Latest Policy Developments for DLT

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Prepared exclusively for INATBA Members.

Content

Highlights: INATBA Policy Developments

The INATBA Healthcare Working Group recently submitted a response to the European Commission's consultation on the European Health Data Space (EHDS). Working Group members noted the potential of blockchain to improve transparency and efficiency in the health field and called for a patient-centric healthcare system.

INATBA is continuing its work on smart contracts via developing a response to the public consultation on the Data Act and a position paper. If you are interested in contributing, please contact martina.piazza@inatba.org.

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 17th July to the 30th July 2021. During these past two weeks, EU developments focused on the publication of the Anti-Money Laundering legislative proposal package by the European Commission (Commission) which notably introduces new requirements on crypto-assets. This last week, the European

Institutions have begun their summer recess, so no relevant legislative developments have taken place.

With Congress gearing up to go into recess until September, Congress and regulators have spent considerable time the past two weeks on the topic of crypto and blockchain. Two of the most influential regulators, Treasury Secretary Janet Yellen and Federal Reserve Chair Jay Powell have focus on criticizing stablecoins. Yellen hosted a meeting with other top regulators, known as the President's Working Group on Financial Markets on the topic where she highlighted the risks of stablecoins. Congress held three simultaneous hearings on different aspects of the crypto and blockchain industry and their decision to spend their last week before recess on the topic highlights the growing attention on the topic.

EU Policy Developments

Anti-Money Laundering: European Commission package.

On 20 July 2021, the Commission published its Anti-Money Laundering (AML) Package which aims to improve the AML and countering financing of terrorism (CFT) framework in the EU by ensuring its implementation across Member States, bringing about EU-level AML supervision and introducing additional requirements for the transfer of funds and crypto-assets. The AML package contains several pieces of legislation, including the following: i) an update of the Anti-Money Laundering Directive (AMLD); ii) a proposal for an Anti-Money Laundering Regulation (AMLR); iii) a proposal for an EU AML Supervisory Authority (AMLA); and, iv) specific AML requirements for the transfer of funds and crypto-assets.

Of particular interest, the proposal increases in scope of obliged entities to ensure most entry points into the financial system are covered, notably for Crypto Asset Services providers (CASPS). This is part of a harmonisation effort following from the Recommendations laid out by the Financial Action Task Force (FATF) and the ongoing discussions surrounding the Markets in Crypto-assets Regulation (MiCA) on the emerging AML risks linked to crypto-assets. This increase in scope would oblige all CASPS to conduct due diligence on their customers and collect and store specific information on both the originator and beneficiary of transfers. This aims to ensure full traceability of crypto-asset transfers, and would allow for prevention and detection of their possible use for ML/TF. In addition, anonymous crypto-asset wallets will be prohibited.

Furthermore, on 19 July, the Commission published a tender for a Feasibility Study on a European Asset Registry in the Context of the Fight Against AML and Tax Evasion. The Commission is looking into various possibilities for collecting information to set up an asset registry which may afterwards feed into a future policy initiative. The Commission is considering the possibility to include in the registry data related to the ownership of other assets, including crypto-assets.

Digital Euro: Bank of America research paper.

On 28 July, Bank of America published a global research paper in which it argues that a digital euro is inevitable if eurozone policymakers want to keep the currency relevant on the international stage. The research paper points to looming competition with bank deposits and losing a certain degree of privacy in payments. Creating a digital euro could also trigger bank runs at the click of a button. The paper adds that, despite the risks, central banks that decide to not introduce their own digital currencies could see the demand for their currencies drop.

Cryptocurrencies: Fabio Panetta's comments on Diem

On 29 July, during an interview, Fabio Panetta, Member of the Executive Board of the European Central Bank (ECB), provided some more insights on the ECB's decision to propose a Digital Euro. He stressed that the decision has not been taken due to the ongoing work done by Facebook and China creating their own electronic currencies. He argued that the Digital Euro is the natural continuation to the existing means of payment, and an evolution to the current times. On Facebook's offer to allow the ECB and the Federal Reserve of United States to distribute their currencies via its infrastructure Mr Panetta answered negatively, arguing that the central banks cannot leave the entirety of the payments system into the hands of a private firm. He highlighted that only central banks can offer these services with the sole aim of guaranteeing the common good.

Blockchain: European Investment Fund

On 29 July, the European Investment Fund (EIF), an EU agency largely owned by the European Investment Bank and the Commission together with the Luxembourg Future Fund (LFF), announced it will back a new $100 million fund of Fabric Ventures with an investment of €25 million. The fund is mandated to invest in the development of digital assets and to support the founders of the Open Economy across the globe. This is the first time that the EIF invests in anything related to digital assets. This investment is part of the EIF's and Commission's "InnovFin Artificial Intelligence and Blockchain pilot" fund to support digital transition, amounting to 700 million euros.

European Digital Identity: EDPS Comments

On 29 July the European Data Protection Supervisor (EDPS) published its formal response to the petition by the European Parliament (EP) and the European Council (Council) regarding the establishment of a framework for a European Digital Identity. Overall, the response is positive and supportive of the current proposal. However, there are several points raised by the EDPS on the use of blockchain technology due to General Data Protection Regulation (GDPR) compliance issues, such as data transfers outside the EU, and the impossibility to delete or correct entries in a Blockchain. On this point, the EDPS highlights that it will publish its "Guidelines on blockchain" as part of its 2021/2022 Working Programme.

E-Privacy: Current state of play

According to non-public information, the EP and Council positions on the file are still far apart several topics, including the use of metadata. The current Slovenian and future French Presidencies of the Council have indicated that this is not a priority file.

Sources dismissed the rumour that the Commission will retire the text. The possibility might have been a reality in the past, but the Portuguese Presidency succeeded in finding a common ground. It is thus likely that the Czech Presidency will be the one to revitalise the file next year. Trilogues are nonetheless expected to happen once every two months as of September 2021 onwards although any developments are unlikely.

Digital Company Law: Publication of roadmap

On 20 July, the Commission's Directorate General for Justice and Consumer Affairs (DG JUST) published a roadmap for upgrading digital company law, including the Business Registers Interconnection System. This EU company law initiative aims to improve transparency on EU companies, among other things by enabling the cross-border use of trustworthy company data and adjust the EU company law rules to make them fit for the digital age. This roadmap is now open for feedback for 4 weeks, until 17 August. A public consultation on the matter is to follow (foreseen for Q4 2021).

Cryptocurrencies: IMF Blog entry.

On 26 July, the International Monetary Fund (IMF) published a blog entry regarding cryptocurrencies and their potential to become national currencies. The entry argues that governments that try to make crypto-assets a national currency would be taking an "inadvisable shortcut" due to their risks and costs. While a crypto-asset national currency could offer cheaper and more inclusive financial services, they also would pose major risks to macro-financial stability, financial integrity, consumer protection and the environment. Additionally, the entry argues that the previously mentioned factors could derive in domestic prices becoming highly unstable, affecting citizens and societies. However, the entry argues that the advantages of their underlying technologies, including the potential for cheaper and more inclusive financial services, should not be overlooked and that is for governments to step up and provide these services through new forms of digital money that are able to preserve stability, efficiency, equality, and environmental sustainability.

Looking Ahead

**Editor's note: Please be aware that the European Institutions will be mostly on holidays, with reduced activity between the 25th of July and the 25th of August. **

US Policy Developments

Treasury

Treasury Secretary Janet Yellen has asked the regulators overseeing crypto assets to “act quickly to ensure there is an appropriate U.S. regulatory framework in place” for stablecoins. Yellen then convened a meeting of the President’s Working Group on Financial Markets (PWG) on 19 July to discuss potential regulation, in collaboration with the Federal Reserve, Securities and Exchange Commission, and Commodity Futures Trading Commission. Secretary Yellen emphasized the need to have appropriate framework for stablecoins and the working group expects to issue recommendations in the coming months.

The meeting was attended by Yellen, Fed Chairman Jay Powell, SEC Chairman Gary Gensler, CFTC Acting Chairman Rostin Behnam, Federal Deposit Insurance Corp Chairman Jelena McWilliams, Acting Comptroller of the Currency Michael J. Hsu, Fed Vice Chair Randal Quarles, and Treasury’s Under Secretary for Domestic Finance J. Nellie Liang.

Securities and Exchange Commission (SEC)

SEC Chair Gary Gensler continues to indicate that crypto will not be a priority for him and his agency, letting the 28 July date set by Senator Warren (D-MA) in her letter asking to him to provide regulatory clarity for the crypto industry pass without a response.

During a 21 July meeting, Gensler discussed the intersection of security-based swaps and crypto assets, warning that that services offering crypto tokens backed by securities and operating like derivatives — "whether in the decentralized or centralized finance space" — must work within the agency’s rules and that that may be more cases involving retail offerings of security-based swaps.

Two Republican SEC commissioners, Hester Pierce and Elad Roisman, publicly protested a move by the SEC to settle charges on 14 July with the owner of cryptocurrency website, Coinschedule.com, for promoting initial coin offerings without disclosing the compensation it received from issuers. The two commissioners’ issue with the action was that the settlement with Coinschedule did not explain which digital assets touted by Coinschedule were securities, arguing the omission was a part of a larger problem by regulators not providing clarity for the industry. Still it remains to be seen whether Gensler will be collaborative in looking for nonpartisan issues and including other commissioners in leading crypto efforts.

Ripple won a small battle the week of 19 July in its lawsuit with the SEC. A judge ruled that Ripple may depose a former SEC official, a move that the agency opposed, not least because it will shed light on how the regulatory decisions are made when it comes to crypto. The decision is not a deciding point for the case, but it does put the SEC in a spot to discuss crypto regulation, and their decision to act through enforcement rather than regulation. The case continues to have broader implications for the entire crypto industry and its future.

The Federal Reserve (The Fed)

During a 16 July Senate hearing on the Semiannual Monetary Policy Report to Congress, Federal Reserve Chair Jay Powell said he is "legitimately undecided" on the pros and cons of a central bank digital currency (CBDC), but he would want authorization from Congress before taking any action to create one. Powell also said bitcoin and other cryptocurrencies have "completely failed" to become a common means of payment and that stablecoins are dangerously unregulated.

Powell's remarks reflect ongoing ambiguity among Fed officials about developing a digital version of the dollar. A number of Fed officials recently have openly questioned the need for one, and Powell has repeatedly said the Fed is not eager to be first with a CBDC, but he would strive to get it right, if it goes down that road at all. Powell's comments also mark a harsher view on cryptocurrencies as a common payment means, separate from his criticism of stablecoins.

Congress

Congress hosted three hearings on the topic of crypto in one day, two directly on the topic and one crypto-adjacent. The Senate Judiciary Committee hosted a hearing on ransomware, the Senate Banking Committee held a hearing on crypto uses and the House Financial Services Committee held a hearing on central bank digital currencies (CBDC).

During the House Committee on Financial Services hearing titled "The Promises and Perils of Central Bank Digital Currencies" (CBDCs) many lawmakers expressed fears over a digital dollar. Concerns over China leading the way in establishing standards and using the digital yuan for cross border payments was also prominently featured during the hearing, with Ranking Member Patrick McHenry (R-NC) and Rep. Jake Auchincloss (D-MA) expressing particular concern on the subject. Some members discussed the possibility of separate domestic and international digital dollars and several witnesses responded that it makes sense to iron out issues domestically before moving to international. While the general conclusion was that the U.S. is behind in establishing a CBCD, witnesses didn't see any immediate threats to the dollar's reserve currency status. It's important to note that this hearing was held by the Subcommittee on National Security, International Development and Monetary Policy, the same subcommittee which held a hearing on how cryptocurrencies might be used in terrorist financing earlier this year.

The Senate Banking Committee hosted a hearing titled "Cryptocurrencies: What are they good for?" to discuss the systemic risk and concentrated power of the crypto industry. While some Senators such as Senator Cynthia Lummis (R-WY) defended the industry, the majority of lawmakers indicated that they were still hesitant that cryptocurrencies would be a good solution to financial system. Senator Warren (D-MA) notably heavily criticized the industry, calling it a "shadowy, faceless group of super coders and miners." Chairman Sherrod Brown (D-OH) made some positive comments about blockchain but later called crypto "funny money" and expressed doubts on the industry. The hearing focused on two topics: the decentralized nature of cryptocurrencies and system failures in the crypto market that could overflow to the traditional financial market. Lawmakers also discussed the potential "systemic risk" of cryptocurrencies. Jerry Brito, Executive Director of the Coin Center, called for the US not to shy away from cryptocurrencies but instead put appropriate guardrails in place for hedge funds and other market participants.

During the Senate Judiciary Committee hearing on ransomware entitled "America Under Cyber Siege: Preventing and Responding to Ransomware Attacks", officials remained skeptical on cryptos role in ransomware but had conflicting views on how to regulate it. Richard Downing, deputy assistant attorney general with the Justice Department's criminal division, said that digital currency has "unfortunately fueled this rise in crime." On the other hand, FBI Cyber Division Assistant Director Bryan Vorndran advised members of the Committee against the idea of banning companies from paying hackers behind ransomware attacks. He noted that reports of ransomware incidents to the FBI showed a 20 percent increase last year and a 225 percent increase in ransom amounts and that in the agency's opinion, banning ransom payments put U.S. companies in a position to face yet another extortion. Senate Judiciary Chair Dick Durbin (D-IL) raised concerns about crypto's involvement in ransomware, stating that cryptocurrency and bitcoins are on the realm when it comes to this ransomware and called for crypto to be the subject of a review, surveillance or regulation.

After the 16 July Senate hearing on Semiannual Monetary Policy Report to Congress, crypto-friendly Senator Cynthia Lummis (R-WY) stated that "smart legislation" is on the way "in the coming months". During the hearing Lummis pressed Powell to be precise about terms, warning against speaking about all digital assets interchangeably.

The latest version of bipartisan infrastructure bill looks to raise nearly $30 billion from crypto investors by applying new information reporting requirements to exchanges and other parties. The draft of the legislation states any broker that transfers any digital assets would need to file a return under a modified information reporting regime. The draft defined digital assets as "any digital representation of value … recorded on a cryptographically secured distributed ledger" or related technology. It states that cryptocurrencies are treated as a subsection of the broader digital asset umbrella.

Department of Justice (DoJ)

The Justice Department is investigating possible bank fraud by executives of Tether. The DOJ is looking into whether the company concealed transactions linked to crypto from banks in the company's early days. The probe has implications for the crypto market since the stablecoin is tied to half of all Bitcoin trades and came after several officials voiced concern over the coin. Tether and its sister exchange Bitfinex settled an investigation by the New York Attorney General's Office (NYAG) into whether the stablecoin issuer was covering up the loss of nearly $1 billion in customer funds earlier this year.

State Updates (New Jersey, Texas, Alabama, and Vermont)

During the week of 24 July, authorities in Texas, New Jersey, Alabama, and now Vermont have opened a new regulatory investigation on crypto, alleging BlockFi accounts amounted to an unregistered offering of securities.

New Jersey's Bureau of Securities issued a cease-and-desist order on 17 July against BlockFi demanding that it stop offering interest-bearing accounts and cease taking new customers in New Jersey. The state's order alleges the company may be in violation of state securities law. BlockFi's accounts aren't registered as securities or bank accounts under state law, nor are they exempt from regulation, New Jersey's officials said. In New Jersey, the state now appears to view the high-yielding crypto accounts as securities, which could subject them to additional regulations and disclosure rules. The Alabama, Texas and Vermont orders came after, alleging similar issues, with the Alabama one noting that there needs to be a federal mandate on the product.

The state crackdowns occurred in states on both sides of the political spectrum. Alabama, Texas, and Vermont lead by Republicans and New Jersey by Democrats, indicating that the issue is bipartisan.

Looking Ahead

August 2021	• Senate and House are on recess
September 2021	• MIT and Fed research on potential US digital dollar

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