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ALERT MEMORANDUM

President Biden Issues Executive Order on Digital Assets

March 10, 2022

On March 9, 2022, President Biden signed a wide-ranging Executive Order on Ensuring Responsible Development of Digital Assets (the "Order"). While the Order does not mandate any particular regulatory prescriptions, it lays out key policy goals for a whole-of-government approach to digital asset regulation and directs the U.S. Government to assess the potential for a U.S. Central Bank Digital Currency ("CBDC"). Reflecting the rapid growth and adoption of digital assets, the Order identifies potential benefits and risks while signifying that digital assets will be an important focus of U.S. financial regulatory efforts for the Biden Administration.

The Order emphasizes the link between federal action and national security – both in terms of ensuring appropriate regulation and in staking out a U.S. leadership role in developing digital asset technology. Notably, in an area where some federal agencies have been criticized for moving slowly or failing to coordinate with each other, the Order mandates interagency cooperation on a series of reports, with most to be finished during 2022. The Order sets the stage for an active and potentially transformative year for U.S. regulation of digital assets.

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Background

In the last decade, digital assets have transformed from a nascent technology to an important component of the global financial system. By November 2021, digital assets reached a combined market capitalization of more than $3 trillion, up from $14 billion in 2016.[1] Surveys indicate that approximately 16% of adult Americans – around 40 million people – have invested in, traded, or used cryptocurrencies.

The growth of digital assets has garnered attention from a range of U.S. agencies and regulators, including the Department of the Treasury, Department of Justice, Securities and Exchange Commission, Commodity Futures Trading Commission, Federal Reserve, Consumer Financial Protection Bureau, Federal Trade Commission, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency. The Order discusses the "inconsistent controls" that currently exist, which "necessitate an evolution and alignment of the United States Government approach to digital assets."[2] With the growing development and adoption of digital assets, the United States is among the more than 100 countries currently exploring the use of a CBDC – a digital form of a national currency that is a direct liability of the central bank.

Executive Order on Ensuring Responsible Development of Digital Assets

The Order identifies U.S. interests that are furthered by the development of digital assets, including responsible financial innovation, expanding access to safe and affordable financial services, and reducing the cost of domestic and cross-border funds transfers and payments, including through the modernization of public payment systems. It also identifies risks that digital assets may pose to consumers, investors, and business protections; financial stability and financial system integrity; combating and preventing crime and illicit finance; national security; the ability to exercise human rights; financial inclusion and equity; and climate change and pollution.

United States Central Bank Digital Currency

Most notably, the Order calls for exploration of the potential adoption of a U.S. CBDC. The Order states that the Biden Administration "places the highest urgency on research and development efforts into the potential design and deployment options of a [U.S.] CBDC," notes that a U.S. CBDC may support efficient and low-cost cross-border transactions and foster greater access to the financial system, and stresses the importance of U.S. leadership in international efforts involving CBDCs. The Administration's policy position is decidedly more forward-leaning than the Federal Reserve's recent CBDC report, which was "not intended to advance a specific policy outcome and

[1] FACT SHEET: President Biden to Sign Executive Order on Ensuring Responsible Development of Digital Assets, The White House (Mar. 9, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/09/fact-sheet-president-biden-to-sign-executive-order-on-ensuring-responsible-innovation-in-digital-assets/.

[2] Executive Order on Ensuring Responsible Development of Digital Assets, The White House (Mar. 9, 2022), https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/.

[took] no position on the ultimate desirability of a U.S. CBDC."[3]

The Order directs the Secretary of the Treasury to coordinate an interagency report within 180 days on the benefits and drawbacks of a U.S. CBDC that will address, for example, the potential implications for economic growth and stability. The Order also encourages the Chairman of the Federal Reserve to continue to research whether a CBDC could improve the efficiency and reduce the costs of payments systems, and evaluate the steps and requirements for potential implementation to launch a U.S. CBDC. In addition, the Order directs the Attorney General to assess whether it would be necessary to adopt legislation to issue a U.S. CBDC, with a corresponding legislative proposal to be provided to the President within 210 days.

Illicit Finance and Associated National Security Risks

The Order recognizes that digital assets, including cryptocurrencies, have been used to facilitate crimes including ransomware, money laundering, terrorist and proliferation financing, fraud and theft schemes, and corruption. The Order also notes that digital assets may be used as a tool to circumvent United States and foreign financial sanctions regimes, an issue that has taken on greater significance in light of recent enhanced sanctions on Russia – including, in particular, the Russian financial sector. (A summary of recent U.S. sanctions developments can be found here.) It thus directs the Secretary of the Treasury, in consultation with other agency heads including the Attorney General, Secretary of Commerce, and Secretary of Homeland Security, to develop a coordinated action plan for mitigating digital-asset-related illicit finance and national security risks. The plan will address potential measures to increase financial services providers' compliance with anti-money laundering and countering the financing of terrorism (AML/CFT) obligations related to digital asset activities.

National Policy for Digital Assets

The Order also sets out six principal policy objectives to guide the federal government's approach to digital assets and related regulation:

1. Protect U.S. consumers, investors, and businesses by ensuring safeguards are in place for digital asset exchanges and trading platforms to protect sensitive financial data and maintain privacy;

2. Protect U.S. and global financial stability and mitigate systemic risk by ensuring compliance with regulatory and supervisory standards that govern traditional market infrastructures and financial firms, while adopting a regulatory evolution necessitated by the new and unique uses and functions of digital assets;

3. Mitigate the illicit finance and national security risks posed by the illicit use of digital assets by ensuring appropriate controls and accountability to promote high standards for transparency, privacy, and security;

[3] Money and Payments: The U.S. Dollar in the Age of Digital Transformation, The Federal Reserve System Board of Governors (Jan. 2022), https://www.federalreserve.gov/publications/files/money-and-payments-20220120.pdf.

4. <u>Promote U.S. leadership in technology and economic competitiveness</u>, including through the responsible development of payment innovations and digital assets;

5. <u>Promote equitable access to safe and affordable financial services</u> by promoting responsible innovation that expands equitable access to financial services, particularly for Americans who are underserved by the traditional banking system, including by making cross-border transfers cheaper, faster, and safer; and

6. <u>Support technological advances and ensure responsible development and use of digital assets</u> in a manner that includes privacy and security in their architecture, integrates features and controls that defend against illicit exploitation, and reduces negative climate impacts and environmental pollution.

The Order calls for various interagency reports to assess measures related to these goals.

Takeaways

The Order is the most comprehensive effort yet by the Biden Administration to outline its overarching policy goals and to align regulatory and agency action related to digital assets. In so doing, the Administration highlights both the opportunities and risks of a transformative industry.

The long term impact of the Order could be significant, and can better be assessed after the publication of the reports and studies directed by the Order and the adoption of any legislation and regulation that follows.

Over the short term, the Order does not address a number of important topics, some of which are beyond the scope of an executive order and others of which are not yet ripe, which indicates how much thinking and work remains to be done at a policy level. The Order does not resolve any of the specific regulatory uncertainty that has sprung up from the development of blockchain and digital asset technology, but it does suggest that agencies such as the Securities and Exchange Commission and Commodity Futures Trading Commission should collaborate on appropriate regulatory approaches.

Notably, other than with respect to a potential U.S. CBDC, the Order does not suggest steps toward a legislative framework or tailored agency structure for regulation of digital assets. Instead, the Order relies on an array of separate agencies and departments to craft policies and recommendations on specific aspects of the digital asset ecosystem. There are advantages to this segmented approach given the large palette of policy and regulatory issues implicated by the growth of digital assets, but there are also limitations that can lead to conflicting rulemaking, inter-agency regulatory gaps, and potentially slower-than-ideal progress toward a navigable legal environment that gives certainty to a rapidly evolving industry and protects digital asset owners.

The Order signals the most affirmative support to date by the Biden Administration in favor of a U.S. CBDC. The development of a U.S. CBDC could have profound implications for the regulation and use of U.S. dollar-denominated stablecoins. Companies that issue, hold, or transact in stablecoins and other digital assets will be closely monitoring further developments related to a U.S. CBDC, as will the banking industry. Such developments could also affect digital asset trading platforms, market makers, and decentralized finance platforms that list or transact in stablecoins. Implications for banking institutions will depend on a number of factors, including how a U.S. CBDC is intermediated.

Most fundamentally, the Order suggests that the Biden Administration, while acknowledging both risks and benefits, sees blockchain and digital asset technology as a significant and growing segment of the global financial system with the potential to play a productive role in U.S. financial markets and the U.S. economy going forward. The Order also notably emphasizes U.S. national security interests, including the national security and economic benefits of the role of the U.S. dollar in the global financial system.

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