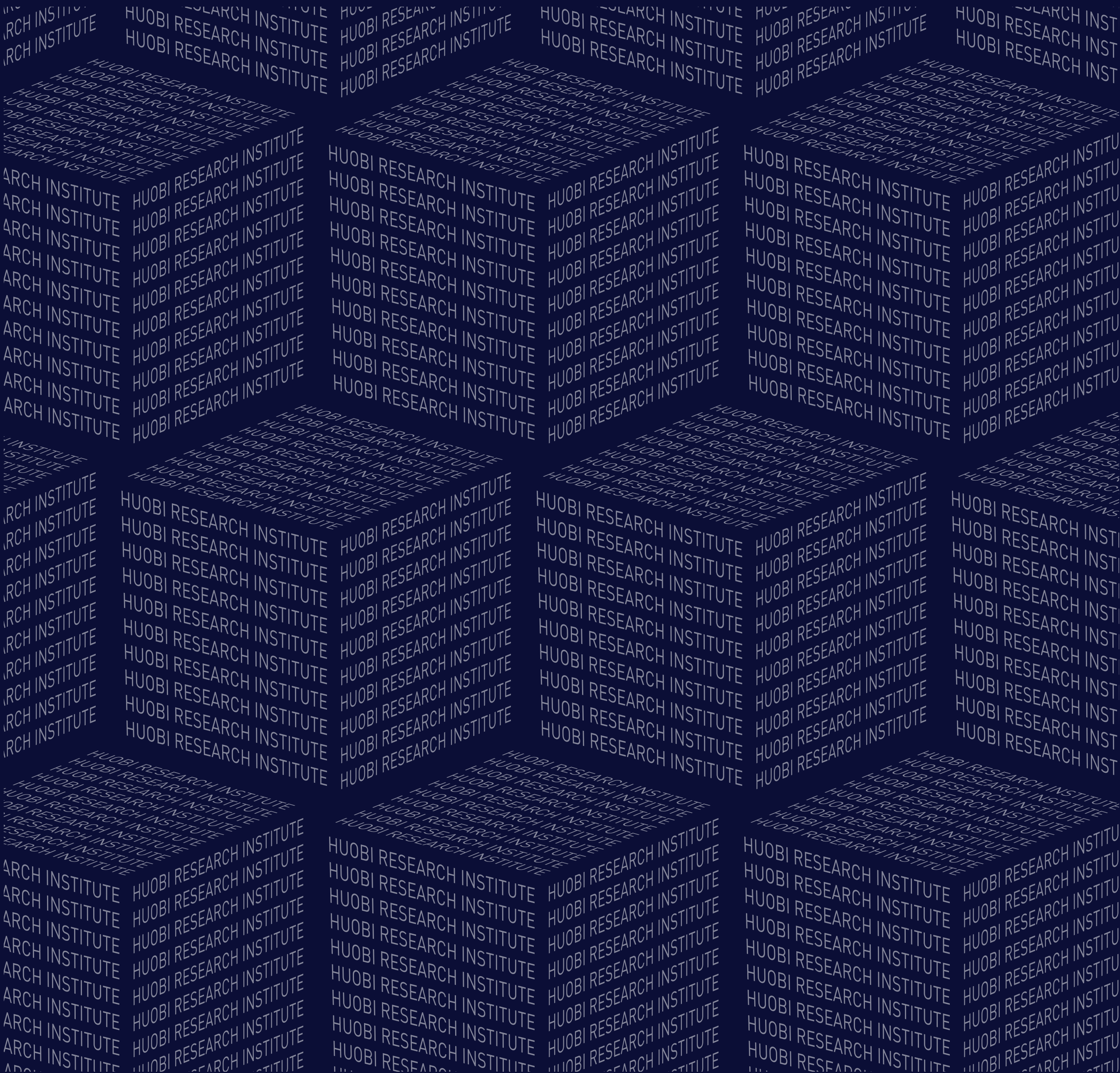

A DEEPER LOOK AT BIDEN'S EXECUTIVE ORDER ON DIGITAL ASSETS REGULATION

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ABSTRACT

On March 9, President Biden signed an executive order to ensure responsible innovation in the digital assets industry. This is the first-ever comprehensive executive approach that attempts to address the risks and harness the potential benefits of digital assets and their underlying technologies. President Biden identified six objectives and assigned tasks to multiple departments to examine the following: principles for law enforcement agencies, frameworks and principles for international cooperation, the impact of CBDCs, protections for investors, consumers, and businesses, the environmental impact of crypto mining, the technological infrastructure of digital assets, financial risks and regulatory gaps, and illicit financial risks.

Approximately 16% of the U.S. adult population have invested in, traded, or used cryptocurrencies, which represents, according to a Pew Research Center study. According to the Diffusion of Innovation Theory, this percentage is right around the division line that separates the early adopter and early mass adoption stages. A comprehensive approach is necessary at this time to make the application of digital assets more in line with the interests of American society as a whole. This Executive Order and the subsequent reports will also have a wide-ranging impact on the development of digital assets.

This article will briefly explain the Executive Order in the following three areas:

1. the objectives and impact of the Executive Order;

2. the functions and regulatory areas of each regulatory agency;

3. follow-up concerns.

Objectives and Impact of the Executive Order

Biden's executive order has two main goals: to reduce the negative impact of digital assets and to promote the positive impact of digital assets.

Negative impact refers to potential risks that introduced by the use of digital assets, including: inadequate consumer protection, privacy breaches, reduced stability of the financial system, illicit financing, national security threats, and climate deterioration.

The first goal of the Executive Order is to protect consumers, investors, and enterprises. In the absence of clear regulations and standards, digital asset service providers may inadequately protect financial data, assets in custody, and other arrangements related to user assets, or insufficiently disclose investment risks. This risk is concentrated on centralized exchanges, which will need to establish norms of conduct in the areas of data, asset security, process design, and risk disclosure.

Stability threats to the financial system arise primarily from digital asset trading platforms and service providers that are rapidly growing in operational scale and product complexity, which may not comply with appropriate legislation or regulation rules. On the other hand, asset issuers, trading platforms, and intermediaries serving digital assets add complexity to the overall financial system and incur new risks. It may not be appropriate for this rapidly evolving industry to obey the same rules of traditional financial firms in a straightforward manner. The Executive Order seeks to improve the regulatory approach to handle new risks and comply with the general principle, "same business, same risks, same rules". This rule may not be fully applicable, especially in the DeFi space, where there are different operators for businesses similar to traditional finance, so the U.S. needs to develop more refined rules.

The misuse of digital assets can pose significant illicit financial risks, including money laundering, cybercrime and ransomware, drug and human trafficking, terrorist financing, and evasion of international financial sanctions. The illicit users often use digital assets in areas where international rules established by the Financial Action Task Force (FATF) are not effectively implemented. DeFi, peer-to-peer payments and privacy blockchains aggravate national security risks. This type of risk makes it difficult for regulators to implement controls due to insufficient information. To reduce such risks, the implementation of more strict KYC and more international cooperation is needed, and the possibility of tighter controls on DeFi cannot be ruled out. This, however, would undermine the DeFi's industry desire to avoid government oversight and centralization of authority.

Privacy and climate impact issues were mentioned as well. Along with stricter KYC, the protection of user privacy is important. It is also important to prevent arbitrary or illegal surveillance, which violates basic rights. Climate issues are already hotly debated in 2021, and clear regulations would give more certainty to the U.S. mining environment.

The positive impact that digital assets can have mainly refers to the following: maintaining U.S. leadership in the global financial system and cutting-edge technology, and building a more accessible financial system. Regulation doesn't have to just revolve around what not to do, but can also steer the market in the way the government wants it to go.

At the heart of the global financial system lies the U.S. dollar, as well as U.S. financial institutions and markets, from which the United States derives significant economic and national security benefits. The United States certainly wants to continue to play a leadership role in the global financial system, maintaining U.S. financial strength and promoting U.S. economic interests. The government needs to ensure that the country remains at the forefront of digital asset development and design, as well as the technologies that support new payments and capital flows in the international financial system. The U.S. is truly a world leader when it comes to crypto assets. The U.S. is the most attractive country for crypto funding, with U.S. startups having received a total of $14.1 billion in investments, accounting for 56% of global crypto funding in 2021, according to PwC. On the other hand, the U.S. has been slightly slower in studying and developing CBDCs, and is still in the research phase.

The report repeatedly mentions safer, more convenient and lower-cost financial services, indicating that they lie in America's national interest. Many Americans do not have access to adequate banking services, and it is also costly to send money within and across borders. The U.S. wants to make investments and payments cheaper through the innovation and use of digital assets, allowing more people to access financial services more efficiently. Some payment service providers may have the opportunity to grow, but the premise is "responsible growth", and must not incur the aforementioned risks.

The Executive Order on Digital Assets is an important document that can be regarded as a milestone in the development of crypto-assets, heralding the dawn of comprehensive regulation. Prior to this, there was no nationwide regulatory framework or administrative guidelines for crypto assets in the United States, and the industry was in a state of wild, unregulated growth. With this order and a series of follow-up reports, the regulatory rules for the industry are becoming even clearer. Considering the leading position of the U.S. in the global financial system, coupled with the fact that the executive order itself also mentions the need to promote international collaboration with allies, future policy guidelines may have a strong demonstrative effect, triggering many countries around the world to follow suit. This would be conducive to the formation of a global regulatory framework for crypto assets.

The functions and regulatory areas of each regulatory agency

President Biden assigned oversight responsibilities to a number of executive departments, including the Department of the Treasury, the Department of Commerce, and regulatory agencies such as the SEC and CFTC, for a total of 20 agencies to take various responsibilities. He also had the Assistant to the President for National Security Affairs (APNSA) and the Assistant to the President for Economic Policy (APEP) coordinate under an interagency protocol.

The following table lists the areas of the Executive Order in which agencies are responsible for making policy recommendations. The length of each bar represents the degree of responsibility each respective agency has.

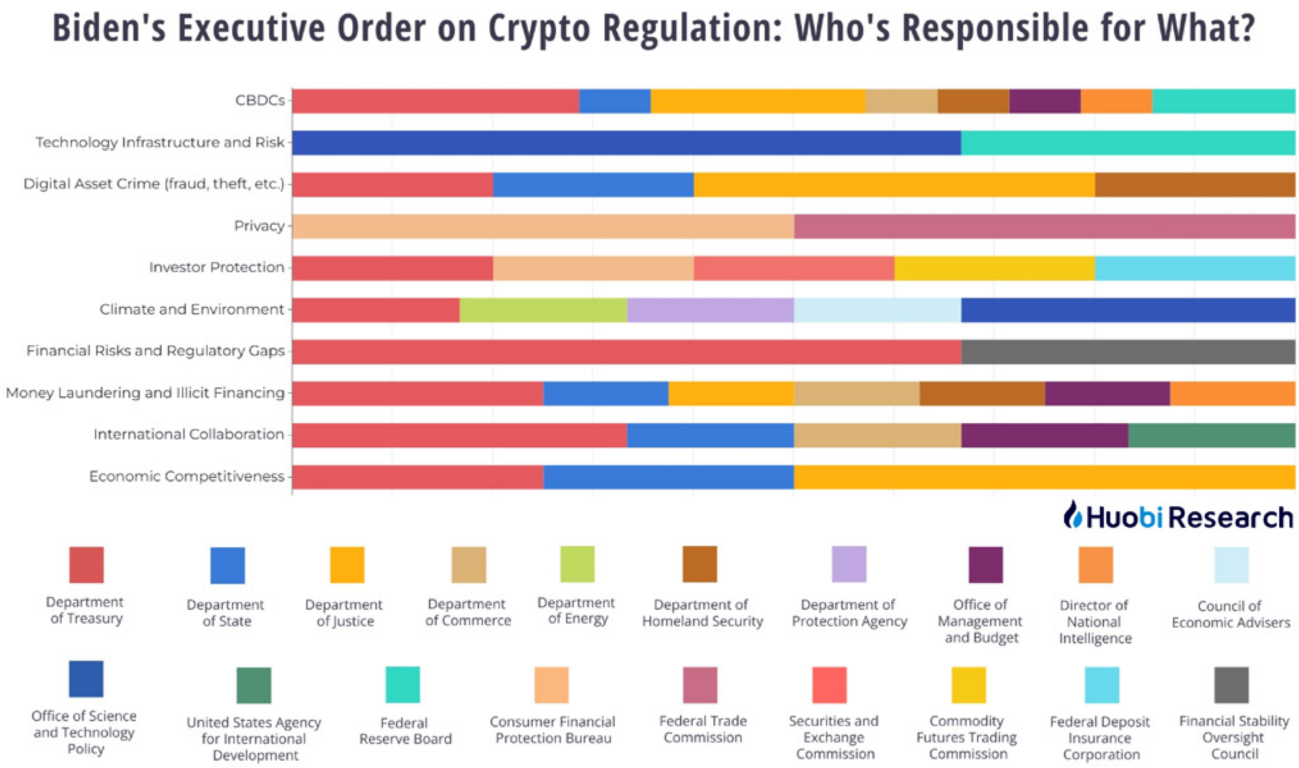

Figure 1. Responsible Chart

Source: White House Executive Order on Ensuring Responsible Development of Digital Assets

The following are the functions and potential areas of regulation of crypto assets for the key agencies involved.

Department of Treasury

The department mentioned most in the Executive Order is the Department of the Treasury, and it is often the lead or first in line for consultation, which shows its significance in the development of digital asset compliance. The Department of the Treasury will make policy recommendations on the issuance and taxation of digital assets, and will also assess the impact and potential financial risks of digital assets and the impact of new payment systems, as well as the extent to which technological innovation may affect industries in the future. It is not an overstatement to say that the Department of the Treasury is the most important department in the regulation of digital assets, and that the words of the Secretary of the Treasury and officials will have much weight in the future.

Treasury subdivisions that are connected to the regulation of digital assets are the Office of the Comptroller of the Currency (OCC), the Financial Crimes Enforcement Network (FinCEN), and the Internal Revenue Service (IRS).

The OCC charters, regulates and supervises all banks within United States, including domestic and foreign banks. It primarily regulates stablecoins and banks' services related to crypto assets, such as custody, derivatives and access to third-party crypto products. The OCC is meticulous as it requires banks and other regulated institutions to consult with the head of the OCC before starting to offer any services in the digital asset space. Given that the OCC previously said it should regulate stablecoins like it regulates banks, it may make more stringent regulatory policy recommendations in the future.

FinCEN is engaged in collecting and analyzing information on suspicious financial activity to combat domestic and international money laundering, terrorist financing and other financial crimes in the US. It was very strict in cracking down on the use of crypto assets for illegal financial activities, even proposing controversial rules like requiring crypto companies to collect KYC information on customers' cryptocurrency wallets. It will launch a series of campaigns in the future and will adjust and define the scale of its actions.

The IRS is primarily concerned with the taxation of crypto assets. What it needs to clarify is who should be taxed and what actions are taxable, and define digital assets, digital asset brokers, etc. Also, it needs to set rules on whether specific actions such as profits made from exchanges between risky cryptocurrencies such as BTC and ETH, staking rewards, mining rewards, etc. are subject to tax. The tax policy proposal has a wide impact, and is expected to have a significant impact on the industry.

Department of Commerce

The President asked the Department of Commerce to establish a framework to enhance U.S.'s competitiveness in technology and the economy. It is expected that the framework will serve as a foundation for agencies to prioritize and incorporate into their policies, research and development, and business approaches to digital assets.

The Department of Commerce, whose primary function is export-related, is less involved in the regulation of digital assets. Before this, it was only responsible for the reporting process for U.S. financial services firms that conducted cross-border cryptocurrency transactions. Biden designated the Department of Commerce to lead the development of a foundational framework aimed at strengthening the U.S. role in the global governance of digital assets, taking a leadership position on all fronts. The Department of Commerce may regulate U.S. crypto companies doing business in foreign countries and promote international rules that are consistent with U.S. interests.

Financial Stability Oversight Council (FSOC)

FSOC is a cross-department agency for systemic risk monitoring and regulatory coordination, consisting of multiple authorities such as the Department of the Treasury, the Federal Reserve, the Federal Deposit Insurance Corporation, and the Commodity Futures Trading Commission, with the primary responsibility of identifying and mitigating various types of risks that threaten the financial stability of the United States.

The FSOC's main task is to study and discuss the specific financial stability risks and regulatory gaps posed by various digital assets, and considers the particular characteristics of each type of digital asset and provides recommendations to deal with such risks, including recommendations for additional or adjusted supervision and new legislation. The FSOC has previously focused on stablecoins, and has released a report pointing out that the rapid growth of digital assets, including stablecoins pegged to national currencies such as the U.S. dollar, is an "important emerging potential vulnerability" and that there is a potential risk of severe price volatility and fraud in this area. It is likely to issue future reports on the risks and regulatory recommendations for stablecoins. Since its role is to identify new risks, its tone will be more cautious.

Office of Science and Technology Policy (OSTP)

OSTP is the White House's science and technology policy-making advisory institute whose primary responsibility is to advise the President on policies affecting science, technology and innovation and to provide the science and technology information needed for public policy.

OSTP's responsibility is to submit to the President a technical assessment of the technical infrastructure, capabilities, and expertise required by the relevant agencies to facilitate and support the introduction of a CBDC system. The assessment should specifically address the technical risks of various designs while including the risks and benefits to cybersecurity, user experience, and societal security. OSTP's evaluation is not limited to CBDCs, but may extend to the crypto space, focusing on technical risks in digital asset trading, custody, data privacy, etc.

Securities and Exchange Commission (SEC)

The Securities and Exchange Commission (SEC) plays the most active role in the regulation of cryptocurrencies in the U.S. The SEC is an independent quasi-judicial agency directly under the U.S. federal government and is responsible for securities oversight and regulation in the United States. The SEC judges whether or not crypto projects are securities based on the Howey test, and monitors token issuance, disclosure, and potential price manipulation. The SEC is also responsible for reviewing and approving trading products that have cryptocurrencies as underlying assets, such as Bitcoin ETFs. Specific measures regarding investor protection in the future will mainly be enforced by the SEC.

Commodity Futures Trading Commission (CFTC)

The U.S. Commodity Futures Trading Commission (CFTC) is an independent agency that regulates financial derivatives. The agency regulates exchanges that offer futures or options contracts on crypto assets to U.S. citizens. It is one of the most commentative official agencies on cryptocurrencies and previously said that it deserves greater power and more resources to regulate. With a clear scope of authority and legal basis, the CFTC is inclined to become a more active regulator.

Others

The Federal Trade Commission (FTC) is the federal agency that enforces a wide range of antitrust and consumer protection laws, and it is responsible for calling out unfair competition, consumer fraud, etc. under the Federal Trade Commission Act. In the area of crypto regulation, it focuses on the investigation and disclosure of alleged monopolies, deception, and other conduct.

The Federal Deposit Insurance Corporation (FDIC) is an independent agency created by the U.S. Congress to insure U.S. bank deposits. It has said it would like to make the assessment of crypto-assets a priority this year. It is potentially proposing rules for crypto asset custody, stablecoin deposits, and insurance services offered by crypto asset-backed lending.

The Consumer Financial Protection Bureau (CFPB) is designed to regulate consumer-related financial products and services to prevent financial harm to consumers. In the future, it will carry out more consumer protection and education functions through investigations and risk alerts for various types of crypto financial services.

The SEC, CFTC, FTC, CFPB, and FDIC are more familiar to the crypto community, but have not been given explicit instructions in this executive order. The President encourages them to consider market protections for consumers and investors in their respective jurisdictions. The government did not give direct orders to these agencies, and did not require them to submit reports. In addition, with respect to the independence of these agencies, the government will take the lead in forming a unified regulatory system and clarifying the boundaries of authority and responsibility among the agencies, so that it can quickly guide the actual operations of the regulators.

The role of the Fed is to research, evaluate and provide materials and participate in consultations on CBDCs, excluding crypto assets.

Follow-up concerns

This article combs through the topics and release dates of 16 reports assigned by the Executive Order.

The two adjacent reports shaded in the table have a sequential relationship. The vast majority of reports must be submitted within 90/180 days of the Executive Order's issuance, and some reports have slightly differed on starting points for release date calculations, indicated by highlighted text in the right column.

	Subject of the Report	Release Date
1	Strengthen international law enforcement cooperation for detecting, investigating, and prosecuting criminal activity	Within 90 days of the date of this order
2	Cross-institutional international cooperation framework and global principles	Within 120 days of the date of this order
3	Priority actions taken under the framework and its effectiveness	Within 1 year of the date of the establishment of the framework
4	The future of money and payment systems	Within 180 days of the date of this order
5	Whether legislative changes would be necessary to issue a United States CBDC	Within 180 days of the date of this order
6	Consideration of the report and materials developed by the Chairman of the Federal Reserve on CBDC	Within 210 days of the date of this order
7	Implications of developments and adoption of digital assets and changes in financial market and payment system infrastructures for United States consumers, investors, businesses, and for equitable economic growth	Within 180 days of the date of this order
8	Technological infrastructure, capacity, and expertise that would be necessary to facilitate and support the introduction of a CBDC system should one be proposed	Within 180 days of the date of this order

9	Law enforcement agencies in detecting, investigating, and prosecuting criminal activity related to digital assets	Within 180 days of the date of this order
10	The economic, energy, environmental and climate impacts of distributed ledger technologies in the short to medium and long term.	Within 180 days of the date of this order
11	Update the report , including to address any knowledge gaps	Within 1 year of submission of the report
12	Enhancing United States economic competitiveness in, and leveraging of, digital asset technologies	Within 180 days of the date of this order
13	The specific financial stability risks and regulatory gaps posed by various types of digital assets and providing recommendations to address such risks	Within 210 days of the date of this order
14	The illicit financial risks associated with digital assets and the tendency to use it illicitly.	Within 90 days of submission to the Congress
15	Coordinated action plan based on the Strategy's conclusions for illicit finance and national security risks	Within 120 days of submission to the Congress
16	Address digital asset illicit finance risks	Within 120 days of completing the money laundering, terrorist financing and proliferation financing risk assessment

These reports may have the following implications:

Number	Possible Impact
1,2,3,9	The United States is going to address international crime mediated by digital assets with a start. First, it will quickly develop a game plan to advance international investigations and law enforcement to combat the use of crypto-assets for transnational money laundering, terrorist financing, proliferation financing, and other criminal activities. This would be followed by clarifying the principles of law enforcement agencies and establishing a framework and principles for international cooperation, extending the pursuit of individual cases to the build up of long-term mechanisms. Since crypto assets often have to pass through exchanges before they can be exchanged for fiat currency, strict monitoring of exchanges may be a necessary policy.
4,5,6,8	Assess the impact of CBDCs, how many resources are needed to support them, and how to do so. The report needs to be clear on the relationship and impact of global sovereign and privately issued currencies with the U.S. financial system. The very fact that such a comprehensive executive order can be issued suggests that the US will not take a simple one-size-fits-all approach to cryptocurrencies and stablecoins, and is likely to strengthen regulation of stablecoin issuers, requiring them to disclose more information and reduce liquidity risk, among other things.
7	An assessment of whether consumers, investors, and businesses in the use of digital assets are protected sufficiently. There may be policy recommendations to protect the above populations, and the SEC, CFTC, FTC and other agencies will implement specific policies based on this report.
10,11	Discuss the economic and environmental impacts of crypto mining. The economic, technological, energy, and environmental consequences should be considered in a holistic manner and watched continuously. It may be possible to nurture US mining industry into a period of smooth development.

12	Technological innovation will be encouraged, and some crypto companies with deep technical capabilities will receive preferential policies.
13	Identify the financial risks and regulatory gaps in various types of digital assets. This report will be released later, and may have the purpose of checking for leaks in previous reports. The tone of this report should be dim and will point out a lot of risks, and it may be issued later to prepare the market psychologically and avoid panic in the crypto industry. It may lead issuers of crypto financial products to reduce risk and optimize design.
14,15,16	These reports are all about illicit financial risks. Strict authentication and transfer amount controls for both originators and recipients of crypto-asset transfers may be introduced, with stricter scrutiny of affiliations between users. Privacy-type items are likely to be a focus of attention.

THE END