Latest Policy Developments for DLT

International Association for
Trusted Blockchain Applications

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Prepared exclusively for INATBA Members.

Content

INATBA Highlights:

The Identity Working Group of INATBA continues its advocacy outreach for eIDAS, the European Commission's proposal on establishing a framework for a European Digital Identity. Previously, the Identity Working Group worked on the Policy Positions and response to eIDAS. Please contact the co-chairs of the Identity Working Group for more information.

The Finance Working Group's focus remains on the AMLR, and The AMLR Initial Response will be published soon. The Policy Notes on Decentralised Finance, Decentralised Autonomus Organisations and Non-Fungible Tokens are published. SubWG1 is concentrated on DAC8 (taxation of crypto-assets) exclusively. The group aims to provide as much valuable feedback to the policymakers before they finish and publish the document. The election of the chairs has been completed, and delegated leadership for the SubWGs has been initiated. To get involved, please contact xenofon.kontouris@inatba.org.

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 4th March until 18th March 2022.

In Brussels, although the focus is very much on Russia's war In Ukraine, there have been some Important legislative developments on digital finance files. The Economic and Monetary Affairs Committee (ECON) in the European Parliament (EP), leading the negotiations on the MiCA file, has finalised its position. This was not done without strong disagreements regarding the sustainability aspect of consensus mechanisms and calls for the progressive phase-out of the "proof of work". On the Anti-Money Laundering side, there have been developments on the Transfer of Funds Regulation negotiations, with an exchange of views having taken place on the Rapporteur's draft compromise amendments on the 14th of March.

Moving to the US, illicit financing and sanctions have dominated the crypto narrative in the recent weeks and will continue to dominate it in the weeks ahead. Alleged reporting and lawmaker concern about crypto being used to subvert sanctions led the White House to release an executive order on digital assets on March 9; marking the first government-wide approach to crypto in the U.S. Within 90-210 days of the Executive Order, several agencies have been directed to issue studies and reports on digital asset with the first reports due will cover the topic of illicit financing.

EU Policy Developments

Markets in Crypto Assets: Vote in Committee

On 14 March 2022, ECON adopted the draft report on the Markets in Crypto Assets (MiCA) Regulation. The vote for the draft report as amended was approved by a margin of 31 in favour, 4 votes against, and 23 abstentions. This split is a result of the alternative compromise amendments which were proposed by S&D, the Greens, and the Left Group which were voted down. These alternative compromise amendments would have included minimum environmental sustainability standards for the proof-of-work mechanism and a phasing out plan for crypto asset services providers (CASPs) to stop offering services related to crypto assets that do not meet the minimum standards. The sentiment from the crypto asset industry was that this would result in an outright ban of Bitcoin in the EU.

All other proposed compromise amendments passed, including the EPP, Renew, and ECR compromise on sustainability, which would only require the inclusion of "crypto asset mining activities" in the EU Sustainable Finance Taxonomy. The adopted draft report is now expected to be announced in Plenary, possibly as soon as the beginning of April. It is anticipated that the Greens and S&D will come up with a sufficient group to challenge the draft report in Plenary, meaning the discussion on sustainability could be reopened – and the final Parliamentary position on MiCA delayed, thus pushing back the timeline for trilogues and entry into force by several months.

Crypto Assets: Risk of circumventing Russian sanctions

Since the beginning of the war in Ukraine, there has been concerns over the role of crypto assets in circumventing Russian economic sanctions. EU policymakers have pledged to act in terms of implementing more restrictions on them. Regulators have been concerned with the lack of regulation relating to cryptocurrencies, which has now been exacerbated due to the current sanctions placed on Russia. The European Central Bank (ECB) also highlighted its concerns on this issue in a report it presented to Finance Ministers. This was followed by French Finance Minister Bruno Le Maire stating that policymakers will now prepare measures to ensure there is no circumvention of the sanctions on Russia using cryptocurrencies. The details of what regulatory action on this issue would look like have not been made public, however pressure is also coming from the European Parliament as MEP Markus Ferber (EPP, DE) urged the European Commission to come up with a specific proposal.

Crypto Assets: ESAs joint warning on risks

On 17 March, the European Supervisory Authorities (ESAs) issued a joint warning to consumers on the risks of crypto-assets. The joint communication shares messages and warnings very much aligned with what was heard from the ESAs in the past regarding consumer protection, namely the role of social media influencers, the possibility of losing all the invested amount or misleading advertisements. This joint communication can be expected to inform both the European Parliament and the Council of the European Union on the ongoing negotiations on the Markets in Crypto Assets Regulation and the elements of the Anti-Money Laundering Package. The key risks perceived by the ESAs include extreme price movement, misleading information, absence of protection, product complexity, fraud and malicious activities, market manipulation and lack of transparency and liquidity as well as hacks and operational risks.

Digital Operational Resilience: Non-paper by the Commission

In the week of 7th March, a non-public non-paper from the European Commission (Commission) was circulated which looked at digital operational resilience testing. More specifically, the non-paper covers the Threat Intelligence-Based Ethical Red-teaming (TIBER-EU) framework that was developed by the European Central Bank (ECB). Its main objective is to assess the protection, detection, response and recovery capabilities of financial institutions and market infrastructures against a simulated real-life cyber-attack. The Commission non-paper provides a textual proposal for its suggestions in the 4-coulmn table (4TC) format which reflects the suggestions it has made. The proposed compromise text and the non-paper will be a part of the next political trilogue meeting which will take place on 29 March 2022.

AML: Exchange of views on Transfer of Funds Regulation

On 14th March, an exchange of views took place in the ECON and Civil Liberties, Justice and Home Affairs (LIBE) Committees of the European Parliament on the proposed draft compromise amendments on the Transfer of Funds Regulation. Importantly the EUR 1000 threshold does appear to have enough support in the Parliament, beyond EPP. Rapporteurs Ernest Urtasun (Greens, ES) and Assita Kanko (ECR, BE) noted that the removal of the "de minimis" threshold for crypto-asset transfers was in line with the Council's General Approach and Financial Action Task Force (FATF) recommendations. The EPP noted that the threshold was necessary to ensure a level playing field and that removing it would hurt innovation and competitiveness in the sector. The Rapporteurs noted that unhosted wallets were key vectors of Money Laundering/Terrorism Financing as pointed out by the FATF. The draft amendments reflect this by obliging CASPS to collect, record and retain (10 years) all transfers from unhosted wallets to their customers and share them with competent authorities. Finally on the Review Clause, the Rapporteurs noted that their objective was to make the review clause as exhaustive as possible in a forward-facing objective taking into account the high pace of technological developments in the space.

AML: Comments by Member States on single rulebook

In the week of 7 March 2022, a non-public document summarising comments by 22 Member States on the French Presidency's proposals regarding the AML single rulebook was circulated. The comments were provided after the Council Working Party on 14 and 15 February 2022. The French Presidency sought Member State views on the definition of groups, how third country branches should be supervised, and where the responsibility for enforcement of group AML requirements should lay. Member States mostly aligned with the French Presidency's proposals – except on group level enforcement where countries seem divided on the requirement for the parent undertaking located at the highest level of the group to ensure implementation of the group's AML/CFT requirements, citing a lack of flexibility. The main focus of the French Presidency was on increasing the scope of sectors (e.g. Crypto-asset service providers) for which contact points could be designated by the host Member State on risk-based considerations. Most countries are in favour of maintaining that draft regulatory technical standards (RTS) drafted by the AML Authority (AMLA) which shall set out the criteria for determining the circumstances in which the appointment of a central contact point is appropriate.

Artificial Intelligence: Opinion by the ECB

On 11th March the European Central Bank's (ECB) published its opinion on the AI Regulation in the Official Journal of the European Union. Importantly for the financial services industry the ECB touches upon the use of AI on the creditworthiness assessment of natura people. The ECB believes that the entry into effect of requirements that relate to the qualification of AI systems intended to be used to evaluate the creditworthiness of natural persons or establish their credit score should be delayed until the adoption by the Commission of common specifications on the matter, and in any case, should not be classified as 'high-risk AI systems'.

E-IDAS: French Presidency starts working on the proposal

The French Presidency has proposed a new revised text of the eID Regulation. The text was presented last week and has been discussed among attachés on 15th March. In this version, the key change is that the French are aiming to change the certification requirements of the European Wallets to bring them closer to the GDPR, notably in Article 6c. Besides that, some definitions in Article 3 are tweaked and article

12c on mutual recognition of electronic identification means has been deleted in order to reinstate Article 6 from the original eIDAS regulation. The role/rules for providers of electronic attestation of attributes to the European Digital Identity Wallets in Articles 45e and 45f have been changed only slightly and are still open for discussion. Besides that, a lot of changes are more focused on keeping internal consistency and several minor adjustments in order to improve the quality of the text.

Looking Ahead

22 March 2022	• Working Party on Financial Counsellors
23 March 2022	• Working Party on Financial Counsellors
24 March 2022	• European Council
25 March 2022	• European Council
29 March 2022	• Working Party on Financial Counsellors
30 March 2022	• Coreper II

US Policy Developments

Sanctions

Congress and the rest of the world are focused on the Russia's invasion of Ukraine. Many members of Congress and the media are concerned that Russia is using crypto to evade sanctions but have not proved that is fully evident or widespread. As a precaution, the Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued an advisory to financial institutions and cryptocurrency exchanges outlining the signs to look for to identify sanction evasions. As part of the alert, financial institutions were reminded of their responsibility to report any potential sanctions evasion attempts and ways to identify sanctions evasion activity. The alert notes that it has not seen widespread evasion of sanctions through crypto and encourages the reporting of suspicious activity promptly. FinCEN has also commented that it is unlikely that Russians would be able to use crypto to fully evade sanctions due to lack of liquidity alone.

Senator Elizabeth Warren (D-MA) has introduced a bill to prevent crypto companies from conducting business with sanctioned companies. The Digital Assets Sanctions Compliance Enhancement Act, introduced by ten Democratic Senators including Sens. Jack Reed (D-RI), Mark Warner (D-VA), and Jon Tester (D-MT), would allow the President to add non-U.S.-based crypto companies to sanctions lists if they support sanctions evasion. In addition, the Act gives the Treasury broad authority to bar crypto service providers like exchanges from transacting with any Russian addresses. A provision of the bill would also authorize FinCEN to identify users who transact with more than $10,000 in crypto. The bill text is now available along with the one page summary. Senator Warren mentioned the bill on March 17, 2022, hearing on illicit financing after the draft was leaked. A companion bill may be introduced by Rep. Brad Sherman (D-CA).

The Department of Justice (DOJ) announced that it will investigate and prosecute people and financial institutions, including crypto exchanges, that assist Russians in hiding their assets from sanctions. Officials from across the Justice Department have assembled a task force composed of prosecutors, agents, analysts, and translators to pursue these investigations.

White House

President Biden signed an Executive Order on Digital Assets (Order), outlining the administration's approach to regulating digital assets and examining the pressing policy issues in the space on March 9. The Order recognizes the industry's rapid growth, how digital assets can reinforce American leadership on technology and contribute to financial inclusion, and how they could affect consumer protection, financial stability, national security, illicit financing, and climate risk. The Order also authorizes a series of studies and examinations of digital assets by federal agencies and offices, resulting in regulatory and legislative recommendations. It specifically called for a technical study of a U.S. Central Bank Digital Currency (CBDC) and asked for implementation recommendations. Studies and examinations are expected to be published within 90-210 days of the Order.

The first deadline for reports is in 90 days and covers the topics of illicit financing and international law enforcement cooperation. Several agencies, including the Departments of Treasury, State, and Commerce, may submit supplemental annexes to the President offering additional views on illicit finance risks posed by digital assets. The law enforcement report directs the Department of Justice to lead on a report to the President on how to strengthen international law enforcement cooperation for detecting, investigating, and prosecuting criminal activity related to digital assets.

The Executive Order is seen as a turning point in the growth of the digital asset industry in the U.S., as efforts are now being coordinated, and a path towards a comprehensive regulatory framework is being defined. The Order did not call for the promulgation of new regulations. However, the studies and reports are likely to call for new legislation and regulation.

Senate Committee on the role of Digital Assets in Illicit Finance

The Senate Banking, Housing, and Urban Affairs Committee convened a hearing titled "Understanding the Role of Digital Assets in Illicit Finance" on March 17, 2022. The hearing covered topics including: crypto regulation, illicit financing, and the utility of crypto. Witnesses agreed that it would be unlikely for President Putin or other sanctioned entities to use crypto to work around the rules. Regulating digital assets was a recurring theme; specifically, noted by witness Michael Mosier, former FinCEN Acting Director, who focused on the need for the government to create regulation to stop illicit activities and provide clarity to the diligent crypto exchanges in the U.S. who want to comply with the government. Another heavily discussed topic was crypto's role in the war between Russia and Ukraine. While some Senators such as Ranking Member Pat Toomey (R-PA), Cynthia Lummis (R-WY), and Bill Hagerty (R-TN) argued there is no correlation between the use of crypto and the ability to avoid sanctions. Others, such as Sens. Elizabeth Warren (D-MA) and Jack Reed (D-RI) disagreed. Witness Michael Chobanian highlighted crypto's benefits for his country, Ukraine, as donations were received and transferred in a matter of minutes.

A bipartisan group of eight Members of the House of Representatives, led by Rep. Tom Emmer (R-MN), sent Securities and Exchange Commission (SEC) Chairman Gary

Gensler a letter on March 16 requesting more information about the SEC's probe into crypto companies. The questions asked were about the SEC's use of authorities in its Division of Enforcement and Division of Examination to obtain information on digital asset and blockchain firms. The Members asked for a response no later than April 29.

According to an anonymous source, several bills related to the President's Working Group (PWG) report on stablecoins will be introduced in the House and Senate this month. While bipartisan opposition exists to requiring stablecoin issuers to have deposit insurance, the issue of creating stablecoin reserves has garnered bipartisan support and will likely be a part of several bills. There is a chance of some type of digital asset legislation passing out of committee, but its passage is law seems premature.

A possible rift within the Democratic Party over crypto is contributing to the delay of crypto legislation moving forward. Several members of the party, including Rep. Richie Torres (D-NY) and Sens. Ron Wyden (D-WA), and Cory Booker (D-NJ), have discussed the benefits of crypto, citing the potential to expand financial inclusion. Rep. Torres argued that crypto is a liberal issue in a recent Op-Ed. Meanwhile, Senators Sherrod Brown (D-OH) and Elizabeth Warren (D-MA), and Rep. Brad Sherman (D-CA) continue to criticize the industry. The lack of consensus among Democrats further decreases the likelihood of Congress acting anytime soon to pass significant legislation.

Treasury Department

The Treasury Department is launching a digital asset initiative to raise awareness about the consumer risks of investing in cryptocurrencies. The initiative is organized by the Treasury's Financial Literacy Education Commission (FLEC), a 23 member agency body that coordinates financial education throughout the government and supports financial education with the private sector. FLEC will create educational materials and organize outreach to inform the public on how crypto assets work and differ from other forms of payment.

Looking Ahead

29 March 2022	• House Financial Services Committee hearing, "The Future of Money: Assessing the Benefits and Risks of a U.S. Central Bank Digital Currency"

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