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Executive order aiming to coordinate digital assets policies may bring much-needed clarity

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As the digital asset sector has exploded in recent years, there has been growing frustration in the U.S. at the lack of clarity on the application of existing laws to this new ecosystem and a perceived lack of coordination amongst federal agencies. Underlying this issue is the need to protect consumers, investors and businesses without stifling innovation or potentially placing the U.S. at a competitive disadvantage compared to other countries.

In an important step toward addressing this issue, on March 9, 2022, President Joe Biden signed a first-of-its-kind executive order directing federal agencies to collaborate[1] on a cohesive approach to digital assets, including an exploration of the pros and cons and legislative and technical requirements for creating a federal digital currency, also known as a central bank digital currency (CBDC). The order comes at a time of increasing scrutiny by regulators and the media as to how cryptocurrencies might be used to evade sanctions or for other improper means.

The overall tone of the executive order is receptive to the use of digital assets, provided it is done in a way that protects individuals and entities in areas such as data privacy and security; financial stability and systemic risk; crime; national security; human rights; financial inclusion and equity; and energy demand and climate change.

As discussed below, a good portion of the order is dedicated to mandating various reports that government departments and agencies need to generate on different aspects of the digital asset space. Hopefully, this means that over the course of 2022 there will be greater clarity for digital asset stakeholders about the U.S. government's policy posture toward digital assets, which would be a net positive for the industry as a whole.

Principal policy objectives and reports

The executive order does not propose new regulations or legislation, or stake out a specific policy position. Rather, it lays out six policy objectives, along with a list of reports to be produced in coming months.

All of the objectives are centered around a goal of fostering "responsible innovation."

Protect consumers, investors and businesses. The order notes that digital assets can pose significant financial risks to consumers, investors and businesses if appropriate protections are not in place. This can include inadequate protections for sensitive financial data; a failure to disclose risks associated with investments; cybersecurity and privacy risks; arbitrary or unlawful surveillance; fraud and theft; and unfair and abusive acts or practices.

- **Relevant report:** Within 180 days of the order, the treasury secretary, in consultation with the labor secretary and the heads of other relevant agencies, such as the Federal Trade Commission, the Securities and Exchange Commission (SEC) and the Commodity Futures Trade Commission (CFTC), must submit a report outlining the implications of adoption of digital assets for U.S. consumers, investors and businesses, and for equitable economic growth. This includes the conditions that would drive mass adoption of different types of digital assets and the risks and opportunities such growth might present, focusing on those most vulnerable to disparate impacts. The report also must include policy recommendations, including potential regulatory and legislative actions.

Protection of financial stability and mitigation of system risk. The order cites the importance of protecting global financial stability and mitigating systemic risk, especially given the size and complexity of the digital asset space. According to the order, any stakeholder in the digital asset space (such as issuers, exchanges and trading platforms) should, as appropriate, be subject to regulatory and supervisory standards that govern traditional market infrastructures and firms pursuant to a "same business, same risks, same rules" principle.

- **Relevant report:** Within 210 days of the order, the treasury secretary is to convene the Financial Stability Oversight Council (FSOC) and produce a report outlining the specific financial stability risks and regulatory gaps posed by digital assets and provide recommendations to address such risks. This might include proposals for additional or modified regulation and supervision as well as for new legislation.

Illicit activity. The order notes that, without appropriate controls, the relative anonymity afforded by decentralized finance ecosystems and obscured blockchain ledgers could compromise national security and be used to further illegal activity, including money laundering, cybercrime, trafficking operations and terrorism. The order directs agencies to develop plans to counter illicit use of decentralized finance ecosystems, peer-to-peer payments and obscured blockchain ledgers, and to analyze how bad actors are using digital assets.

The order comes at a time of increasing scrutiny by regulators and the media as to how cryptocurrencies might be used to evade sanctions or for other improper means.

Relevant reports:

- Within 120 days of submission of an updated National Strategy for Combating Terrorist and Other Illicit Financing (NSCT), the secretary of the treasury, in consultation with the secretary of commerce, the secretary of homeland security, the director of the Office of Management and Budget, the director of national intelligence and other relevant agencies are to develop an action plan for mitigating the risks associated with illicit activity related to digital assets.
- Within 120 days following completion of updates of the NSCT and three other reports — the National Money Laundering Risk Assessment; the National Terrorist Financing Risk Assessment; and the National Proliferation Financing Risk Assessment — the secretary of the treasury is to notify the relevant agencies of any pending, proposed, or prospective rulemakings to address the risks associated with illicit activity related to digital assets.

U.S. competitiveness. According to the order, the development of new digital asset technologies can protect U.S. economic interests by ensuring the country remains at the forefront of financial systems and innovation. However, the introduction of new digital assets must also consider the potential impact on the dollar's place as the world's reserve currency, the order states. It says that new developments in this sector are to set the standards that promote democratic values; protect privacy; and respect the rule of law.

- **Relevant report:** Within 180 days of the order, the secretary of commerce, in consultation with the secretary of state, the secretary of the treasury and the heads of other relevant agencies, is to establish a framework for enhancing the U.S.'s economic competitiveness related to digital asset technologies.

Financial inclusion. The order notes that digital assets could be a tool to expand access to safe, affordable and equitable financial services. The goal is to make domestic and cross-border funds transfers cheaper, faster and more efficient.

- **Relevant report:** Within 180 days of the order, the secretary of the treasury, in consultation with the secretary of state, the attorney general, the secretary of commerce and the heads of other relevant agencies, is to provide a report on the future of money and payment systems. Thirty days after that report, the attorney general, in consultation with the secretary of the treasury and the chairman of the Federal Reserve, is to provide a legislative proposal, based on the report submitted by the secretary of the treasury.

Financial innovation. The order aims to ensure the development, design and implementation of digital assets and their ecosystems in a thoughtful manner that weighs various factors including privacy and security concerns. It also considers the mitigation of environmental and climate impacts from cryptocurrency mining.

- **Relevant report:** The director of the Office of Science and Technology Policy and the Environmental Protection Agency have been tasked with drafting a report on the impacts of distributed ledger technology on the climate, including potential measures to mitigate energy usage, within 180 days of the order.

International coordination. The order also requires the following reports to be delivered to the president.

- Within 120 days of the order, the secretary of the treasury, in consultation with the secretary of state and the heads of other relevant agencies, is to establish a framework for international engagement with foreign agencies. According to the order, the framework should include global principles and standards for digital assets in a way that promotes consistency with U.S. values and legal requirements.
- Within one year of the establishment of this framework, the secretary of the treasury, in consultation with the secretary of state, the secretary of commerce, the director of the Office of Management and Budget, the administrator of the United States Agency for International Development and the heads of other relevant agencies as appropriate, are to submit a report to the president on priority actions taken under the framework and its effectiveness.
- Within 90 days of the order, the attorney general, in consultation with the secretary of state, the secretary of the treasury and the secretary of homeland security, is to submit a report on how to strengthen international law enforcement cooperation. This report is also to include methods of detecting, investigating and prosecuting criminal activity related to digital assets.

Inter-agency cooperation

Until now, the regulatory response to digital assets in the U.S. has been largely fractured. The order calls for an "unprecedented focus of coordinated action" across relevant government agencies and makes clear that interagency cooperation is needed to develop a comprehensive framework that includes the input of key policymakers, such as the secretary of state, the secretary of the treasury, the secretary of defense and the attorney general. The "interagency process" described in the order and referred to in that memo includes formations of committees and meeting regularly to review and coordinate implementation of policy decisions.

Notably, the order does not clearly speak to the roles of some agencies that have been involved in the regulation and policy debate around regulation of digital assets, including the SEC, CFTC or the Federal Deposit Insurance Corporation. Thus, while the order offers helpful clarity on the administration's policy objectives, it remains unclear how the regulation and supervision of digital assets will be assigned to and handled by various regulatory agencies.

Central bank digital currency

Coming only a few weeks after a January 20, 2022, discussion paper by the Board of Governors of the Federal Reserve System on the possible benefits and risks of creating a U.S. CBDC, the order directs various departments and agencies to evaluate the feasibility, benefits and risks of issuing a U.S. CBDC, exploring issues such as the relationship between a CBDC and private sector digital assets. Like cash, a CBDC would be a direct liability of the Federal Reserve, but the order notes that private participants could be involved in supporting the infrastructure of such a currency.[2]

The order does not clearly speak to the roles of some agencies that have been involved in the regulation and policy debate around regulation of digital assets.

The order highlights the view that the potential creation of a Federal Reserve-issued digital currency would reinforce U.S. leadership in the global financial system and contribute to its economic and technological competitiveness. According to the order, CBDCs could be a potential solution to inefficient and high-cost transactions, especially for cross-border payments, according to the government.

Relevant reports:

- **Treasury department CBDC report.** Within 180 days, the Treasury Department, in consultation with a number of other government agencies, is to provide a report on the future of money and payment systems, including the risks and benefits of a U.S. CBDC.
- **Director of the office of science and technology policy and chief technology officer CBDC report.** Within 180 days, the director of the Office of Science and Technology Policy and chief technology officer of the United States, in consultation with the secretary of the treasury, the chairman of the Federal Reserve and the heads of other relevant agencies, are to provide a technical evaluation of the infrastructure, capacity and expertise that would be needed at relevant agencies to facilitate a CBDC system. Specifically, the report will cover how a CBDC could impact the provision of government services, such as social safety net programs.
- **Attorney general report.** Within 180 days of the order, the attorney general, in consultation with the secretary of the treasury and the chairman of the Federal Reserve, is to provide an assessment of whether legislative changes would be needed to issue a CBDC.

The order also encourages, but does not require, the chairman of the Federal Reserve to research and report on the optimal form of a CBDC, considering, among other things, how to reduce the costs of future payment systems, and to evaluate the necessary steps for the potential launch of a CBDC.

Key takeaways

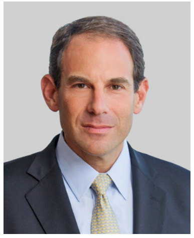
- The executive order marks a watershed moment in organizing and establishing a federal strategy toward the regulation of digital assets and signals that the government may consider cryptocurrency as a legitimate and important part of the economy in the future.
- While it is too early for companies in the digital asset sector to take actions based on the order, the reports to be issued later this year may start to provide some much-needed clarity on how different departments and agencies will approach this growing industry.

Notes

[1] https://bit.ly/3JobhVv

[2] See our February 4, 2022, alert "The Federal Reserve Weighs Risks and Benefits of a US Central Bank Digital Currency" at https://bit.ly/37IHngE

About the authors



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