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Cabinet News and Views

Informed analysis for the financial services industry

Delving into Digital Assets

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This week's issue of *Cabinet News and Views* has a distinct digital assets focus. And why not? There is so much going on in this space, starting at the very top, with an important directive from the White House. We encourage you to read the analyses from our colleagues Mercedes Tunstall and Peter Malyshev, who take a deep dive into the digital developments.

And, as always, we welcome your thoughts. Just write to us here.

Daniel Meade and **Michael Sholem**
Co-Editors, *Cabinet News and Views*

White House Fact Sheet: Comprehensive Framework for Responsible Development of Digital Assets

By **Mercedes Kelley Tunstall**
Partner | Financial Regulation

Last Friday, September 16, the White House released a "Fact Sheet" that lays out a comprehensive framework around which a plethora of Federal Government agencies and departments are being tasked with addressing digital assets, in one way or another.

The scope of this framework is quite expansive and is not too surprising, because it mirrors early statements from President Biden's March 2022 Executive Order ("EO") regarding digital assets but contains some interesting detail and unexpected positions, once one delves below the surface. For example, while the EO discusses central bank digital currency ("CBDC") as being a topic for further exploration, the Fact Sheet reveals an Administration that is now quite bullish on the development of a United States CBDC.

After observing that 16% of adult Americans to date have purchased digital assets of some kind and that the market capitalization of digital assets, as of November 2021, was $3 trillion, the Fact Sheet organizes the plethora of activities covered into seven main categories. Meanwhile, the EO had directed several parts of the Federal Government to issue reports on various aspects of digital asset development, with an early September 2022 due date, and so the Fact Sheet liberally intersperses conclusions and information from those reports throughout.

The first category of activity centers around the topic of Protecting Consumers, Investors and Businesses, and the Fact Sheet lists the following activities as part of this pillar of the framework:

- Continued enforcement against unlawful practices in the digital asset space by the Securities & Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC");
- Continued monitoring of consumer complaints and use of unfair or deceptive acts or practices authority by the Federal Trade Commission ("FTC") and the Consumer Financial Protection Bureau ("CFPB");
- Collaboration among enforcement and regulatory agencies to address consumer, investor and business risks raised by digital assets; and
- Public awareness campaigns to be organized and disseminated by the Financial Literacy Education Commission[1] ("FLEC").

The second category of activity addresses Safe, Affordable Financial Services and includes the following:

- Encourages the development and adoption of instant payment systems by federal agencies, including by utilizing digital asset-related technologies such as blockchain software and distributed ledger technology;

- Calls for the development of a federal framework to regulate nonbank payment providers;
- Prioritizes efforts to improve the efficiency of cross-border payments; and
- Directs the National Science Foundation ("NSF") to ensure that digital asset ecosystems are designed to be usable, inclusive, equitable and accessible.

The third pillar of the comprehensive framework announced by the Fact Sheet is called Fostering Financial Stability and highlights that there is "potential for instability" even when the digital asset in question is a so-called stablecoin. To that end, the Financial Stability Oversight Council ("FSOC") has been directed to issue a report in October 2022 regarding financial stability risks of digital assets, generally; identify regulatory gaps in addressing digital assets; and to make recommendations. In addition, Treasury is directed to work with financial institutions to bolster digital assets in the U.S. economy and to work with other agencies to identify and track strategic risks.

The fourth set of activities are around Advancing Responsible Innovation of digital assets. Specifically, the NSF is again tagged, in conjunction with the White House's Office of Science and Technology Policy ("OSTP"), to create a research and development agenda that addresses: next generation cryptography, transaction programmability, cybersecurity and privacy protections, environmental impacts of digital assets, and methods of informing, educating and training diverse stakeholders regarding digital assets. Additionally, the Department of Energy and the Environmental Protection Agency ("EPA") are directed to work on the environmental impacts of digital assets, particularly with an eye to aligning them to transition to a net-zero emissions economy. Finally, the Department of Commerce is tasked with bringing government, industry, academics and the public together to discuss digital assets.

The fifth pillar addresses Reinforcing Global Financial Leadership and Competitiveness, and largely draws from Treasury's on-going exploration of "the implications of development and adoption of digital assets and changes in financial market and payment infrastructures." See 87 Fed. Reg. 40881.

The sixth category involves Fighting Illicit Finance activities. The main purpose of these activities are intended to significantly cut back and reduce the use of digital assets for money laundering, criminal goods and services and human trafficking, which occurs frequently today due to the anonymous nature of existing digital assets such as Bitcoin. Specifically, the Administration indicates support for legislation to target unlicensed money transmission such that the definition of money transmission is expanded to include digital asset exchanges, including non-fungible token ("NFT") marketplaces. Treasury is directed to issue a February 2023 report on illicit finance risks and a July 2023 report on NFTs.

Finally, the seventh pillar of the framework focuses on Exploring a U.S. Central Bank Currency and includes a broad list of benefits the Administration sees from a US CBDC, including such a CBDC could:

- Result in a more efficient payment system that would reduce costs and the amount of time needed for payments to be considered final;

- Facilitate faster cross-border transactions;
- Offer environmental sustainability;
- Promote financial inclusion and equity by enabling broad access;
- Foster economic growth;
- Protect against privacy and security attacks;
- Safeguard sensitive data better;
- Minimize illicit transactions;
- Preserve the U.S.'s global financial leadership; and
- Support the effectiveness of U.S. monetary sanctions.

Cadwalader will be providing in-depth Client & Friends memos in the days to come regarding a number of topics discussed in this summary, including an examination of what a CBDC could mean for consumers, investors and businesses and the financial institutions that serve them, as well as the environmental, social and government ("ESG") considerations of digital assets, and the implications of an expanded definition of money transmission and increased anti-money laundering ("AML") requirements for several digital asset industry participants. If you would like to ensure receipt of these memos, please write to us at Cabinet News and Views.

[1] The Financial Literacy Education Commission sits within the Department of the Treasury and is chaired by the Secretary of the Treasury, vice-chaired by the Director of the CFPB and coordinated by Treasury's Office of Consumer Policy. Nineteen federal agencies and departments are members of FLEC, including the federal banking regulators, as well as the several Departments and FEMA.

Crypto-Assets and Climate Change – It's Complicated

By Peter Y. Malyshev
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On September 8, the White House published a report ("Climate-Crypto Report") on Climate and Energy Implications of Crypto-Assets in the United States, which was followed by a detailed Fact Sheet summarizing the findings in the report. The Climate-Crypto Report was prepared following President Biden's March 9, 2022 Executive Order 1407 that mandated examination of distributed ledger technologies' ("DLT") impact on energy transactions and ultimately on the environment.

The Climate-Crypto Report addressed four questions: (1) *how* digital assets affect energy usage and grid management? (2) *what is the scale* of climate, energy and environmental impacts of digital assets? (3) *what are potential uses* of DLT that could support climate monitoring? and (4) *what critical policy decisions*, innovation and research are needed to mitigate the environmental impact of digital assets?

The Report acknowledges that although President Biden's Administration has set the policy at responsible development of U.S. digital assets markets, it also recognized the increasing costs on U.S. energy infrastructure and the impact on the environment, considering that mitigation of climate change is also one of President Biden's key priorities.

First, the Climate-Crypto Report finds that crypto-assets use a significant amount of electricity – globally equal to the amount of electricity used by Argentina or Australia. It also found that not all crypto-assets technologies consume the same amount of power, with Proof of Work ("PoW") mechanisms far exceeding the power usage the Proof of Stake ("PoS") processes.

Second, the Climate-Crypto Report found that there is a sizable impact on the environment of anthropogenic greenhouse gas ("GHG") emissions associated with crypto-assets markets. In addition to the increased demand on the power grid, generation of crypto-assets also generates noise pollution, water impact, and a lot of other environmental waste.

Third, the Report also finds that there are broad and various uses of DLT in environmental markets, better resource coordination and supply chain management.

Finally, the Climate-Crypto Report recommends reduction of associated GHG emissions, reduction of power-intensive technologies (such as PoW) in favor of more low-impact PoS processes, and efforts to avoid negative impacts on the underserved and overburdened communities. In fact, on September 6, Ethereum did just that – it launched The Merge to switch to the less energy intensive PoS process.

During the recent Senate hearing on September 15 to review the recently proposed Digital Commodities Consumer Protection Act, several panelists acknowledged the carbon footprint of crypto-assets markets. These findings are further addressed in a September 16 release from the White House that proposed a comprehensive framework for responsible development of digital assets in the U.S.

White House Announces Intent to Nominate Two Republicans to FDIC Board

By **Daniel Meade**
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On September 20, the White House announced President Biden's intent to nominate two Republicans, Travis Hill and Jonathan McKernan, to the FDIC Board. It has also been reported that President Biden will nominate a permanent Chair to the FDIC shortly. What is unclear is whether that nominee will be current Acting Chair Martin Gruenberg, or someone new.

Mr. Hill, who served as a principal aide to former FDIC Chair Jelena McWilliams, has been designated as the Vice Chair nominee. He also previously served as a staffer on the Senate Banking Committee. Mr. McKernan is currently a Senior Counsel at the FHFA, but is on detail to the Senate Banking Committee Republican staff.

The FDIC's Board of Directors comprises five members. Under the Federal Deposit Insurance Act ("FDI Act"), no more than three members of the Board can be in the same political party. The FDI Act also calls for the Director of the CFPB and the Comptroller of the Currency to be members of the FDIC Board. Thus, generally, the Chair of the FDIC, the Comptroller and the CFPB Director are members of the President's party, and the Vice Chair and one other member are members of the other party.

Whomever the President chooses to nominate as FDIC Chair, it is likely that the Chair's nomination will be "packaged" together with the nominations of Messrs. Hill and McKernan. Acting Chair Gruenberg's term as an FDIC Board member is expired, but he can serve until a successor is confirmed. If Mr. Hill is confirmed as Vice Chair, but the President's choice to be Chair is not confirmed, Mr. Hill would become Acting Chair of the FDIC Board per the FDI Act.

Cadwalader Finance Forum Returns October 27

Cadwalader's annual Finance Forum returns as an in-person event at the JW Marriott in Charlotte on Thursday, October 27. Programming will begin at 1:00 p.m. and continue throughout the afternoon, followed by a networking reception. Click here for a list of current panel topics and to register.