committee on Agriculture, the bill aims to tackle and eliminate gaps in the existing regulatory framework by creating a new structure that would cater to the "specific risks of different digital asset-related activities."
	
	• This latest draft of the bill also looks to establish conditions for various digital assets to be considered commodities based on criteria about their decentralization.
	  · Assets that are considered to be digital asset commodities would be able to be sold via SEC-registered digital asset trading systems.
	  · Notably, many market participants would be subject to new and more intensive rules and requirements surrounding registration and disclosure.
	
	• Lawmakers, including bill cosponsors Reps. French Hill and Dusty Johnson, also sent letters to regulators criticizing their current regulation and enforcement strategy and have called for a clear regulatory framework to be established, as the bill has sought to do.
	
	• However, some in the industry have claimed that changes contained in this latest version of the bill introduce further uncertainty and ambiguity, rather than clarifying issues surrounding digital asset regulation.

Regulatory references/other materials: Financial Innovation and Technology for the 21st Century Act[5]

4. Stablecoin issuance

4.1 Draft stablecoin legislation

Clarity for Payment Stablecoins Act of 2023	
Agency: US House of Representatives	**Date:** July 27, 2023
Key summary points	**Implications**
• In a July 27 markup session, the HFSC approved the Clarity for Payment Stablecoins Act of 2023 with some bipartisan support. The bill would establish a clear regulatory framework for stablecoins in the United States. • This third draft of the bill is substantially shorter than previous drafts and retains key elements of the bipartisan Water-McHenry stablecoin bill from last year. • This newest version of the bill would call for the Federal Reserve to issue requirements and regulations surrounding stablecoins themselves. However, states would retain the ability to regulate companies issuing the tokens in their states. • The updated draft of the bill does not include an earlier call for research of the merits of a digital dollar or central bank digital currency (CBDC).	• This bill has already had a long history. It was first conceived by Rep. McHenry (NC-10), who called stablecoin legislation a priority last year. After McHenry became head of the HFSC, he once again made this bill a priority. • Democrats and Republicans have since issued their own, competing versions of the bill. Rep. McHenry released a new version of the bill earlier this year that focused on stablecoin payments rather than overseeing other aspects of digital asset markets, such as custodial service providers and algorithmic stablecoins. The bill's latest version is more concise and grants specific powers to state legislatures as well. • State versus federal oversight remains a sticking point between Democrats and Republicans. The Waters-McHenry bill had a more explicit role for the FRB in oversight of state-licensed issuers. • Additionally, this version of the bill does not include requirements for the Federal Reserve to study a potential US CBDC. As noted in previous issues of the digest, the prospect of a US CBDC ha become an increasingly partisan topic.

Regulatory references/other materials: Stablecoin bill[6]

5. Path to a US CBDC

5.1 Treasury speech on payments and US CBDC

Treasury speech on payments and US CBDC	
Agency: US Department of the Treasury	**Date:** June 13, 2023
Key summary points	**Implications**

• In a speech at the Transform Payments USA 2023 Conference, Assistant Secretary for Financial Institutions Graham Steele emphasized that "the United States has not yet determined whether it will pursue a CBDC."
 	
• Currently, Steele said, the Treasury department is "leading an interagency working group to provide a broader Administration perspective for considering the implications of any potential U.S. CBDC" in conjunction with work being done by the federal reserve.
 	
• Steele also addressed some of the benefits and risks of developing and introducing a CBDC or similar digital-dollar project.
  ◦ Among the benefits, according to Steele, would be increased innovation in the payments system, greater financial inclusion, and preservation of "the face value redemption of currency."
  ◦ However, Steele also noted that "the extent to which a retail CBDC would promote these objectives depends on many future design decisions" and pointed out several potential flaws with the technology, including runs on a retail CBDC that could destabilize private-sector lending, increased threats to user privacy, and continued risks of illicit financial transactions.
 	
• The Assistant Secretary also addressed serval other digital payments topics at the conference, including FedNow, Open Banking, and more.
	• Notably, Steele was quick to emphasize that the decision has not yet been made about whether to progress with the development of a CBDC, and any efforts right now remain in the research or exploratory phase.
	
	• Despite this officially neutral tone, however, Steele seemed to highlight some of the issues and risks surrounding the development of a CBDC in his remarks.
	  ◦ For instance, while Steele did point out some benefits of CBDC development and issuance, he spent most of his time on the subject highlighting the risks and challenges of working with a digital dollar, while also nothing that the benefits of a CBDC could be reduced by design decisions, intermediaries, and more.
	
	• Research and development of a CBDC or other so-called digital dollar has become increasingly politicized and controversial in recent months.
	  ◦ In March, US Senator Ted Cruz proposed an outright ban of CBDCs issued in the United States, seemingly riding a wave of increasing conservative criticism of the idea, as Florida governor Ron DeSantis did the same in his state only a week prior.[7]

Regulatory references/other materials: Treasury speech on payments & US CBDC[8]

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Endnotes

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2. Sandali Handagama, "Crypto, Tradfi broadly welcome proposed norms for digital assets," Coindesk, updated May 25, 2023.
3. US House of Representatives House Financial Services Committee, "McHenry, Thompson, Hill, Johnson release digital asset market structure proposal," press release, June 2, 2023.
4. US House of Representatives Financial Services Committee and Committee on Agriculture, "Financial Innovation and Technology for the 21st Century Act, 118th Cong., July 2023.
5. Ibid.
6. US House of Representatives, Stablecoin bill, 118th Cong., June 2023.
7. Mat Di Salvo, "US Senator Ted Cruz proposes CBDC ban amid growing republican pushback, *Decrypt*, March 22, 2023.
8. US Department of the Treasury, "Remarks by Assistant Secretary for Financial Institutions Graham Steele on the digitization of financial services at the Transform Payments USA 2023 Conference (Austin, TX), June 13, 2023.

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