Latest Policy Developments for DLT

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Prepared exclusively for INATBA Members.

Content

Highlights: INATBA Policy Developments

Led by members of the **Identity Working Group** and supported by the Executive Team, INATBA is continuing to build its response to the European Commission's most recent eIDAS proposal. If you are interested in getting involved, please contact martina.piazza@inatba.org for access to the response document.

Last week on 24 June, INATBA presented a number of smart contracts use cases from its members to **DG Grow**. INATBA will be meeting with the European Commission to discuss further developments in this area and where members can get involved.

The INATBA **Identity Working Group** participated in a meeting with EBSI/ESSIF stakeholders on 29 June. The Identity Working Group has established a meaningful dialogue on blockchain and self-sovereign identity within the EU via recurring meetings with this group in which **EBSI/ESSIF** representatives can share updates on their project progress, while Working Group members can give feedback based on their expertise in topics like compliance, architecture and decentralisation.

The **Finance Working Group's** Sub-Working Group 3 is writing a policy position on DAOs and DeFi that will explain what these industries are and address some of the issues brought by decentralised structure of these protocols. To get involved, please contact xenofon.kontouris@inatba.org.

Reminder to join INATBA for two upcoming events! On 9 July at 16:30 CET we will be hosting a discussion with FTI Consulting on the future of global blockchain policy. On 14 July, we will be contributing to a joint workshop with the Japanese Ministry of Economy, Trade and Industry (METI) and Japan Electronics and Information Technology Industries Association (JEITA). Speakers include members from the Japanese and European public and private sectors as well as speakers from the INATBA Working Groups and Board.

Highlights: EU and US Policy Developments

This is INATBA's bi-weekly newsletter covering policy developments which affect Distributed Ledger Technology (DLT) and its applications in the EU And US. It covers the period from the 21st June to the 02nd July 2021. During these past two weeks, the EU developments have focused mainly on the finalisation (or not!) of the negotiations of the digital finance package in the Council of the European Union (Council), with what seems to be a deadlock between Germany and France on supervision at the eve of the Slovenian Presidency of the Council (PCY), which began on the 1st of July 2021 and will end on 32 December 2021. The eagerly anticipated Anti-Money Laundering Package has been delayed to 20 July.

In the US Despite the belief the Securities and Exchange Commission (SEC) would take the lead on crypto and blockchain regulation, Congress over the past month has largely been the group taking action on the industry. The SEC has continued to take action through enforcement rather than policy or rule making, continuing to crack down on the industry through lawsuits and other regulatory action.

On 9 July, from 16:30 CET INATBA and FTI Consulting will discuss global developments of DLT policy. Join us here.

EU Policy Developments

Digital Finance Package: Update on DORA, MiCA and DLT Pilot Regime

According to non-public information circulated during the week of 21 June 2021, it is understood that the silence procedure on the Digital Ledger Technology (DLT) Pilot Regime, which ended on 23 June, was not broken by Member States. This means that the file has moved to the next step of the legislative procedure, Post approval, Parliament will remain the last of the co-legislators to reach a position on the DLT Pilot regime before the beginning of trilogues with the Council and the Commission. We understand reaching compromise there is closer, compared to the other Digital Finance files.

On the Markets for Crypto-assets Regulation (MiCA) and the Digital Operational Resilience Act (DORA), Member States have not been able to agree on a common position. Supervisory powers are one of the key areas where a compromise has not yet been found. This means that the incoming Slovenian presidency will have to find an agreeable midway, pushing the MiCA and DORA timelines back. With Parliament working through large volumes of amendments on the files too, their entry into force might be potentially delayed to well into 2022.

As the three files are considered part of the same package, their timelines, as well as negotiations, are connected.

MiCA: European Data Protection Supervisor Opinion

On 24th June the European Data Protection Supervisor (EDPS) published its non-binding opinion on MiCA. In its opinion, the EDPS calls for a general reflection on how to better ensure that the underlying technology of crypto assets respect data protection rules and principle before the legislative document enters into force. This reflection should also cover the implementing phase of the proposal.

To achieve this objective, the EDPS proposes to explicitly designate the issuers of crypto assets as controllers and make data protection guarantees mandatory for issuers. The opinion will most likely have an impact on the upcoming negotiations in trilogues as the EDPS is highly regarded among institutions.

Digital Finance: Renewed Sustainable Finance Strategy

The non-public version of the Renewed Sustainable Finance Strategy to be presented by the European Commission the 6th of July has been circulated. It explores the opportunities arising from digital technologies for sustainable finance.

Importantly, the Commission will look at a possible expansion of the taxonomy regulation to cover the activities of data centres and distributed-ledger technologies, especially crypto-assets due to their highly energy consuming needs. By 2023, the Commission will explore whether the EU Taxonomy should be expanded to include said supporting activities.

Additionally, the Commission will look into innovative solutions to help SMEs use digital sustainable finance tools and to support retail investor understanding of the sustainability impact of financial products. The Commission will also be publishing a digital sustainable finance roadmap to implement these proposals.

Digital Finance: Slovenian Council Presidency Priorities

Non-public documents providing an overview of the priorities of the PCY for Financial Services have been in circulation since last week. They highlight that the digital finance package (MiCA, DORA, Pilot Regime) would be a high political priority, as they aim to have trilogues start and end during their tenure.

On MiCA, the PCY highlighted its approach on asset referenced tokens, supporting the separation on tokens with payment functionality from those with an investment functionality. The PCY is also in agreement that ARTs with a payment function should be subject to the approval of ECB or other Central Banks when deemed significant.

The PCY noted the high sensitivity of the Anti-Money Laundering (AML) Package expected on 20 July 2021, and thus falling under its remit. The package will aim to harmonise AML rules across the EU and tackling these deficiencies within the current framework. The package will be in the form of a regulation, rather than a Directive (the case currently), which implies a uniform approach and a set implementation date across EU Member States. The PCY pointed to the need for a greater level of harmonisation in the field of AML through amendments to the AML Directive and a review of certain elements of the Funds Transfer Regulation.

A key element of the package is the proposal to establish an EU-level AML supervisor with a focus on the financial services sector. The PCY stated that the new EU AML supervisory authority should not only focus on the financial sector but the non-financial sector, calling for an enhanced scope of the authority's remit. Particular mention should also be made of Virtual assets. The Financial Action Task Force (FATF) has recently published draft guidance increasing AML requirements on a wide array of Virtual asset services providers (VASPs). The Commission has indicated that its AML package will take stock of ongoing FATF discussions on virtual assets and integrate similar requirements.

DG FISMA Event on Financial Literacy

On 30th June DG FISMA held an event with a number of high-level speakers on financial education, panellists included Isabel Benjumea (Member of the European Parliament, EPP) and Flore-Anne Messy (Principal Administrator in the Directorate for Financial and Enterprise Affairs, OECD). While the event did not introduce new policies on the topic, it showed that policymakers have common objectives. Participants agreed on the need for specific educational programmes at all academic levels to foster financial literacy among young people. Employee share ownership was also mentioned as an element that could encourage participation in and knowledge of financial markets. Panellists also agreed on the advantages that the new digital instruments can bring in the formation of citizenship, as well as the risks they entail, which can deepen the digital and economic divide in certain population groups.

CBDC: Digital Euro - Interview with Fabio Panetta

On 20th of June, during an interview with the Financial Times, Fabio Panetta, Member of the Executive Board of the ECB, provided further insights into the Digital Euro project. Panetta mentioned that a new digital euro would not use the Distributed Ledger Technology (DLT) that underpins tokens like Bitcoin.

Panetta highlighted that the ECB has experimented with DLT and the existing centralized settlement system TIPS. The ECB has seen very good results, while on DLT the ECB considers that the amount of transactions that could take place could add further risk to the infrastructure. Additionally, it was outlined that the ECB been reviewing and experimenting the use-cases of both, but that further information could not be provided at this moment.

Regarding stablecoins, Panetta argued that none of the so-called stablecoins today are truly so, since the regulation and oversight of them is limited. In order to be considered as true stablecoins, they will first need to be regulated and supervised, since they pose a number of risks for individual consumers and for the wider financial system.

CBDC: Bank for International Settlements Report

On 23rd of June, the Bank for International Settlements (BIS) published a report on Central Bank Digital Currencies (CBDCs) in which they argue on the benefits to the whole economic system they could bring if properly implemented.

The report states that the benefits of CBDCs as a new payment technology will depend on the competitive structure of the underlying payment system and data governance arrangements. If CBDCs can encourage a virtuous circle of greater access, lower costs and better services, they might equally induce a vicious circle of data silos, market power and anti-competitive practices. In addition, the report highlights that CBDCs built on digital identification could improve cross-border payments and limit the risks of currency substitution.

The report also develops on the risks presented by non-centrally controlled crypto-currencies currently widely available to the public. The lack of transparency and the possibility of using them as a payment method are a concern for the BIS, notably due to the money laundering (ML) they pose. The report delves deeper into these risks, highlighting that cryptocurrencies are unregulated speculative assets rather than money and adds that the correct implementation of CBDCs as an alternative to existing crypto-currencies would be an effective way of combating money laundering, terrorist financing and other illicit activities.

Looking Ahead

5 July 2021	• Financial Services Attachés Meeting
6 July 2021	• Working Party on Financial Counsellors
7 July 2021	• Coreper II
7 July 2021	• Financial Services Committee
14 July 2021	• Coreper II
14 July 2021	• Financial Services Attachés
16 July 2021	• Working Party on Financial Counsellors

US Policy Developments

Biden Administration

Officials in the Biden administration are reportedly raising alarms over stablecoins, warning stablecoin makers that many consumers are not aware that the dollar-linked tokens are not federally insured and could result in losses on their investments. The officials also fear stablecoins could be used to sidestep the formal banking system, letting criminals launder money with impunity.

Treasury

During a nomination hearing for two nominees to the U.S. Treasury Department on June 22, crypto was put in an unfavorable light. Both Brian Nelson, President Biden's nominee for undersecretary for terrorism and financial crimes, and Elizabeth Rosenberg, his pick for assistant secretary for terrorist financing, said they would prioritize implementing new anti-money laundering regulations for crypto. Both Nelson and Rosenberg also emphasized that they would have to work with international partners to fight crypto crime. While this signals a less than favorable view of crypto by potential Biden officials, it does provide some clarity on the administration's views on the industry and indicates what crypto's regulatory landscape for the agency will be in the future. There was hint that regulations might not be as restrictive as previously thought with Nelson saying that he still wanted to support innovation in the U.S. and not leave it to other countries.

Securities and Exchange Commission (SEC)

Following the exclusion of crypto on the SEC regulatory agenda, Chairman Gary Gensler has focused largely on other issues such as SPACs and retail apps. However, the agency itself has continued to ramp up enforcement of the industry.

Republican SEC Commissioner Hester Peirce also continued to keep crypto as a priority of hers and in an June 18 interview laid out three main aspects of the crypto space that she hopes to tackle soon. The three priorities for the her at the SEC are: a token safe harbor to give some clarity around token distribution events; approve an exchange-traded product (ETP) based on Bitcoin; and provide clarity around custody for regulated entities. On June 23, Peirce reiterated her support for the crypto and blockchain industry at a conference where she praised decentralized finance for its positive potential and urged agencies to provide framework rather than relying on enforcement actions.

The SEC recently delayed Robinhood's efforts to go public over concerns about the crypto side of their business. While the company experienced backlash after the January GameStop market volatility, it is the app's ability to lets users purchase Ethereum and dogecoin that is the main concern of the SEC.

The SEC also once again postponed a decision to approve the first bitcoin exchange-traded fund (ETF) on June 22.This marks another in a series of postponed decisions on the topic of a bitcoin ETF. The SEC the same week charged John Wise and his company Loci Inc for allegedly selling an unregistered digital asset and making false statements related to its sale. These actions all coincide with several other enforcement cases against cryptocurrency companies.

According to a recent report from the blockchain analysis firm Elliptic, the SEC leads other U.S. regulators in cracking down on crypto misconduct — mostly in the form of unregistered securities. The other top regulator is the Commodity Futures Trading Commission (CFTC) and Treasury's Office of Foreign Assets Control (OFAC) was the agency with the least actions against crypto.

Commodity Futures Trading Commission (CFTC)

Representatives from the Securities and Exchange Commission and the Commodity Futures Trading Commission met with representatives from leading decentralized finance companies during a conference hosted by the International Organization of Securities Commissions during the weekend of June 26. While neither agency commented on details around the conference, it came after CFTC commissioner Dan Berkovitz has suggested that many DeFi apps could be illegal, arguing that automated software programs for derivatives trading appeared to violate the Commodities Exchange Act.

Dawn Stump, Republican CFTC Commissioner, during a June 23 conference gave a more positive position on the crypto industry, saying that technology should be allowed to develop with a focus on potential rather than skepticism. She added that with regards to crypto, there should be a natural evolution and not something to be feared. She stressed that the CFTC only has the power to regulate certain derivatives products, such as futures based on commodities and certain options and swaps but does not have jurisdiction to regulate exchanges or other markets for cash commodity transactions, such as Coinbase.

The Federal Reserve (The Fed)

In contrast to the majority of Fed officials, Federal Reserve Vice Chair Randal Quarles said at a bankers' conference on June 28 that the U.S. should find ways to say "yes" to stablecoins. Quarles added that the U.S. central bank has a "strong regulatory interest" in stablecoins but also said there is no need to fear them. Quarles also downplayed bitcoin and foreign CBDCs as potential threats to the U.S. dollar. Quarles' comments should not signal a broad support for the industry because during the conference he also expressed serious concerns over a U.S. central bank digital currency (CBDC). He said a digital dollar "could pose significant and concrete risks", while the benefits are unclear.

On June 28, New York Fed President John Williams said that he believes the emergence of cryptocurrencies poses a significant challenge to existing regulations. Williams is a member of this year's Federal Open Market Committee, the group responsible for setting U.S. monetary policy.

Boston Fed President Eric Rosengren also expressed concerns surrounding the broader crypto industry, calling Tether's USDT stablecoin a risk to the stability of the financial system. Rosengren included the stablecoin among what he termed "new disruptors" to short-term credit markets. While Fed governor Lael Brainard and Chairman Jay Powell have expressed concerns over stablecoins, Rosengren called 'tether' by name, indicating an increased concern over stablecoins.

Congress

The subject of cryptocurrency was once again on display during a June 30 entitled, "America on 'FIRE': Will the Crypto Frenzy Lead to Financial Independence and Early Retirement or Financial Ruin?". The hearing took place before the subcommittee on Oversight and Investigations, where the Financial Services Committee sends issues that have become especially problematic. The hearing focused on crypto markets, specifically whether to consider crypto volatility to be a risk to the many retail investors, which led some members to compare the crypto volatility to the 2008 financial crisis. Subcommittee Chair, Al Green (D-TX), a known fintech skeptic, voiced strong concerns over the crypto market volatility and called for existing regulators to step up to prevent “catastrophe”. Ranking Member Tom Emmer (R-MN), a long-time crypto supporter, argued that laws already exist in the securities area to protect investors. Frequent crypto critic Rep. Brad Sherman (D-CA) came out the most aggressively against the industry, urging lawmakers to consider completely shutting down cryptocurrencies, arguing that they are “highly volatile”. Maxine Waters (D-CA), who chairs the full committee, called out risks that crypto adoption by hedge funds posed.

The U.S. House of Representatives passed two crypto bills on June 22. The Consumer Safety Technology Act, sponsored by Rep. Jerry McNerny (D-CA), directs the Consumer Product Safety Commission to establish a pilot program to explore use cases for artificial intelligence in commerce. The two blockchain bills – the Blockchain Innovation Act and parts of the Digital Taxonomy Act – direct the Secretary of Commerce and the Federal Trade Commission (FTC) to study and report on the use of blockchain technology and digital tokens. The Consumer Safety Technology Act was approved in a previous session of Congress but was never approved by the Senate. By reintroducing the bill and passing it onto the Senate again, McNerny and his co-sponsors, including longtime blockchain advocate Rep. Darren Soto (D-FL), are giving the bill a second chance. Soto said the Consumer Safety Technology Act is the first step toward the Congressional Blockchain Caucus’ long-term goal of creating a Blockchain Center of Excellence in the Department of Commerce.

A bipartisan group of lawmakers, led by Reps. Josh Gottheimer (D-NJ) and Brian Mast (R-FL) introduced legislation June 23 aimed at further cutting off funds for the Palestinian militant group Hamas, citing a rise in bitcoin donations to the terrorist group that spiked amid its latest conflict with Israel last month. This feeds into a growing concern over cryptocurrencies, especially Bitcoin, being used in terrorist financing.

Rep. Warren Davidson (R-OH), ranking member of the Financial Technology Task Force, during an interview on June 23 called for clearer rules on issues, including whether digital tokens should be classified as securities and when transactions with crypto should be taxed. He stressed that financial technology firms shouldn’t have to worry about regulators bringing enforcement actions against them after the fact.

Rep. Bill Foster (D-IL), a member of the Blockchain Caucus and new working group on crypto, during an Axios event warned about the growing anti-crypto sentiment among lawmakers and stressed that ransomware could be potentially deadly for crypto's reputation before Congress. He emphasized that laws must be passed to allow federal courts to identify digital-asset holders and then reverse transactions in bitcoin or other digital currencies, a policy that is anathema to many cryptocurrency investors

Digital Dollar Developments

With the Federal Reserve set to release a much-anticipated report this summer on the potential creation of a digital dollar, Fed’s vice chair for supervision Randal Quarles on June 28 expressed that he has significant doubts about the idea. He argued that the benefits of a U.S. CBCD is unclear, while it could pose significant and concrete risks. Among the downsides he cited are the challenges if the public could bypass traditional banks and go straight to the Fed for digital money and concerns over cyberattacks. Along the same lines, he said the benefits that consumers get through bank competition might be diminished if the Fed stepped further into the space. Rep. Warren Davidson (R-OH) in an interview on June 29 suggested a central bank digital currency could be built in a way that allows authorities to catch bad actors without requiring too much centralization of the CBDC. He also stressed the importance of keeping America’s competitiveness through cryptocurrency regulation and DeFi regulation right, especially to take on China’s CBDC.

Looking Ahead

July 2021	• MIT and Fed research on potential US digital dollar

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