Latest Policy Developments for DLT

International Association for
Trusted Blockchain Applications

Latest Policy Developments for DLT

Prepared exclusively for INATBA Members.

Content

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 18th March until 1st April 2022.

In Brussels, the last weeks have been dominated by the Anti-Money Laundering negotiations picking up pace and the ongoing discussions around the Digital Euro by several of the key stakeholders. Additionally, on 31st March, the first Trilogue on the Markets in Crypto Assets Regulation took place, and notably, also on that same day, the Parliament held the vote on the final draft version of the Transfer of Funds Regulation proposal, with only the rapporteur of MiCA voting against the final text from his party. Finally, and moving into the international arena, the Financial Stability Board and the International Organisation of Securities and Commissions have published their reports on FinTechs and BigTechs, and Digital Finance respectively.

After weeks of focusing on illicit financing and potential sanctions evasion, Members of Congress had a busy week introducing several digital asset-related bills, including several anticipated bills related to stablecoins and central bank digital currency (CBDC). However, the likelihood of crypto legislative passing is dwindling as the election cycle begins to uptick, and only nine months remain in the current session.

The Securities and Exchange Commission (SEC) created some controversy over the past two weeks. First, the SEC introduced a new proposal to redefine securities dealers, which many crypto experts claim threatens the decentralized finance (DeFi) industry. The Commission also released new guidance on crypto assets, which SEC Commissioner Hester Pierce criticized for being another misguided attempt by the SEC to regulate the industry.

EU Policy Developments

MiCA: Start of Trilogues

In the week of 28 March, the French Council Presidency shared a non-public note with Member States ahead of the first political trilogue on the Markets in Crypto Assets Regulation (MiCA). The note draws on the main differences found by the negotiators so far between the positions of the European Parliament and the Council which include the following topics: Framework applicable to Asset Referenced Tokens (ARTs) and E-Money Tokens (EMTs); Supervisory Institutions; Decentralized Finance (DeFi); Climate impact of crypto-assets; CASPS; Non-Fungible Tokens (NFTs); Authorisation and notification of issuers of general crypto assets and white paper process; Third countries regime, non-EU issued assets; AML-related requirements and Implementations period.

On 31 Match, the first Trilogue took place – mostly outlining the lines of divergence between Council and Parliament. A next formal Trilogue is expected in end-April.

Digital Euro: Latest Developments

On 30 March, Fabio Panetta, Member of the Executive Board of the European Central Bank participated in a hearing in the European Parliament with Members of the Economic and Monetary Affairs Committee (ECON). Mr Panetta stressed that people tend not to understand the difference between a digital euro and the digital payments solutions that they already use. Public money and commercial money are meant to be interchangeable yet distinguishable. The ECB representative pointed that the digital euro could also be used for government-to-person (G2P) payments. Additionally, he highlighted that anonymity is not a viable option. The ECB proposes baseline scenario where the digital would provide a level of privacy equal to or greater than that of private digital solutions. Finally, the ECB is exploring offline functions whereby holdings, balances and transaction amounts would not be known by anyone other than the users. For this, the digital euro would have an upper limit and lower value transactions would be more suitable for offline payments.

On 31 March the ECB published a study on the payment preferences of consumers and society on new digital payment methods. The study focuses on general public, tech-savvy, merchants and individuals with limited access to financial services. Overall, all target groups shared similar interests and worries regarding the implementation of the Digital Euro and other innovative payment methods. Generally, the universal acceptance of the method, paired with the low fees, ease of use, security and the ability to co-exist with other methods already in place are the most sought out characteristics for all groups. These features will have to be addressed by the ECB in case it wants a rapid and solid implementation by the society. It is expected that the main findings of this report will be reflected in the final results of the investigative phase being carried out by the ECB. Currently the ECB is developing the investigative phase of the Digital Euro until 2023.

TFOFR: Transfer of Funds Regulation Vote in ECON/LIBE.

On 31st March, the European Parliament's ECON and LIBE committees held votes on the final version of the EP's TFOFR text. All the proposed compromise amendments were accepted, and the final text was agreed with 93 votes in favour, 14 against and 14 abstentions. Of particular interest, MEP Stefan Berger (DE, EPP), the Rapporteur on MiCA, voted against the text – the sole EPP member to do so - signalling his stark disagreement with the final version of the text. The EP's final text notably removes the "de minimis" exemption threshold of 1000 EUR for information accompanying transfers in crypto assets – in line with the Council's general Approach reached late in 2021. In addition, the text also specifies that the information of transfers between CASPs and unhosted wallets will have to be verified and made available to competent authorities upon request.

The vote to enter into interinstitutional negotiations (trilogues) passed with 95 in favour, 12 against and 13 abstentions. Trilogues are expected to begin soon.

AML: Comments by the Parliament on the Regulation

In the week of 21 March 2022, the non-public draft report on the AML Regulation (AMLR) from the ECON and LIBE committees of the European Parliament was circulated. Co-Rapporteurs Eero Heinaluoma (S&D,FI) and Damien Careme (Greens. FR) overall agree with the Commission's AMLR proposal for a single rulebook and its objective of harmonising the fragmented AML regulatory landscape in the EU. The draft report builds on the Commission's proposal, focussing on the need to (i) take into account the current geopolitical situation (i.e. sanctions), (ii) extend and enhance the framework towards CASPS, (iii) reinforce the Commission's powers to take action against identified high-risk third countries and select entities on a risk based approach. More specifically on crypto-assets, the draft report extends CDD obligations to crypto-asset occasional transactions amounting 1000 EUR or more. The draft report is due to be presented in the ECON/LIBE joint committee on 31 March, with the deadline for amendments scheduled for 26 April.

AML: French Council Presidency on AMLA

In the week of 28 March, non-public documents were circulated by French Council Presidency on the AML Authority (AMLA). Importantly, on the evaluation and selection procedure for the entities of directly supervised by AMLA, a large majority of Member States are in favour of focusing the AMLA's direct supervision on the financial sector and Crypto-asset service providers (CASPs). In addition, the vast majority of Member States are in favour of taking better account of the risks associated with activities under the freedom to provide services in the evaluation and selection procedure. Regarding CASPS, the PCY notes that the European Commission's concern on including CASPs in scope of direct supervision is the lack of sufficiently discriminating criteria. Essentially, according to the Commission, this would mean a majority of CASP's would fall under the direct supervision of AMLA and would not allow it to focus on other types of entities. The PCY notes that for the selection of CASPs, it could be envisaged to target entities whose volume of crypto-fiat transactions exceeds a certain threshold.

Decentralized Finance: IOSCO report

The International Organization of Securities Commissions (IOSCO) published a report on decentralized finance (DeFi) and the steps taken by the DeFi industry to mirror conventional financial markets. Overall the report covers the main developments until now, including the products and services offered as well as main market participants of the decentralized finance industry. The majority of the report is focused on the main differences found between the DeFi services and products and the traditional financial services products they mirror, namely (i) lending and borrowing, (ii) derivatives trading and use of bots and aggregators, (iii) trading platforms, (iv) asset management, (v) clearance and settlement activities (vi) capital rising. Additionally, the report outlines the main risks that the DeFi processes present, which are the recurring ones as highlighted by other international and European regulators and supervisors.

Artificial Intelligence: Discussion in Parliament

Members of the European Parliament (MEPs) from the Committee on the Internal Market and Consumer Protection (IMCO) and the Committee on Civil Liberties, Justice and Home Affairs (LIBE) and guest experts discussed the Artificial Intelligence Act proposal. MEPs discussed risk assessments, the handling of high-risk AI systems, governance models, regulatory sandboxes and their impact on conformity assessments, empowering users with the right to information and redress mechanisms, possible risk-mitigating obligations for AI deployers, and protections for fundamental rights. Co-rapporteur Brando Benifei (S&D, Italy) pointed out the need for further reflection on the distribution of responsibilities across the AI value chain, the governance structure and the criteria defining high-risk AI.

Digital Finance: FSB Report on FinTechs and BigTechs

The Financial Stability Board (FSB) published a report on FinTechs and BigTechs and the impact on financial stability. Recognising the lack of data available, the report looks at the growth of FinTech and BigTech in retail financial services due to the COVID-19 pandemic. The report notes both the benefits around cost efficiency and financial inclusion and the risks and potential negative impacts. The report acknowledges the differences between jurisdictions on the regulatory treatment of software such as robo-advisors, hence applying different supervisory requirements. Additionally, the FSB highlights the importance on the application of new technologies promoting increased competition, lowering costs and overall greater financial inclusion. Overall, the report leans more to identifying the increasing influence of Bigtech and large Fintech in retail financial services – which may start shielding of the market for smaller fintechs to compete.

Looking Ahead

04 April 2022	• Eurogroup
04 April – 07 April 2022	• European Parliament Plenary Session
05 April 2022	• Economic and Financial Affairs Council
06 April 2022	• Coreper II
06 April 2022	• Financial Services Committee
07 April 2022	• Working Party on Financial Counsellors
13 April 2022	• Coreper II

US Policy Developments

White House

President Joe Biden's proposed 2023 budget calls for modernizing rules around digital assets, which will generate an additional $11 billion in revenue by 2023. Modernization would include changing mark-to-market rules for digital assets, modifying rules outlining securities loans, and amending securities loan nonrecognition rules. Also included in the proposal is a raise to the Securities and Exchange Commission (SEC)'s enforcement budget, which will likely support crypto-related investigations and enforcement actions. Additionally, the proposal asks for enhancing the DOJ's ability to combat ransomware and cryptocurrencies.

The White House's Office of Science and Technology (OSTP) invites interested parties and stakeholders to submit comments on the potential effects digital assets could have on the climate, particularly regarding methods to reduce digital assets' energy consumption. Comments must be submitted by May 9, 2022.The feedback requests came after the administration's executive order on digital assets tasked the OSTP with preparing a report by September 2022 on digital assets' potential to hinder or advance efforts to combat climate change and move towards a clean and reliable electricity grid.

Congress

As reports leak of more stablecoin legislation in the pipeline, Rep. Trey Hollingsworth (R-IN) and Sen. Bill Hagerty (R-TN) announced they are introducing stablecoin legislation. The bill requires stablecoin issuers to hold their reserves in cash, repurchase agreements or short-duration government securities. The bill would also compel stablecoins — whose value is linked to other assets like the U.S. dollar — to publish audited financial statements every 30 days. Given its narrow scope it could be folded into a larger bill as well. The bill marks the latest entrant in a series of policy proposals advanced by lawmakers and federal agencies to govern stablecoins.

Congressional Blockchain Caucus member Rep. Stephen Lynch (D-MA) introduced legislation that would require the Treasury Department- not the Federal Reserve- to issue a digital version of the U.S. dollar. Electronic Currency And Secure Hardware Act (ECASH Act) directs Treasury to issue a digital dollar that would be stored and transferred on encrypted hardware devices, such as cell phones while ensuring anonymity, privacy and generating minimal transaction data. The "e-cash" would be considered legal tender. Unlike ideas circulated by the Federal Reserve regarding a central bank digital currency (CBDC), transactions would not be recorded on a distributed public ledger or blockchain.

Senators Kirsten Gillibrand (D-NY) and Cynthia Lummis (R-WY) are working together on a bipartisan, comprehensive framework to provide the crypto industry with some regulation clarity. The framework includes a complex and intensive review of different aspects of the industry, such as consumer protection and market certainty. The Senators also plan to include language that would create a system for classifying digital assets as securities or commodities — or another category entirely — saying that crypto markets tend to evolve quickly. This would give the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC) shared regulatory control over the crypto ecosystem. The two agencies have been fighting to take ownership of the space, and the legislation will clarify that both agencies have jurisdiction.

The framework will be the first major bipartisan attempt to create a framework for the crypto ecosystem; past attempts have been limited in scope and/or partisan. The announcement comes after Senator Lummis has teased the release of a comprehensive bill on crypto for months. The Senators plan to introduce their legislation in the coming weeks.

The "Accountability for Cryptocurrency in El Salvador (ACES) Act", which looks mitigate risks to the U.S. financial system from El Salvador's adoption of Bitcoin as legal tender, passed out of committee on March 23. The bipartisan bill was introduced in February by Sens. James Risch (R-ID), Bob Menendez (D-NJ) and Bill Cassidy (R-LA) over concerns after El Salvador adopted bitcoin as legal tender last fall .

Senator Ted Cruz (R-TX) introduced a Senate companion bill to Rep. Tom Emmer's (R-MN) bill introduced in January to amend the Federal Reserve Act. The bill would amend the Federal Reserve Act to prohibit Federal Reserve-regulated banks from issuing a central bank digital currency (CBDC).

Treasury Department

Treasury Secretary Janet Yellen, in a CNCB interview, admitted that there are benefits to cryptocurrency. Yellen said that crypto plays a "significant role" in the investment decisions of Americans, but not transactions yet. She added that the Treasury Department is working on regulatory recommendations for healthy innovation; however, she noted that she is still skeptical about crypto, specifically concerning financial stability, consumer-investor protection, and use for illicit transactions.

Securities and Exchange Commission (SEC)

A new proposal by the Securities and Exchange Commission (SEC) aims to redefine what it means to be a securities dealer – a move industry experts say could cripple the decentralized finance (DeFi) industry. The proposal would expand the definition of “dealer” to include people and businesses that use automated and algorithmic trading technology to execute trades and provide liquidity in the market. While the proposal is aimed at electronic traders of U.S. Treasury securities, a footnote buried in the 200-page text says the proposed rule would also apply to digital assets deemed securities. The proposal would bring all automated market makers (AMMs) and liquidity providers with more than $50 million in total assets under management of the SEC’s regulatory oversight, subjecting them to the SEC’s registration requirements – something impossible for many, if not all, decentralized exchanges.

The Securities and Exchange Commission (SEC) released new accounting guidance calling for digital asset exchanges and other digital trading platforms to mark the crypto assets they hold on to behalf of their users as liabilities. SEC officials said they issued the new guidance due to growing crypto exchanges that maintain digital wallets on behalf of their users. The guidance applies to SEC registrants, or those seeking to register, holding cryptographic keys to access digital wallets used to trade and store crypto assets. In response to the guidance, pro-crypto SEC Commissioner Hester Pierce slammed the guidance, labeling it as “another manifestation of the Securities and Exchange Commission’s scattershot and inefficient approach to crypto.” Pierce added that the guidance was only needed because of the SEC’s inability to provide a clear regulatory approach for crypto innovators.

Commodity and Futures Trading Commission (CFTC)

The Commodity and Futures Trading Commission (CFTC) is finally back to its full strength after the Senate has confirmed Christy Goldsmith Romero, Kristin Johnson, Summer Kristine Mersinger, and Caroline Pham as Commissioners. Both Goldsmith Romero and Johnson highlighted their work with cryptocurrencies in their opening remarks before a confirmation hearing.

The CFTC is asking for a bigger budget and the authority to impose industry user fees as it looks to expand its oversight of crypto trading. The new budget would be a 20% boost from the fiscal year 2021 and include $116 million in proposed user fees on the CFTC’s regulated entities, which would require separate authorizing legislation and bring the commission “in line with nearly all other Federal financial and banking regulators.” CFTC Chairman Rostin Behnam said last month his agency may need at least $100 million in additional funds and expanded regulatory authority to oversee the fast-growing cryptocurrency market.

Federal Reserve

The Federal Reserve (Fed) Acting Chair Jerome “Jay” Powell outlined four qualities that a hypothetical U.S. digital dollar needs; while noting that no final decision has been made on whether to proceed with creating one. Powell emphasized that a U.S. CBDC would need to ensure privacy and “identify verifiable” to prevent money laundering. A CBDC would also need to be "intermediated," or widely embraced by the banking system, and serve as a widely accepted form of payment. The Fed is still gathering feedback on its report on a CBDC published in January, which did not endorse the creation of a U.S. digital dollar. The feedback is due May 20, 2022.

The Federal Reserve leadership continues to be conflicted on the issue of CBDCs, with Federal Reserve Governor Christopher Waller maintaining that he is unconvinced the U.S. needs a digital dollar. He claims that issuing a CBDC would change the Fed's role as their position is to stay in the background of the financial system.

State and City Updates

The New York State Assembly Environmental Conservation Committee voted to move along with a proposed law that would ban so-called proof-of-work (PoW) cryptocurrency mining for two years. The legislation still requires passage by the entire New York State Assembly and the state's Senate and then would need to be signed into law by the governor.

Austin, Texas, city councils advanced a plan to investigate the feasibility of accepting tax payments via "bitcoin or other cryptocurrencies." The "fact-finding" study will task the city's City Manager on the legality of the proposal, the benefit to public services, and the impact on the environment. The study is due on June 16.

Looking Ahead

9 May 2022	• White House's Office of Science and Technology: Energy and Climate Implications of Digital Assets Feedback Requested

Contact details:

Website	inatba.org
Contact	contact@inatba.org
Join INATBA	membership@inatba.org