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Will 2022 deliver a unified US federal approach to crypto regulation?

The Digital Regulator



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Executive summary

One year ago, we revealed seven regulatory developments we expected to happen during 2021. All seven expectations but one materialised, albeit to different extents. Two jurisdictions went live with their Central Bank Digital Currency (CBDC); the Financial Action Task Force (FATF) continued to enforce the Travel Rule and addressed Decentralised Finance (DeFi); several Global Stablecoin (GSC) projects developed further while Tether considerably clarified its legal position with the US NY District Court and Commodity Futures Trading Commission (CFTC); the US Securities and Exchange Commission (SEC) approved the first bitcoin crypto Exchange Traded Fund (ETF), albeit one trading in the futures market and not spot, and enforcement continued to shape cryptofinance; contrary to our expectation, the Basel Committee on Banking Supervision (BCBS) did not introduce crypto prudential regulation although material development is expected in 2022. Finally, during 2021, US regulators initiated a clarification and alignment process of their cryptofinance regulatory framework.

We expect this work to be completed during 2022. We anticipate the issuance of a federal cross-agency cohesive and coherent framework able to strengthen market infrastructure, market conduct, and investor protection. We expect the framework to close the gaps currently affecting cryptocurrency markets and grant complementary roles to federal agencies. We also expect core focus areas to include crypto exchanges, DeFi, stablecoins as well as banks' crypto exposures. As some of these areas are working sites shared with international standard setting bodies such as the G7, the Financial Stability Board (FSB) and the Bank for International Settlements (BIS), we expect material influence of the US framework on this international work. Finally, we expect cryptoactors to have to adjust operations to comply with the requirements of a framework that on balance will support the development of sustainable cryptofinance.

The regulatory work initiated by US authorities in 2021 should give rise to a federal crypto-finance framework in 2022. The expectation is a framework supportive of sustainable crypto-finance that may influence the international approach on issues such as Decentralised Finance (DeFi), stablecoins and banks' crypto exposures, as well as require compliance adjustments from cryptoactors.

1. The US is expected to complete its crypto-finance regulatory framework in 2022

The US has long been surprisingly relatively passive on crypto regulation. This has resulted in the SEC enforcing securities laws on crypto-finance processes such as Initial Coin Offerings (ICOs) at the federal level, while member states have handled cryptocurrencies individually, with each doing so in very different ways. The growth of cryptocurrency markets and the considerable involvement of US investors during Q4 20 and Q1 21, as well as the material market correction that occurred in April and May 2021 changed this stance. We review this development below and highlight the regulatory work that has been created. We illustrate the expectation for completion of this activity in 2022 and speculate on the influence the work by US authorities will have on the work carried out internationally in similar areas.

- For several years since the emergence of cryptocurrencies and crypto-finance, the US regulatory approach has suffered from a complex federal and state-based regulatory system and a directionally unsettled economic policy stance. This resulted in a differentiated crypto-finance regulatory landscape, featuring opposing inter-state positions, diverging federal stances, unclear economic policy direction and - emblematically - the absence of a uniform definition of 'cryptocurrency' within the country.
- The market correction that took place in April/May 2021 after a period of growth characterised by an unprecedented involvement of US investors exposed market conduct issues (legitimacy of influential market participants materially moving the market by tweeting decisions and opinions), infrastructure issues (opacity surrounding the operations of pivotal elements of cryptocurrency markets such as Tether and outages suffered by major cryptocurrency exchanges during the correction), and investor protection issues (the sell-off mainly affected short term retail holders or late retail investors as well as deleveraging activity).
- The reaction of US regulators has been bold. The Federal Reserve (Fed), the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) began collaborating on the production of a joint cryptocurrency regulatory framework involving, as a first step, a review of cryptocurrency standards, including interpretative letters and guidance regarding cryptocurrencies and digital assets. The SEC initiated action to protect cryptocurrency investors on crypto exchanges - alluding to rules like those characterising traditional exchanges such as the New York Stock Exchange or the Nasdaq.
- During the second half of 2021, the SEC requested Congress for the authority to protect investors by regulating crypto exchanges, with the Fed confirming it had no intention to ban cryptocurrency and the Treasury released its report on GSCs, recognising their potential benefits. However, it elaborated on the risks (including those related to market integrity and investor protection, illicit finance concerns and risks to financial integrity, and prudential and systemic risk concerns). It asked the SEC and the CFTC to address market integrity and investor protection, the Treasury to lead on anti-money laundering/combating the financing of terrorism (AML/CFT) aspects, and the FDIC/OCC to deal with prudential/systemic risk concerns.
- The SEC has been particularly active in debating these issues. It reiterated its mission to protect investors, facilitate capital formation, and maintain efficient markets, and the belief that investors are insufficiently protected when it comes to crypto-finance. It holds the view that investor protection could be improved by recognising the securities nature of many tokens and subjecting DeFi platforms to relevant oversight. The SEC also emphasises that the bulk of trading on crypto exchanges occurs through GSC, and the view that if the GSC are securities and investment companies they should be subject to the Investment Company Act and the other federal securities laws applicable to these products. The SEC has also anticipated focusing on custody of crypto assets to enhance investor protection. In conclusion, the SEC has prioritised work on crypto exchanges and DeFi and has called for cryptoactors to work with regulators.

- The FED, OCC, and FDIC have been clarifying regulatory terms and policies for banks handling crypto assets, including GSC. The FDIC anticipated the issuance of policy statements meant to facilitate compliance at banks. During 2022, these agencies are expected to define the way banks should act in, and interact with, cryptocurrency markets. There will be guidelines that apply to the holding of crypto assets on the balance sheet, the issuance of GSC, and the extent to and conditions under which banks can provide custodial services or crypto trading services for their customers. The range of permitted crypto activities and the expectations for safety and soundness, consumer protection, and compliance with existing laws and regulations will also be clarified.

After tackling crypto regulation in 2021, the US is expected to complete its framework in 2022 with a focus on crypto exchanges, DeFi, GSC, and banks' crypto exposures. Internationally, while the task of extending the regulatory perimeter to crypto exchanges appears to be left to individual jurisdictions, DeFi, GSC, and banks' crypto exposures are areas being tackled by international regulators.

Thus, the BIS has been exploring the possibilities and limitations of decentralisation in digital finance as well as the risk posed by DeFi to investors during the last months of 2021, and anticipates a global crypto regulatory framework for DeFi next year. The BCBS has consulted further with the industry and stakeholders on the prudential treatment of crypto asset exposures by banks during 2021, and announced the release of an updated consultative proposal on these exposures by mid-2022. The FSB has been examining the role of GSC in improving cross-border payments and the G7 reiterated that GSC will only be allowed to operate under appropriate oversight.

The US authorities have traditionally been instrumental in shaping international financial regulation and it is reasonable to expect that the approach being developed on these topics will materially influence the international approach. The US authorities have also been clear in supporting cryptocurrencies and clarified their intention not to ban them shortly after China announced a blanket ban on 24 September 2021. We therefore expect the regulatory framework to be constructed in a manner that promotes sustainable crypto-finance practices and infrastructure over time.

2. Other noteworthy developments

The Swiss National Bank, Banque de France, and BIS have concluded a successful cross-border wholesale CBDC experiment.

- The experiment, run under the code name '[Project Jura](#)' indicates that CBDCs can be used effectively for international settlements between financial institutions. The experiment consisted of settling foreign exchange transactions in euro and Swiss Franc wholesale CBDCs as well as issuing, transferring, and redeeming a tokenised euro-denominated French commercial paper between French and Swiss financial institutions.

The situation in India regarding crypto regulation appears to be evolving rapidly and away from outright bans.

- India recognised the potential of Digital Ledger Technology (DLT) as early as 2013. However, the authorities emphasised the risks of DLT-based financial products and services to consumers, and in May 2018 announced a ban on all financial firms operating in the country from dealing with or providing services to crypto asset operators. The announcement of the lifting of the banking ban on the crypto industry in March 2020 was followed by proposals to re-introduce the cryptocurrency ban again during the second half of 2020. Even in January 2021, when the Indian government introduced for consideration and passing, the Cryptocurrency and Regulation of Official Digital Currency Bill supporting the creation of the official CBDC, it was reiterated that private cryptocurrencies are prohibited.
- In recent weeks, India made the headlines when the government reportedly [announced](#) the passing of a crypto bill centred around the regulation of cryptocurrencies instead of their ban and issued a [national](#) strategy on blockchain that did not mention the ban on cryptocurrencies. The passing of the crypto bill has been delayed until after winter. The crypto community looks forward to learning which direction crypto regulation in India will take in 2022.

Several jurisdictions announced plans to introduce comprehensive crypto regulation.

- [Australia](#) announced the introduction of new rules seeking to regulate and bring cryptocurrencies and digital assets to the mainstream, promoting their innovation and bringing transparency in the industry.
- The Central Bank of [Thailand](#) announced the issuance of comprehensive legislation on the digital asset industry in early 2022 that will contribute to reduced risks and promote protection for investors.
- [South Africa](#) plans to introduce crypto regulations in 2022 and [Turkey](#) announced the creation of a law regarding the use of cryptocurrencies in the country.

The US SEC has continued to delay or reject bitcoin spot ETF applications.

- The SEC has delayed its decision on [two](#) bitcoin spot ETFs proposals by Bitwise and Grayscale and rejected [two](#) other applications submitted by Valkyrie and Kryptoin.

3. Conclusion

Twelve months ago, we discussed seven predictions concerning crypto regulatory developments expected to materialise during 2021. All predictions but one materialised. For 2022, we concentrate on the developments that are expected to occur in the US, namely the issuance of a comprehensive federal regulatory framework for cryptofinance. As this will include de facto the most important working areas at the international level (DeFi, GSC, and banks' crypto exposures), we expect it to influence the international outcome in these areas in a material way. While, as a consequence, cryptoactors will have to adjust operations to comply with the requirements, we stick to our outlook that on balance, the framework will support the development of sustainable cryptofinance.

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