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Editorial Office
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What to Watch for in Crypto Policymaking for the Remainder of 2022

By Aaron Cutler and Chase Kroll*

In this article, the authors discuss some developments that will affect cryptocurrency policymaking efforts for the remainder of 2022.

As federal legislators and regulators look to build a regulatory framework around digital assets, this article provides an overview of what the industry can expect for the remainder of the year.

This year, we predict a continued back-and-forth largely consisting of (1) somewhat industry-friendly legislation from proponents in Congress looking to encourage innovation, and (2) increasingly strong rules and enforcement actions from Biden Administration regulators looking to mitigate risk. This will remind many observers of the pro-innovation attitude some in Congress took several years ago in their negotiations with risk-averse regulators concerning the FinTech sector.

Political momentum may have shifted in the favor of risk mitigation as a result of the recent crypto downturn and related consolidation of certain crypto companies. We hope a healthy balance is struck and recommend financial institutions engage with Congress and the executive agencies throughout this consequential year. Outlined below are some developments that will affect policymaking efforts for the remainder of 2022.

COMPREHENSIVE BIPARTISAN BILL

On June 7, 2022, Senators Cynthia Lummis (R-WY) and Kirsten Gillibrand (D-NY) introduced their much-anticipated comprehensive cryptocurrency bill, S.4356, the Lummis-Gillibrand Responsible Financial Innovation Act. The bill, if enacted, would provide regulators with clear guidance on which assets belong to different classes, offer protections for consumers, regulate stablecoins, and create a new organization under the joint jurisdiction of the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") to oversee the digital asset market.[1] Oversight of crypto

* Aaron Cutler, a partner at Hogan Lovells, leads the firm's Government Relations and Public Affairs practice. Chase Kroll is director of strategic communications at the firm. Resident in the firm's office in Washington, D.C., the authors may be contacted at aaron.cutler@hoganlovells.com and chase.kroll@hoganlovells.com, respectively.

[1] https://www.bloomberg.com/news/articles/2021-12-23/pro-crypto-senator-lummis-to-propose-overhaul-bill-next-year.

assets will be given to the SEC "when something fits within the Howey Test that makes it a security," Senator Lummis said, referring to the 1946 Supreme Court decision (related to a Florida orange grove) on the definition of a security.[2]

The Lummis-Gillibrand bill is receiving much attention, and a significant amount of praise from industry, and from certain regulators, particularly the CFTC. Still, in an evenly split Senate, an ambitious bill is unlikely to advance through the Banking Committee, let alone become law. We view this as a multiyear legislative effort.

STABLECOIN LEGISLATION

Senator Pat Toomey (R-PA), the retiring Ranking Member of the Senate Banking Committee, released a set of principles in December of 2021 to help lay the framework for forthcoming legislation of stablecoins.[3] "Stablecoin Principles to Guide Future Legislation" (the "principles"). Among the principles, Senator Toomey suggests that stablecoin issuance should not be limited to insured depository institutions; that stablecoin issuers be able to choose from at least three regulatory regimes based on their business models; and that non-interest bearing stablecoins should not necessarily be regulated like securities.

Senator Toomey formally introduced[4] a discussion draft of a bill on April 6, 2022, along these same lines.[5] Given recent controversies around stablecoins, including the collapse of TerraUSD, there is political energy behind stablecoin-specific legislation. The political calendar is increasingly constraining, but Senator Toomey's Stablecoin TRUST Act has a fair chance of advancing through the Senate Banking Committee and possibly passing the Senate. Speaking at Consensus 2022, Senator Toomey said, "I'm going to go out on a limb and say we get stablecoins done this year."[6]

Senator Gillibrand agrees. She recently said Congress could pass stablecoin legislation this year, "because it's urgent." On the House side, Rep. Patrick

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[2] https://cointelegraph.com/news/sen-lummis-teases-upcoming-crypto-bill-says-nfts-won-t-be-included-in-it.

[3] https://www.banking.senate.gov/newsroom/minority/toomey-outlines-stablecoin-principles-to-guide-future-legislation.

[4] https://www.banking.senate.gov/newsroom/minority/toomey-announces-legislation-to-create-responsible-regulatory-framework-for-stablecoins.

[5] https://www.banking.senate.gov/imo/media/doc/the_stablecoin_trust_act.pdf.

[6] https://www.coindesk.com/policy/2022/06/10/us-stablecoin-law-could-actually-pass-this-year-lawmakers-say/.

McHenry (R-NC) presaged, "We're close to significant movement and in a big bipartisan way on stablecoins in the House" and promised the Financial Services Committee will advance a bipartisan bill on stablecoins "this summer."[7]

BIDEN ADMINISTRATION EXECUTIVE ORDER

The Biden Administration Executive Order ("EO") on Ensuring Responsible Development of Digital Assets was published March 9, 2022.[8] This much-anticipated EO was delayed due to (1) disagreements on jurisdictional outlines, and (2) the Russian invasion of Ukraine.

This EO is just one step in a long and complex policy-making process. The EO solicits non-binding policy recommendations from regulatory agencies covering elements of the cryptocurrency and digital assets industry, consistent with their respective jurisdictions, and there are various reporting deadlines.

Agencies' Roles in the EO

The EO outlines agency responsibilities including, notably, the following:

- The Treasury Department will lead development of broad "policy recommendations to address the implications of the growing digital asset sector and changes in financial markets for consumers, investors, businesses, and equitable economic growth."
- The Treasury Department will also produce a report on the future of money and payment systems "to include implications for economic growth, financial growth and inclusion, national security, and the extent to which technological innovation may influence that future."
- The Financial Stability Oversight Council ("FSOC") will look at systemic risk posed by digital assets and recommend how to mitigate "economy-wide financial risk."
- The Commerce Department "will work across the U.S. Government in establishing a framework to drive U.S. competitiveness and leadership in and leveraging of digital asset technologies."
- The Federal Reserve will lead on researching, developing, and assessing efforts for a U.S. Central Bank Digital Currency ("CBDC").
- The White House Fact Sheet accompanying the EO also calls for an

[7] https://www.coindesk.com/policy/2022/06/10/us-stablecoin-law-could-actually-pass-this-year-lawmakers-say/.

[8] https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/.

> "unprecedented focus of coordinated action across all relevant U.S. Government agencies" in order to "mitigate the illicit finance and national security risks posed by the illicit use of digital assets."[9]

Industry Engagement on the EO

The EO process presents an excellent opportunity for industry to engage with the regulators, directly and indirectly. We hope this process will lead to a healthy balance between encouraging innovation and mitigating risk, but that requires robust involvement from industry. Industry stakeholders should consider (1) direct engagement with the regulatory agencies as they study, seek comment on, and prepare policy recommendations, and (2) indirect engagement through legislators, think tanks, and other influential third parties.

Treasury Secretary Janet Yellen said in a statement, "President Biden's historic executive order calls for a coordinated and comprehensive approach to digital asset policy. This approach will support responsible innovation that could result in substantial benefits for the nation, consumers, and businesses. It will also address risks related to illicit finance, protecting consumers and investors, and preventing threats to the financial system and broader economy."[10]

As far as the process, Secretary Yellen says,

> Treasury will partner with interagency colleagues to produce a report on the future of money and payment systems. We'll also convene the Financial Stability Oversight Council to evaluate the potential financial stability risks of digital assets and assess whether appropriate safeguards are in place. And, because the questions raised by digital assets often have important cross-border dimensions, we'll work with our international partners to promote robust standards and a level playing field.

INTERAGENCY GUIDANCE

On November 23, 2021, the Office of the Comptroller of the Currency issued a joint statement with the Federal Reserve and Federal Deposit Insurance Corp. announcing the completion of their collaborative effort to have staff from "various backgrounds and relevant subject matter expertise" analyze the banking sector's potential involvement with the growing crypto asset industry. The three agencies said they plan to provide greater clarity "throughout 2022" on whether

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[9] 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/.

[10] https://home.treasury.gov/news/press-releases/jy0644.

certain activities by banking institutions, such as crypto asset custody or the issuance of stablecoins, are legal and how they fit within the existing regulatory framework.[11]

FINCEN RULES

Also in Fall 2021, the Financial Crimes Enforcement Network ("FinCEN") took under consideration two rules governing the collection and transmission of digital assets: (1) Requirement to Collect, Retain, and Transmit Information on Transactions Involving Convertible Virtual Currencies and Digital Assets With Legal Tender Status, and (2) Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets. FinCEN issued notices of proposed rulemaking under the Trump Administration in 2020, which the Biden administration is now reviewing.

FinCEN had shared its intention to release a new rule on the first item in Spring 2022, with a final ruling on the second (and more controversial) proposed rule in the fall. Industry experts have suggested the second rule, as initially proposed, could limit users' privacy and push cryptocurrency business overseas. The Biden Administration will likely offer formal or informal guidance on the forthcoming rules throughout the year.[12]

SEC PROPOSED RULES

SEC Chairman Gary Gensler recently proposed two new rules that would expand and strengthen the SEC's role overseeing digital assets and exchanges.

On January 26, the SEC proposed rules to "better protect investors" by bringing Alternative Trading Systems ("ATS") "under the regulatory umbrella." According to the agency's Fact Sheet, "the proposed amendments also would include Communication Protocol Systems within the definition of 'exchange' so that Communication Protocol Systems that choose to operate as ATSs would need to comply with the existing Regulation ATS provisions that protect investors and promote fair and orderly markets." Many in the crypto industry weighed in on the proposed rule warning that such a regulatory overreach could erode personal privacy protections, and stifle innovation. The public comment period for the proposed rule closed April 18, 2022.[13]

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[11] https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20211123a1.pdf.

[12] https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202110&RIN=1506-AB47.

[13] https://www.sec.gov/news/press-release/2022-10; https://www.sec.gov/files/34-94062-fact-sheet.pdf.

More recently, on March 28, the SEC proposed a rule that would redefine what it means to be a securities dealer, including individuals and platforms running algorithmic trading technologies.

Specifically, "under the proposed rules, any market participant that engages in activities as described in the rules would be a "dealer" or "government securities dealer" and, absent an exception or exemption, required to: register with the SEC under Section 15(a) or Section 15C, as applicable; become a member of an self-regulatory organization ("SRO"); and comply with federal securities laws and regulatory obligations, including as applicable, SEC, SRO, and Treasury rules and requirements." The public comment period for the proposed rule closed May 27, 2022.[14]

Key Republican lawmakers criticized the proposed rules. Representatives Patrick McHenry (R-NC), and Bill Huizenga (R-MI), submitted a public comment letter expressing concerns with how the SEC rulemakings could impact the digital asset ecosystem. Representative McHenry, Ranking Member of the Financial Services Committee, and Mr. Huizenga, Ranking Member of the Subcommittee on Investor Protection, Entrepreneurship and Capital Markets argued that "the rule makings fail to define the SEC's statutory authority" and that the regulator "fails to identify the problem that the rulemakings are intended to solve, particularly as it relates to requiring certain market participants facilitating digital asset transactions to register with the SEC."[15]

CONGRESSIONAL OVERSIGHT AND INVESTIGATIONS

Currently, the House Financial Services Committee and the Senate Banking Committee are helmed by energetic Democratic chairs, skeptical of financial institutions and critical of cryptocurrencies. With their majorities in both houses of Congress at risk, we expect to see increased attention to oversight and investigations this year, while they still hold institutional power. In the coming months, we foresee hostile hearings with industry executives and potential committee markups of partisan legislation.

Recently, Financial Services Committee Chair Maxine Waters (D-CA) held a hearing on "Digital Assets and the Future of Finance" with six industry chief

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[14] https://www.sec.gov/news/press-release/2022-54; https://www.sec.gov/rules/proposed/2022/34-94524.pdf.

[15] https://republicans-financialservices.house.gov/news/documentsingle.aspx?DocumentID=408313.

executive officers.[16] We expect more such hearings, with increased scrutiny throughout 2022. What remains to be seen is the full scope of such congressional scrutiny and if the increased oversight leads to a committee-backed bill. These are reasons for industry to engage with both sides of the aisle.

CONCLUSION

2021 was the year the cryptocurrency industry realized it could no longer be separate from politics. The $27 billion pay-for in the infrastructure bill made that painfully obvious.[17] The industry lobbied hard and, in some cases, even had some wins. 2022 is the year legislators put forth major bills, and regulators finalize and promulgate rules that will shape the industry for decades. We recommend the cryptocurrency industry, as well as traditional financial institutions, engage the Hill and the Biden Administration throughout the year, to protect their interests and those of their users and customers.

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[16] https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=408856.

[17] https://www.nytimes.com/2021/07/30/us/politics/infrastructure-deal-cryptocurrency.html.