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Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

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Congress' Crypto Crash Course

By J.C. Boggs, Ana B. Daily, Luke Roniger and John T. Morrison*

With increased Congressional scrutiny, continued interest from committees in both the House and Senate, and a turf war between Congress and key regulatory agencies, digital assets continue to be under the regulatory microscope. The authors of this article discuss key initiatives in the crypto realm.

Throughout the past year, Congress has exhibited increased signs of engagement with the FinTech industry through committee hearings and proposed legislation. This heightened interaction suggests that, slowly but surely, Congress is positioning itself to establish an overarching regulatory framework for cryptocurrency issuance and trading. In light of recent market volatility, we will likely see Congress continuing to educate itself on key policy issues and gearing up to act on this goal in the coming months.

BACKGROUND

The House Financial Services Committee Oversight Plan for the 117th Congress highlighted several key areas of focus for the current term, including a look at the "cybersecurity implications of the creation, movement, and management of cryptocurrencies and the usage of blockchain technology" as well as the rise of "initial coin offerings" ("ICOs") as a means of raising capital for blockchain-based enterprises.

Significantly, the committee indicated that it would "review the SEC's oversight of the ICO markets" and "consider legislative proposals to improve regulatory clarity for ICO issuers and investors." More generally, it committed to looking at the need for "clear guidelines and regulations for crypto assets, stable coins, digital currencies, and related products."

Rep. Patrick McHenry (R-NC), the Ranking Republican on the committee and presumptive committee chair in the event of a leadership change in 2022,

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* J.C. Boggs (jboggs@kslaw.com) is a partner with King & Spalding LLP's Government Advocacy and Public Policy group and co-leads the firm's FinTech, Blockchain and Cryptocurrency and State Attorneys General practices. Ana B. Daily (adaily@kslaw.com) is an associate at the firm focusing on white collar criminal defense, internal and government investigations, and corporate compliance and governance. Luke Roniger (lroniger@kslaw.com) is a senior associate at the firm focusing his practice on complex civil litigation and international arbitration. John T. Morrison (jmorrison@kslaw.com) is an associate at the firm representing clients through all phases of complex civil litigation in state and federal courts.

has specifically called for further regulation[1] of cryptocurrency that would give Congress more direct control over emerging policies. He contended that Congress "should not cede these important issues to regulators such as SEC or CFTC, or to the judicial branch, to determine" and that the committee "should do its work to appropriately categorize [digital] assets and determine the rules that will govern their use."

RECENT PROPOSALS AND HEARINGS

In working toward these objectives, numerous committee hearings have been held on cryptocurrency and multiple bills have been introduced on the subject. For example, last summer, Congress held two hearings entitled "Cryptocurrencies: What are they good for?" and "Building a Stronger Financial System: Opportunities of a Central Bank Digital Currency." In December 2021, chief executives of six cryptocurrency companies testified[2] before the House Financial Services Committee about the possibilities and risks of cryptocurrencies. So far in 2022, Congress has had a robust start with numerous hearings related to digital assets and stablecoins.[3]

More than 35 measures relating to cryptocurrency, blockchain, and central bank digital currency ("CBDC") have been introduced during the 117th Congress. One set of bills focuses on how regulators such as the Securities and Exchange Commission ("SEC") and Commodities and Futures Trading Commission ("CFTC") will regulate crypto and blockchain tokens. Of those, the Eliminate Barriers To Innovation Act (H.R. 1602) passed the House of Representatives last year. That bill creates an SEC and CFTC Working Group on Digital Assets that would report to Congress and help clarify differences in blockchain tokens between the two agencies.

In April, a bipartisan group of Representatives introduced a bill that aims to expand this effort. If passed, the Digital Commodity Exchange Act of 2022[4]

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[1] https://republicans-financialservices.house.gov/uploadedfiles/2022-01-24_pmc_to_waters_digital_asset_letter_final.pdf.

[2] https://financialservices.house.gov/events/eventsingle.aspx?EventID=408705.

[3] For example, Rep. Maxine Walters' February 8, 2022, hearing entitled "Digital Assets and the Future of Finance: The President's Working Group on Financial Markets' Report on Stablecoins." A forthcoming client alert will discuss the outcome of this hearing in detail. Additionally, the Senate Committee on Agriculture, Nutrition, and Forestry held a hearing titled "Examining Digital Assets: Risks, Regulation, and Innovation" on February 9, 2022.

[4] https://khanna.house.gov/media/press-releases/khanna-thompson-emmer-soto-introduce-bipartisan-digital-commodity-exchange-act.

would provide "regulatory oversight for spot digital commodity exchanges, market intermediaries, and stablecoin providers" by building on frameworks that already exist in commodities law.

A second group of bills addresses distributed ledger technology and the broader use of blockchain technology in other sectors of the economy.[5]

Finally, a third tranche of bills deals with Central Bank Digital Currencies ("CBDCs") as policymakers become more cognizant of risk to the dollar's primacy due to technological innovations such as stablecoins,[6] a type of cryptocurrency pegged to the value of stable assets such as the U.S. dollar.

Indeed, stablecoins were the subject of a December 2021 Senate Banking Committee hearing titled "Stablecoins: How Do They Work, How Are They Used, and What Are Their Risks?" In his opening remarks, the committee chair, Senator Sherrod Brown (D-OH), said that "stablecoins create a very real link between the real economy and this new fantasy economy."

Moreover, he noted that "stablecoins and crypto markets aren't actually an alternative to our banking system." Instead, "[t]hey're a mirror of the same broken system—with even less accountability, and no rules at all."

More recently, Rep. Josh Gottheimer (D-NJ) released a draft of the "Stablecoin Innovation and Protection Act"[7] that aims to define stablecoins and to offer a legal framework where stablecoin issuers could operate. In particular, the draft bill proposes to designate certain digital currencies as "qualified" stablecoins if they can be redeemed for a one-for-one basis for U.S. dollars.

A NOTE ON STABLECOINS

Importantly, on November 1, 2021, the President's Working Group on Financial Markets ("PWG") released a long-awaited report[8] on stablecoins. The report highlighted what it viewed as significant gaps in the prudential regulatory authority of stablecoins used for payment purposes and offered several recommendations for legislation and regulation.

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[5] *See, e.g.*, Blockchain Innovation Act (H.R. 3639), Blockchain Promotion Act of 2021 (S. 1869), Blockchain Technology Coordination Act of 2021 (H.R. 3543), Blockchain Regulatory Certainty Act (H.R. 5045).

[6] *See, e.g.*, Central Bank Digital Currency Study Act of 2021 (H.R. 2211), 21st Century Dollar Act (H.R. 3506). The Federal Reserve Board has also released a discussion paper that examines the pros and cons of a potential U.S. central bank digital currency. *See* https://www.federalreserve.gov/publications/files/money-and-payments-20220120.pdf.

[7] https://gottheimer.house.gov/news/documentsingle.aspx?DocumentID=3020.

[8] https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

First, the Report recommended that Congress pass legislation requiring:

- Stablecoin issuers to be insured depository institutions subject to capital and liquidity standards;
- Federal oversight of custodial wallet providers and any entity that performs activities critical to the functioning of the stablecoin arrangement; and
- Stablecoin issuers to limit affiliation with commercial entities to encourage competition and interoperability among different stablecoins.

The President's Working Group also recommended collaboration across various federal financial agencies to address stablecoin risks with their respective jurisdictions.

Finally, the Report recommended that the Financial Stability Oversight Council consider taking steps to address stablecoin risks, such as designating certain activities within a stablecoin arrangement as being, or likely to become, systemically important payment, clearing, and settlement activities.

The proposed Stablecoin Innovation and Protection Act, mentioned above, would effectively codify the first of these recommendations.

As 2022 progresses, further focus on stablecoins is expected, with hearings and legislation aiming to provide accountability in this space by enhancing practical standards and limiting the category of entities authorized to issue stablecoins. Following the crash of TerraUSD in May, Sen. Pat Toomey (R-PA) hosted a press conference to promote his proposed legislation, the Stablecoin TRUST Act.[9] The bill would subject stablecoin issuers to additional disclosure requirements and set up a new regulatory framework that aims to improve clarity while limiting the role of SEC enforcement actions. It would also create a new special-purpose federal banking charter for stablecoin issuers, which could be used as an alternative to operating with a state money transmitter license.

WIDE-RANGING LEGISLATIVE IMPLICATIONS

The sectors and policy issues implicated by potential cryptocurrency legislation are broader and more varied than one might think.

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

Privacy and consumer protection concerns also underpin crypto-related legislation. For example, Rep. Tom Emmer (R-MN)[10] introduced a bill in January 2022 bill that would impose restrictions on how the Federal Reserve could issue its own digital currency by barring the central bank from issuing digital currencies directly to consumers to "ensure the Fed would not have unilateral control over a new form of currency." The proposal would leave the responsibility for disseminating digital money to private financial institutions.

Additionally, Congress continues to focus on the transition to online and digital payments, a trend accelerated by the pandemic and projected to continue intensifying. Fueling this focus is skepticism that cryptocurrency has the potential to actually decentralize digital assets and concern that partnerships with BigTech (e.g., Facebook Meta's Novi digital wallet) will put ownership of crypto assets in the hands of a few large companies, concurrently causing a host of data privacy issues.

Relatedly, in mid-February 2022, Rep. Warren Davidson (R-OH) introduced the "Keep Your Coins Act" that would restrict federal agencies from prohibiting users from "conducting transactions through a self-hosted wallet."

Given the vital role that custodial wallet providers play within a stablecoin arrangement, and the risks associated with the relationship between custodial wallet providers and stablecoin users, Congress will likely also focus in on federal oversight of custodial wallet providers. Along that track, Congress is also likely to examine BigTech-crypto partnerships from additional angles—industry players involved in these partnerships should be ready for scrutiny of consumer protections, data privacy issues, cybersecurity, and mergers.

There is also increasing Congressional interest in creating a new federal agency to regulate technology platforms. Two bills—one in the House and one in the Senate—were introduced in May for this purpose. Legislation introduced by Sen. Michael Bennet (D-CO) aims to create an agency that would "provide comprehensive, sector-specific regulation of digital platforms to protect consumers, promote competition, and defend the public interest." The House bill,[11] introduced by Rep. Peter Welch (D-VT), is nearly identical.

Environmental concerns related to crypto mining could also lead to future legislation. In April, a group of House Democrats sent a letter[12] to the

[10] https://emmer.house.gov/2022/1/emmer-introduces-legislation-to-prevent-unilateral-fed-control-of-a-u-s-digital-currency.

[11] https://welch.house.gov/media-center/press-releases/welch-introduces-bill-provide-oversight-big-tech.

[12] https://huffman.house.gov/download/crypto-letter-to-epa_4202022.

Environmental Protection Agency urging it to investigate whether cryptocurrency mining operations throughout the country are operating in compliance with the Clean Air Act and Clean Water Act. However, no bills have yet been introduced on this specific topic.

CONCLUSION

We can expect to see Congress continue searching for a path forward with regard to legislation and oversight. Many new industry players have entered the arena to add their voice. For example, Coinbase has proposed a "unified joint regime" on crypto for agencies like the SEC and CFTC, or a new regulator. Sam Bankman-Fried, the CEO of FTX, a crypto derivatives exchange, has said that he would be "excited" to work with the SEC on "common-sense regulations."

In December 2021, FTX published a blog post containing ten general proposals that Congress should consider, including the implementation of a single market regulator with a single rulebook, and the requirement that cryptocurrency exchanges "conduct regular anti-money laundering surveillance."

Also in December 2021, SEC Chair Gary Gensler again called for regulation of crypto, calling it an asset class "rife with fraud, scams, and abuse." Treasury Secretary Janet Yellen echoed this call in May, urging Congress to create a "comprehensive framework" to guard against risks demonstrated by recent volatility in the crypto market.

Going forward, we are likely to see more Congressional action as legislators attempt to wade into the digital asset waters.