SEBA BANK

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The Day the US Endorsed Cryptofinance

The Digital Regulator

Redefining Finance for the New Economy

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Executive summary

The White House Executive Order on Ensuring Responsible Development of Digital Assets, issued on 9 March 2022, provides the US and global crypto industry with the long-awaited and well welcomed regulatory certainty. The US will promote a sustainable approach to crypto that ultimately aims to strengthen its leadership role in the global financial system. The US stakeholders involved in crypto in the US can now plan and operate based on a clear, top-down, federal regulatory direction - despite the details that are yet to be specified. This Order resolves the uncertain and volatile regulatory policy stance that has characterized the US crypto market to date. This continued uncertainty and policy vagueness has limited the overall adoption and growth of crypto industry in the US and created a gap to the clear stance taken by the major international standard setters and political bodies over time. Switzerland's first-mover advantage and relative advantage of jurisdictions such as Singapore and, to a lesser extent, the EU are, of course, not compromised. Global cryptofinance will be incentivized by the regulatory policy clarity that has emerged in the US - the largest capital market globally.

During the last few weeks, the EU Parliament approved the proposals to ban anonymous cryptoasset transactions. This decision is not surprising if the context of the Financial Action Task Force's (FATF) analysis and communications in the last few years. Several jurisdictions including the UK, Dubai, UAE, and Vietnam have either established or refined their regulatory frameworks applying to crypto. Subsequently, the International Monetary Fund (IMF) has called for more harmonious frameworks internationally. Central Bank Digital Currency (CBDC) projects have progressed in jurisdictions such as Brazil, the Philippines, India, Qatar, Japan, and Jamaica. The Organization for Economic Co-operation and Development (OECD) started a consultation on a tax framework for crypto assets and crypto-market participants. Switzerland clarified the criteria for the participation of Distributed Ledgers Technologies (DLT) trading facilities to the Swiss interbank clearing system.

On 9 March 2022, the White House issued a Presidential Executive Order that formalizes the top-down, federal-wide, adoption framework for cryptofinance in the US. This watershed milestone had a long gestation. Over time, it will promote cryptofinance both, domestically and internationally

1.
The US endorsement of cryptofinance: A review and assessment

The uncertain and volatile regulatory framework for crypto in the US has kept many entrepreneurs and investors away from this important capital market and has contributed to the success of innovative first-mover jurisdictions such as Switzerland and Singapore. The lingering regulatory uncertainty has also limited the overall adoption and growth of crypto, and over the last few years, it has created a gap between the uncontroversial adoption of crypto that has been put forward by the major international standard setters and the US. What follows reviews the development of crypto regulation in the US since 2017 and assesses the recent Presidential Executive Order – clarifying why it has a watershed nature.

By 2020, the US suffered from a directionally unsettled policy stance on crypto and its intricate federal and state-based regulatory system.

- **States' decisions dominated**

  In the absence of a clear federal stance, individual states took their own positions on crypto, resulting in a mix of states supporting or opposing crypto. Authorities of a dozen of states including California and New Mexico issued warnings against investing in cryptocurrencies; others, like New York, passed laws that are generally considered restrictive. On the contrary, some states such as Wyoming, Colorado, Arizona, Nebraska, and Georgia promoted crypto by voting for very favorable regulations, often exempting cryptocurrencies from state securities laws and/or money transmission statutes.

- **SEC dominated Federal decisions**

  During the same period, the Securities and Exchange Commission (SEC) was left alone in leading the discussion and taking the decisions at the federal level. The SEC's position is that if a token is classified as a security, it must be registered with the SEC by the issuer or can be offered under an exemption from registration. During the Initial Coin Offering (ICO) hype (2017-18), the SEC announced that a token issued in an ICO would be classified as security token, even if it has only utility functions. The SEC tracked several ICOs that were launched outside the US but targeting US consumers, determining for instance the discontinuation of the Telegram ICO and kicking off the pending case against Ripple.

- **Inconclusive discussion at the Congress**

  Till 2020, the discussion at the federal level failed to produce a consensus, despite several attempts made to introduce clarifying bills, such as the Crypto-Currency Act (2020), which aimed to provide clarity and legitimacy to cryptoassets, and the Digital Commodity Exchange Act (2020), proposing to endorse the Commodity Futures Trading Commission (CFTC) with the task to streamline all state-based regulatory requirements for US-based crypto exchanges under a single framework.

During 2021 - The May 2021 crypto market correction led to a rapid involvement of all federal financial and banking regulators and the Treasury Department in discussions around about the assessment and regulation of crypto-markets.

- **Fed, OCC, FDIC, and SEC cooperate**

  In the months following May 2021, the Federal Reserve System (Fed), the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Commission (FDIC) began collaborating on the production of a joint regulatory framework for crypto involving, as a first step, a review of crypto standards, including interpretative letters and guidance regarding crypto and digital assets. The SEC initiated measures to protect the investors on crypto exchanges – alluding to rules like those characterizing traditional exchanges such as the New York Stock Exchange or the Nasdaq. The SEC prioritized work on crypto exchanges and Decentralized Finance (DeFi) and called for crypto-actors to work with regulators. By the end of 2021, it became clear that these agencies were expected to define how banks should act, and interact with, cryptofinance, issue guidelines applicable to the holding of crypto assets on the balance sheet, the issuance of Global Stable coins, and the extent to, and conditions under which, banks can provide custodial services or crypto trading services to their customers. Thus, the range of permitted crypto activities and the expectations for safety and soundness, consumer protection, and compliance with existing laws and regulations would also be clarified.

- **SEBA Bank's Research prediction**

  On 13 January 2022, we expressed our expectation that 2022 would witness the creation of a federal, interagency and coherent framework capable of strengthening the market infrastructure, market conduct, and investor protection. We have clarified our expectation based on an organization of the roles of the different federal agencies and of the definition of some core areas of focus such as crypto exchanges, DeFi, Global Stable coins, and the banks' crypto exposures.

The 9 March 2022 Presidential Order – The issuance of the Presidential Order on 9 March 2022 officializes the endorsement of the crypto industry by the US and its intention to be the global leader in the field.

- **Policy endorsement**

  From a policy stance perspective, the executive order takes a supportive and sustainable approach, thus, recognizing the need to align the governmental approach to digital assets, the national interest in responsible innovation – one capable to expand access to safe and affordable financial services and to reduce the cost of domestic and international fund transfers and payments – and the need to protect consumers and investors as well as combating illicit finance and mitigating systemic risk.

- **Global leadership**

  The Order goes further and clarifies the objective of strengthening the leadership of the US in the global financial system and preserving the economic and national security benefits that are derived from the central role played by the USD and US financial institutions globally.

- **Agencies' coordination**

  The Order shall be implemented through effective interagency coordination, involving the Treasury, Fed, SEC, CFTC, FDIC, and OCC.

- **CBDC: An inclusive part**

  The Order also tackles the issue of CBDC, prioritizing research and development aimed to display the leadership of the US and focused on ensuring privacy protection, transparency, connectivity, interoperability, and economic benefits in terms of reduced transaction costs and greater inclusiveness.

- **Rapid implementation**

  Gap and implementation analyses related to the topics discussed in the Order should take place during the next 180-210 days regarding CBDC, 360 days concerning consumer and investor protection aspects, 210 days for financial stability risk, and the next 120 days in relation to illicit finance.

- **International alignment**

  The US will continue to support the G20 roadmap for improving cross-border funds transfers and payments, including the potential of well-regulated stablecoin arrangements, and related work by the Financial Stability Board (FSB) and by the FATF.

The recent Presidential Executive Order on Digital Assets constitutes a watershed episode in the history of crypto regulation in the US. It aligns the governmental approach to digital assets and promotes a supportive and sustainable approach clarifying the goal to reinforce the leadership of the US in the global financial system. It puts an end to the years characterized by an uncertain and volatile crypto regulatory framework that limited the overall adoption and growth of crypto over time and even created a gap between the clear-cut stance taken by the major international standard setters and the US. Going forward, US crypto-actors will be able to operate and plan within a much-enhanced regulatory and political environment, which is characterized by a clear-cut top-down, federal-wide, adoption plan – despite the details awaiting to be specified. In turn, global cryptofinance will benefit from the political certainty and resoluteness that has emerged in the major capital market globally.

2.
Other noteworthy developments

The EU Parliament approved proposals to outlaw anonymous cryptoasset transactions.

- The proposals adopted by the EU Parliament will outlaw anonymous crypto transactions by extending anti-money laundering (AML) requirements applicable to conventional payments to the crypto-sector and by scrapping any floor for crypto payments. Payers and recipients involved in any transaction operated from any (hosted or unhosted) wallet will need to be identified. Unregulated crypto exchanges will be cut off from the conventional financial system. The adopted proposals need to go through tripartite meetings between the EU Parliament, European Commission, and European Council. The expectation is that this step will not affect the substance of the adopted proposals.

Several progresses occurred in different jurisdictions such as UK, Dubai, UAE, Vietnam, as well as from the IMF, concerning the establishment or refinement of cryptofinance regulatory framework.

- The Bank of England (BoE) published the report 'Financial Stability in Focus: Cryptoassets and decentralized finance'. The report marks the beginning of the process of establishing a comprehensive regulatory framework for crypto assets in the UK. The report says that enhanced regulations are needed to address the ongoing developments and encourage sustainability of innovations.
- Dubai established a virtual asset regulator and announced a new crypto law; the regulatory agency is the Dubai Virtual Asset Regulatory Authority (VARA). It is endorsed with enforcement powers in the Emirate's special development and free zones (but not with respect to the Dubai International Financial Centre). The new crypto law shall create a legal framework for crypto-focused on investors' protection and aligned with international standards.
- A regulatory authority of Dubai (Dubai International Financial Centre) is consulting on a regulatory framework for cryptocurrencies that would cover appropriate investor protection requirements for market participants following the directions given by international standard-setting bodies.
- Vietnam kicked off work aimed to create a legal framework for cryptocurrency.
- The IMF analyzed the state of crypto-regulation and concluded that more work is needed, in particular, to harmonies crypto-frameworks around the globe.

The developments surrounding CBDC projects continue with developments in Brazil, the Philippines, India, Qatar, Japan, and Jamaica.

- The Brazilian central bank has selected nine projects as part of its effort to develop a digital real. A status update is planned for July.
- The Philippines central bank has started a CBDC research effort that is focused on design, architecture, technology, and policy implications.
- The Indian Finance Minister confirmed the expectation of a roll out of the CBDC within the current year. The government confirmed that this digital currency will be a digital version of traditional paper currency and not a blockchain or DLT-based currency.
- The Qatar central bank confirmed that it is carrying out a feasibility study for its CBDC.
- The Bank of Japan denied plans to launch a digital currency.
- The central bank of Jamaica specified that its CBDC will be focused on boosting financial inclusion.

Other key developments include the OECD consultation on a tax transparency framework and Switzerland's clarification of the criteria for the participation of DLT trading facilities to the interbank clearing system.

- The OECD is developing a new global tax transparency framework that foresees the automatic exchange of tax information on transactions in cryptoassets, along with a set of amendments to bring in the scope of the tax framework, new financial assets, products, and intermediaries. The consultation on these proposals will close on 29 April 2022.
- The Swiss National Bank has set the criteria for admitting DLT trading facilities to the Swiss interbank clearing payment system.

3.
Conclusion

The day of 9 March 2022 will be remembered in history for when the US endorsed crypto from a federal policy point of view and planned for the rapid establishment of certainty at the level of the regulatory framework that supports responsible adoption in a broad alignment with the directions set by international standard setters. The global crypto community and market will benefit from the clarity and supportive stance taken by the biggest capital market worldwide. During the past weeks, the EU parliament took the bold decision to outlaw anonymous crypto transactions, with an impact on payers and recipients involved in crypto-transaction – that will need to be identifiable. This decision does not come as a surprise if the directional context that has been consistently put forward by the FATF over the last few years is considered. The expectation is for more countries to follow suit.

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