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NAFCU

ISSUE BRIEF

Digital Assets

EXECUTIVE SUMMARY

As an early patchwork of digital asset regulation makes clear, digital assets' accelerating adoption poses unique challenges and opportunities for credit unions. The National Association of Federally-Insured Credit Unions (NAFCU) is committed to ensuring credit unions remain competitive and has already helped spur the publication of much-needed digital asset guidance from the National Credit Union Administration (NCUA). However, we remain in the early stages of digital assets' evolution, adoption, and integration into the broader economy.

Those digital asset conversations that do not get unnecessarily mired in technical jargon are all too often peppered with largely meaningless buzzwords. This Digital Assets Issue Brief is intended to help cut through that noise and better position credit unions to compete on a level digital assets playing field. The goal is to help readers better understand the meaningful differences between cryptocurrencies, stablecoins, and central bank digital currencies (CBDCs), how different digital asset networks operate, how digital assets are currently being used and may be used, and how federal agencies and Congress are approaching digital assets' early regulation. NAFCU will continue to update this Issue Brief to provide readers insight into digital asset developments most meaningful to credit unions.

BACKGROUND

While cryptocurrencies, stablecoins, and CBDCs may share a great deal in terms of their creation, transmission, and safekeeping, these digital assets have meaningful differences. For example, the terms currency and coin are often thought to be synonymous with the term money, and, in many circumstances, the distinctions are hardly meaningful. When something simultaneously serves as (1) a store of value, (2) a unit of account, and (3) a medium of exchange, that something is money – be it a cowrie shell, a precious metal, or the U.S. dollar. However, when something adopts a currency label but fails to meet the aforementioned three-part test, the differences between that something and money are fundamentally important. Some digital assets, particularly CBDCs when used in their respective jurisdictions, may be fairly considered digital money, but other digital assets are more closely analogous to equity or debt securities or securities derivatives. How closely a digital asset resembles one or more of these more traditional assets plays a leading role in determining if, how, and by whom the digital asset is and may be regulated.

Cryptocurrencies

Cryptocurrencies are perhaps the most oft-discussed and, arguably, least understood type of digital asset. Several cryptocurrency whitepapers and at least one deployed cryptocurrency project preceded the October 31, 2008, publication of *Bitcoin: A Peer-to-Peer Electronic Cash System*. However, for all intents and purposes, the mining of Bitcoin's genesis block sometime in early January 2009 laid the foundation for what is now a digital asset market that has neared a $3 trillion total valuation.

Cryptocurrencies, like Bitcoin, are created, exist, and are transferred on cryptocurrency networks developed by private individuals and private organizations, not central banks. The typical cryptocurrency network is a peer-to-peer (P2P) network comprised of many personal computers, or nodes. Each node maintains an identical copy of the cryptocurrency network's ledger, its entire history – from its first mining event to its most recent transfer of ownership, and networks often have nodes in dozens of countries and territories across the world.[1] Whereas the Federal Reserve System's ledger of institutional accounts, is largely inaccessible to the public, anyone with an internet connection may freely access the entire history of many cryptocurrency networks. Those interested in reviewing the Bitcoin network's history, as voluminous as it is, may track any individual Bitcoin from its mining, through every transaction of which it has been a part, and to the digital wallet in which it is held today.[2]

Broadly speaking, when a cryptocurrency network participant requests to transfer cryptocurrency from one digital wallet on the network to another, network nodes simultaneously attempt to authenticate the request. To authenticate a request, a network node must match the private cryptographic key provided by the purported sender to the private cryptographic key of a digital wallet on the network and confirm that the digital wallet contains at least the amount of cryptocurrency requested to be sent. Once the requisite number of network nodes can authenticate a transfer request, the transfer request is validated and its information appended to each copy of the network's ledger. If a sufficient number of network nodes are unable to authenticate a transfer request, the transfer request is completely rejected. This process, broadly

[1] Bitcoin network nodes operate not only in countries and territories with major world economies but also in as sparsely populated areas as the Faroe Islands (1) and in as economically-challenged countries as Kyrgyzstan (3).
[2] At any given moment, a small number of the largest Bitcoin wallets are likely to each hold 100,000+ Bitcoins. Transactional histories suggest many of the largest wallets are under common control, with the largest collection of ostensibly connected wallets containing in excess of 1 million Bitcoins, or roughly 5% of the 21 million Bitcoins that may ever be mined.

referred to as distributed ledger technology (DLT), may be used to facilitate not only recordkeeping functions but even execute embedded monetary policy. [3]

How accepted changes are appended to a cryptocurrency network's distributed ledgers depends on the type of DLT the network uses. While blockchain technology, used by both the Bitcoin and Ethereum networks, predominates the digital asset market in terms of both transaction value and volume, it is just one type of DLT. In a blockchain network, information about many different accepted changes is stored in "blocks" that are then "chained" to the network's distributed ledgers. Other types of DLT include Tangle, DAG, Hashgraph, Holochain, and Tempo.

Beyond these somewhat subtle differences in their digital infrastructure, cryptocurrency networks are also distinguishable in terms of their participant populations. Private cryptocurrency networks, most often used in commercial contexts, expressly limit who may participate and what roles participants may serve. Some private networks are leveraged to facilitate high-value transactions somewhat anonymously, like Wall Street's dark pools in which large blocks of securities trade amongst institutional investors wary of spooking public markets. Other private networks are utilized to make routine but data-heavy commercial processes, like supply chain tracking, less time-consuming and more cost-effective.

Permissioned cryptocurrency networks are semi-private. While the number of participants in a permissioned network is not static, as is the case with private networks, a permissioned network's operator serves as a gatekeeper of sorts, granting and revoking participants' access to the permissioned network.

Public, or permissionless, cryptocurrency networks, like the Bitcoin and Ethereum networks, are far and away the most common at present. While public networks have a founding participant and follow embedded governance protocols, anyone with an internet connection may freely engage a public network. El Salvador President Nayib Bukele made world news in June 2021 when he led efforts to afford Bitcoin legal tender status in El Salvador.[4] The El Salvadoran government has encouraged citizens' use of Bitcoin by providing small amounts of Bitcoin to individuals who sign up for a

[3] A cryptography network may include one or more cryptocurrency supply mechanisms that drive cryptocurrency mining and burning, or destruction.
[4] The U.S. dollar, which replaced the El Salvadoran colón in 2001, is the only other currency afforded legal tender status in El Salvador.

government-sponsored digital wallet and has enabled citizens to pay federal taxes with Bitcoin.

Stablecoins

Stablecoins comprise a significant portion of the digital asset market. As of late February 2022, Tether's USDT has a market capitalization of nearly $80 billion. For comparison, the Bank for International Settlements estimated that the equivalent of roughly $68.71 billion of Mexican currency and $64.4 billion of Canadian currency was in circulation at the end of 2016. At that time, there was just under $10 million of USDT in circulation. Like cryptocurrencies, stablecoins are created, exist, and are transferred on networks developed and operated by private individuals and organizations, not central banks. Cryptocurrencies and stablecoins, however, part company when it comes to an issue often front and center in digital asset discussions – price elasticity. While Bitcoins have variously traded for less than a U.S. penny and more than $68,000, stablecoins are designed to mirror a specific fiat, most often the U.S. dollar.

In the United States, though depository institutions, bond issuers, and money market mutual funds, just to name a few, are subject to strict financial reporting and auditing standards, no such standards have yet been broadly applied to stablecoin issuers. In the absence of such standards, stablecoin issuers have employed various practices to stabilize stablecoin prices. Tether purports to maintain $1 of cash or cash-equivalent in reserves for every USDT it issues. MakerDAO, a Decentralized Autonomous Organization that operates on the Ethereum network, on the other hand, does not make significant use of fiat or fiat-equivalent reserves to support the roughly $6.5 billion DAI market. MakerDAO maintains excess digital asset collateral, mostly Ethereum, well over a DAI-to-dollar ratio and employs automated portfolio management and market maker strategies designed to ensure DAI regularly trades within a relatively small tolerance of $1 on major cryptocurrency exchanges even during periods of extreme cryptocurrency market volatility.[5]

Central Bank Digital Currency

A CBDC, as the name implies, is issued by a central bank and, in its respective jurisdiction, has legal-tender status. Presently, central banks in the Bahamas, six independent states and one British Overseas Territory in the Eastern Caribbean, and Nigeria, have officially issued a CBDC. To date, no central bank that has issued a CBDC has intimated it expects its CBDC to fully displace its traditional fiat. Furthermore,

[5]MakerDAO's digital currency collateral, unlike Tether's dollar-denominated deposits and more traditional debt instruments custodied by banks and broker-dealers, is publicly viewable on the Ethereum network.

considering the first-of-its-kind Bahamian Sand Dollar was launched only in October 2020, CBDCs' use remains largely limited to early technology adopters.

If, as seems likely, the People's Bank of China (PBOC) moves its digital renminbi, or digital yuan or e-CNY, beyond the present public testing phase, China would likely be the world's first major economy central bank to officially issue a CBDC. Early distributions of e-CNY have been affected primarily through state-sponsored lottery distributions in relatively small communities. The PBOC announced in late December 2021 that Chinese citizens and foreign visitors to the Beijing 2022 Winter Olympics, even those without a Chinese bank account, would be able to transact in e-CNY throughout the Beijing Olympic Village and related venues. Shortly thereafter, in January 2022, the PBOC announced that WeChat, a Chinese messaging and payments service app with an estimated one billion individual users, will begin supporting e-CNY payments alongside more traditional payments. In mid-February 2022, the PBOC reported Chinese citizens and foreign visitors to the Beijing Olympic Village were spending the equivalent of roughly $315,000 in e-CNY per day.

In the United States, on January 20, 2022, the Board of Governors of the Federal Reserve System (Federal Reserve) released its CBDC discussion paper and request for comment entitled Money and Payments: The U.S. Dollar in the Age of Digital Transformation. In what the Federal Reserve describes as its "first step in a public discussion" about CBDCs with stakeholders, the Federal Reserve states it is interested in fostering deeper discussions of a digital U.S. dollar's potential benefits and risks without advancing specific policy decisions. The Federal Reserve takes pains to make clear it feels the decision as to whether or not it should issue a digital U.S. dollar is best left to Congress and the White House but adds that, if a digital U.S. dollar is to be issued, a privacy-protected, intermediated, widely-transferrable, and identity-verified digital U.S. dollar would best serve Americans.

On February 3, 2022, the Federal Reserve Bank of Boston (Boston Federal Reserve) and the Massachusetts Institute of Technology's (MIT) Digital Currency Initiative released the much-anticipated initial findings of *Project Hamilton*, a multi-year CBDC research collaboration. The Project Hamilton team's early research revolves around the creation and testing of a high-performance, resilient CBDC core transaction processor. One of the two CBDC network architectures the Project Hamilton team tested is theoretically capable of handling up to 1.7 million transactions per second. For comparison, the Solana cryptocurrency network made world news relatively recently when it matched the Visa network's 65,000 transactions per second capacity.

REGULATION

The digital asset regulatory landscape is constantly shifting in the United States due to constant and varied innovation, increasing digital asset adoption, and the routine arrival and departure of regulatory agency heads, among other factors. This section will help readers better understand how various federal agencies are approaching digital assets' early regulation and pays particular attention to the NCUA's efforts and NCUA Board members' perspectives. While this section is structured largely to review the digital asset regulatory landscape on a federal agency-by-agency basis, readers should remain cognizant of regulatory overlap.

National Credit Union Administration

The NCUA has a long and reasonably consistent history of following the leads of the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller (OCC) when evaluating financial technology and financial product innovations.[6] Therefore, these other agencies' early regulatory roles in digital assets' evolution, discussed later in this section, may be particularly instructive for the credit union industry. The NCUA is also in the process of standing up its Office of Innovation and Access which will, among other responsibilities, help educate the NCUA Board and staff on digital assets' current applications as well as its potential uses and risks.

In response to the NCUA's July 2021 Request for Information and Comment on Digital Assets and Related Technologies (NCUA Digital Assets RFI), NAFCU encouraged the NCUA to promptly issue Letters to Credit Unions confirming (1) that a credit union may directly, or in partnership with a credit union service organization (CUSO) or another third-party vendor, host digital wallets for members, and (2) that a credit union may partner with a CUSO or other third-party vendor to facilitate members' buying, holding, selling, transferring, and exchanging digital assets. NAFCU also encouraged the NCUA to adopt a form-agnostic approach to assessing credit unions' adoption of digital assets and related technologies and to form a digital asset adoption sandbox or pilot program in which credit unions and the NCUA may jointly explore more novel digital asset use cases. Finally, NAFCU encouraged the NCUA to collaborate with other federal regulators and stakeholders to develop a common digital assets taxonomy. Ensuring that like digital assets receive like regulatory

[6]https://www.federalregister.gov/documents/2001/08/06/01-19103/federal-credit-union-incidental-powers-activities

treatment in all corners of the economy begins with ensuring that all prudential regulators use a common vocabulary and common digital asset classification schema.

In a December 15, 2021 letter to NCUA Chairman Todd Harper, NAFCU urged the NCUA to promptly respond to stakeholders' comments to the NCUA's Digital Assets RFI. NAFCU also encouraged the NCUA to more fully and proactively engage the President's Working Group on Financial Markets (PWG) and other federal regulators on digital asset issues, citing credit unions' seeming exclusion from the PWG's Report on Stablecoins and related comments by the heads of the OCC, FDIC, the U.S. Securities and Exchange Commission (SEC), and the Commodities Futures Trading Commission (CFTC). The NCUA, NAFCU noted, remained largely silent on uniquely significant digital asset issues despite the OCC's issuing three digital asset-related Interpretive Letters to national banks, the first of which was issued in June 2020.

On December 16, 2021, the NCUA published Letter to Credit Unions No. 21-CU-16, entitled *Relationships with Third Parties that Provide Services Related to Digital Assets*. In the Letter to Credit Unions, the NCUA addresses federally-insured credit unions' (FICUs) "already existing authority" under the *Federal Credit Union Act*'s (FCU Act) grant of incidental powers to engage third-party digital asset service providers to, among other activities, enable members to buy, sell, and hold uninsured digital assets with a third party. The NCUA makes clear that the NCUA, as FICUs' insurer, does not prohibit FICUs from establishing such relationships and will evaluate FICUs' relationships with third-party digital asset service providers in the same manner the NCUA evaluates all other third-party relationships. Concerning all third-party relationships, the NCUA goes on to explain, the NCUA evaluates whether a FICU has exercised sound judgment, conducted the necessary due diligence, risk assessments, and planning and established effective risk management, monitoring, and control practices before introducing members to a third party.

In the Letter to Credit Unions, the NCUA also reminds credit unions of their various responsibilities related to consumer protections, cybersecurity, the *Bank Secrecy Act* (BSA) and anti-money laundering (AML) regulations, the Office of Foreign Assets Control's (OFAC) sanctions requirements, and other safety and soundness practices. While the NCUA recognizes that credit unions are not limited in the types of third-party relationships in which they may engage, the NCUA commits to "look[ing] to provide further clarifications and guidance" in the rapidly evolving digital asset environment.

As it did in Letter to Credit Unions No. 21-CU-16, the NCUA can be expected to apply a three-prong test when determining whether hosting members' digital wallets is a permissible credit union activity under the FCU Act's grant of incidental powers. To be deemed a permissible exercise of an incidental power under the FCU Act, a proposed credit union activity must be "convenient or useful in carrying out the mission or business of credit unions consistent with the FCU Act." A proposed activity must also be the functional equivalent or a logical outgrowth of activities already supporting such credit union mission or business and pose risks similar to those already assumed by credit unions carrying out such business.

Hosting members' digital wallets, NAFCU has argued, advances credit unions' mission to be their members' primary financial institution and may provide credit unions convenient and useful insight into how they may better serve members. Hosting members' digital wallets, too, is the functional equivalent of credit unions providing members safety deposit boxes and poses no dissimilar risks. Just as a credit union is responsible for safeguarding against a safety deposit box's unauthorized physical access, a credit union would be responsible for safeguarding against a digital wallet's unauthorized electronic access. And just as the undulating values of gold and silver coins and bars held by a member in a safety deposit box do not impact a credit union, neither would the undulating values of any digital assets held by a member in a digital wallet hosted by a credit union.

NCUA Board Members' Individual Views

While NCUA Chairman Todd Harper has recognized that credit unions' use of digital assets and related technologies may significantly reduce operational costs and increase transaction speeds, Harper has relatedly voiced concerns about consumer protections, BSA/ AML compliance, and the integrity of the National Credit Union Share Insurance Fund (NCUSIF). Harper has stated that the digital asset market's fast-changing nature demands a bottom-up approach and will require credit union industry stakeholders to keep the NCUA routinely apprised of members' demands and credit unions' efforts to meet those demands. Harper has stressed that the NCUA must commit to working more fully with other federal regulators to ensure all financial institutions may compete on a level regulatory playing field free of regulatory arbitrage opportunities.[7] Concluding that many credit unions interested in providing their members access to digital assets or otherwise adopting related technologies are likely to rely on CUSOs or other third parties, Harper continues to call on Congress to

[7] NCUA Board Meeting, July 22, 2021.

grant the NCUA examination and enforcement authorities over CUSOs and certain other third parties contracting with FICUs.

Vice Chairman Kyle Hauptman is broadly supportive of credit unions' exploring how their adoption of digital assets and related technologies may support their members. Broader digital asset adoption, Hauptman points out, could enable credit unions to facilitate remittances, on which many members' relatives and friends in less developed nations acutely rely, with greater speed and security and at lower costs. Hauptman regularly cautions that regulators' failing to permit credit unions to safely and soundly adopt new technologies unnecessarily risks the entire credit union industry quickly becoming obsolete.[8]

Similarly, Board Member Rodney Hood stresses the NCUA must not be caught flatfooted concerning new technologies and routinely encourages credit unions to safely explore financial innovations, particularly those with the potential to increase access to high-quality credit and deposit services for traditionally unserved and underserved communities. In remarks at NAFCU's 2021 Congressional Caucus, Hood expressed hope the soon-to-be-named Director of the NCUA's Office of Innovation and Access will collaborate with similar domestic and international offices to explore how financial institutions may look beyond facilitating the buying and selling of digital assets and more fully explore DLT's potential to drive operational efficiencies.[9]

Office of the Comptroller of the Currency

On July 23, 2020, the OCC released Interpretive Letter #1170 confirming that the safekeeping and custody of cryptocurrency and crypto-assets are traditional banking services and are, therefore, permissible national bank and savings association activities, provided financial institutions manage related risks and comply with all applicable laws. Roughly two months later, on September 21, 2020, the OCC released Interpretive Letter #1172, which provides that national banks and savings associations may accept stablecoin issuers' dollar-denominated deposits. In OCC Interpretive Letter #1172, the agency specifically reminded national banks and savings associations of their responsibilities to ensure that all deposit activities comply with BSA/AML regulations. Recognizing that stablecoin issuers could face "significant liquidity risks", the OCC encouraged national banks and savings associations interested in accepting stablecoin issuers' deposits to consider entering into contractual agreements with their stablecoin issuer-depositors to "verify and ensure that the deposit balances held

[8] Id.
[9] Id.

by the bank for the issuer are always equal to or greater than the number of outstanding stablecoins issued by the issuer."

OCC Interpretive Letter #1174, released in January 2021, authorizes national banks and savings associations to use stablecoins and related technologies to perform bank-permissible functions, including payment activities. In OCC Interpretive Letter #1174, the agency states that stablecoin payment systems are akin to other widely-used electronically stored value systems (ESVs) and that the "creation, sale, and redemption of [ESVs] in exchange for dollars is part of the business of banking because it is the electronic equivalent of issuing circulating notes or other paper-based payment devices like traveler's checks." Relatedly, the OCC indicates that stablecoins can serve as electronic representations of U.S. dollars, similar to how value is stored on an ESV card. OCC Interpretive Letter #1179 urges interested national banks and savings associations to consult with OCC supervisors before engaging in stablecoin payment activities and to remain vigilant of digital assets' potential use in illegal and illicit activities.

Testifying before the House Committee on Financial Services in May 2021, Acting Comptroller of the Currency, Michael Hsu, compared the OCC's and other agencies' approaches to regulating digital asset activities to the "fragmented agency-by-agency approach" taken in the 1990s and 2000s. Hsu shared that he has asked staff to review prior OCC actions, including Interpretive Letters related to the chartering of certain national banks and trust companies intending to provide digital asset-focused services. Hsu expressed concern that by providing charters to financial technology companies (fintech), regulators could grant fintechs significant economic benefits without corresponding regulatory responsibilities and, thereby, encourage the growth of a shadow banking system beyond regulators' insight and control. Unlike his predecessor, Hsu committed that any new charters issued by the OCC will have to be granted "in coordination with the FDIC, Federal Reserve, and the states."

Securities and Exchange Commission

In a September 14, 2021 hearing before the Senate Banking Committee, SEC Chairman Gary Gensler expressed his view that certain stablecoins could be securities subject to SEC jurisdiction. Roughly two weeks later, the PWG, in coordination with the FDIC and the OCC, released its Report on Stablecoins, which calls on Congress to pass comprehensive payment stablecoin legislation. Gensler shortly thereafter stated the SEC will, irrespective of Congressional inaction, take an active role in bringing stablecoins into an "investor protection framework."

Gensler has repeatedly pointed to burgeoning investor demand for the above-market returns promised by stablecoin issuers and digital asset market makers when arguing that federal regulatory oversight is necessary to ensure stablecoins can be safely incorporated into the broader financial system. While Gensler consistently maintains the SEC has the requisite authority to regulate the majority of not only cryptocurrencies and stablecoins but also the broader digital asset market, Gensler has also recognized a role for the CFTC in nascent digital asset derivatives markets. Gensler has also urged digital asset entrepreneurs to work with the SEC to understand how their projects may work within existing regulatory frameworks and to "actually think about the full protections that our investor protection and consumer protection and banking laws have."

Board of Governors of the Federal Reserve System

Federal Reserve Chairman Jerome Powell stated on October 1, 2021, that the Federal Reserve has no plans to ban cryptocurrencies but that he feels stablecoins should be regulated, drawing parallels between stablecoins and money market funds. According to a report issued by the Federal Reserve on October 6, 2021, a "shifting payments landscape" and the "rapid growth" of both the private sector and foreign CBDCs could reduce reliance on the U.S. dollar. The report found that changing consumer and investor preferences, combined with the prospect of additional financial technology innovations, could shift the balance of perceived costs and benefits enough to overcome some of the inertia that helps preserve the U.S. dollar as the world's reserve currency. The Federal Reserve report concludes, however, that digital assets are unlikely to ever fully usurp the U.S. dollar's world-leading role, stating "It is unlikely that technology alone could alter the landscape enough to completely offset the long-standing reasons the dollar has been dominant."

U.S. Department of the Treasury

As mentioned previously, the PWG, in coordination with the FDIC and the OCC, released its Report on Stablecoins on November 1, 2021. It is worth noting that the PWG, established in March 1988 in direct response to the events of 1987's Black Monday, is chaired by the Secretary of the U.S. Department of the Treasury (Treasury) or her or his designee and is further comprised of the chairpersons of the Federal Reserve, the SEC, and the CFTC, or their respective designees.[10] Despite recognizing in the Report on Stablecoins that both the SEC and CFTF already have significant

[10] On Monday, October 19, 1987, the Dow Jones Industrial Average fell a still-record 22.6%. In addition to nearly 200 trading delays and halts, the Fedwire real-time gross settlement funds system and the New York Stock Exchange's SuperDot order routing system failed intermittently during the record selloff.

enforcement, rulemaking, and oversight authorities applicable to a range of digital assets and related activities, the agencies call on Congress to enact comprehensive federal legislation that:

- Requires stablecoin issuers to be insured depository institutions;
- Limits stablecoin issuers' and custodial digital wallet providers' affiliation with commercial entities;
- Authorizes a stablecoin issuer's prudential regulator to require that any entity performing activities critical to the stablecoin issuer's stablecoin arrangement meet risk-management standards;
- Authorizes a stablecoin issuer's prudential regulator to implement standards promoting stablecoins' interoperability; and
- Subjects custodial digital wallet providers to federal oversight.

In support of their recommendations in the Report on Stablecoins, the agencies address several risks related to payment stablecoins, including the risk of a "run" on a stablecoin's issuer. If a significant portion of a stablecoin's investor base was to lose confidence in a stablecoin's reserves, the agencies caution, "a self-reinforcing cycle of redemptions and fire sales of reserve assets" could produce devastating results that not only drag down the entire stablecoin market but could, perhaps, spillover to otherwise safe, prudently managed sectors of the broader economy.

In the Report on Stablecoins, the agencies' reference to the *Federal Deposit Insurance Act*'s (FDI Act) definition of an insured depository institution, a definition which includes only banks and savings associations, appears to ignore the credit union industry entirely. The agencies' primary recommendation may, therefore, be read to suggest that Congress enact legislation requiring stablecoin issuers to obtain a bank charter or savings association charter – not a bank charter, a savings association charter, or a credit union charter. Notably, former FDIC Chair Jelena McWilliams commented shortly before her abrupt departure that the FDIC is sorting through potential ways "to apply the deposit insurance scheme to different potential stablecoin arrangements." NAFCU wrote to Treasury Secretary Janet Yellen, urging the PWG to clarify that credit unions, as insured depository institutions, have parity with banks concerning the Report on Stablecoin's recommendations to Congress and urging the PWG to support the NCUA's inclusion in ongoing and future PWG efforts. As mentioned above, NAFCU also asked NCUA Chairman Harper to engage with the PWG.

Treasury's Financial Crimes Enforcement Network and Office of Foreign Assets Control

To combat digital assets' use in money laundering operations and terrorist financing, the Treasury's Financial Crimes Enforcement Network (FinCEN) has been proactive in its stance on convertible virtual currencies (CVC). FinCEN defines CVC as "a medium of exchange, such as a cryptocurrency, that either has an equivalent value as currency, or acts as a substitute for currency, but lacks legal tender status". Relatedly, FinCEN deems certain individuals and businesses engaged with CVCs to be money transmitters required to register with FinCEN as a money service business (MSB) under a 2011 final rule and subject to Internal Revenue Service compliance examinations.

FinCEN exercises the authority granted by the BSA to the Secretary of the Treasury to impose AML program requirements on a broad range of financial institutions, including MSBs. Broadly speaking, an MSB must (1) establish a written AML program reasonably designed to prevent the MSB from being used to facilitate money laundering or terrorism financing; (2) file currency transaction reports and suspicious activity reports; and (3) maintain records relating to currency purchases of certain monetary instruments, currency dealer or exchanger transactions, and certain other fund transmittals.

In 2019, former FinCEN Director Kenneth Blanco reiterated that FinCEN applies a "technology-neutral" regulatory framework. FinCEN, Blanco emphasized, regulates the "*activity* of money transmission", not simply the transmission of fiat or some types of money transmission activities. Blanco referenced 2008 FinCEN interpretive guidance, which predates even the Bitcoin whitepaper, in support of FinCEN's determination that stablecoins are a type of CVC and that stablecoin issuers are MSBs based on their accepting and transmitting activity denominated in U.S. dollars. Also in 2019, FinCEN released Advisory FIN-2019-A003, which discusses a range of observed illicit activity involving CVCs, and Interpretive Guidance FIN-2019-G001, which addresses the application of FinCEN regulations to certain businesses engaged with CVCs, including P2P CVC exchangers, digital wallet hosts, and CVC ATM operators.

FinCEN has taken several enforcement actions against money transmitters that have failed to register as an MSB. FinCEN's Digital Currency Advisor, added in 2021, assists in developing FinCEN's CVC policies. A final rule establishing recordkeeping, verification, and reporting requirements for certain un-hosted digital wallet CVC transactions involving a financial institution is expected in the near term. In October 2021, OFAC issued sanctions compliance guidance for the virtual currency industry

that clarifies how OFAC obligations apply to transactions involving virtual currency, explores industry best practices, and outlines the responsibilities of a U.S. person holding virtual currency required to be blocked by OFAC regulations.

United States Department of Justice

In October 2020, the United States Department of Justice's (DOJ) Cyber-Digital Task Force released *Cryptocurrency: An Enforcement Framework*. The DOJ report reviews cryptocurrencies' role in illegal and illicit activities, including money laundering and impermissible tax-sheltering, and describes the tools currently available to federal government agencies responsible for addressing such issues.

LEGISLATIVE OUTLOOK

Lawmakers continue to attempt to better understand digital assets, including both the potential benefits and risks to consumers and financial markets. The 117th Congress has addressed a host of digital asset issues, notably in some of its most significant, much-covered legislation. Both the bipartisan *Infrastructure Investment and Jobs Act*, enacted in November 2021, and the latest version of the yet-enacted *Build Back Better Act* budget reconciliation package contain provisions clarifying existing tax provisions' application to digital assets.

Both the House Financial Services Committee and the Senate Banking Committee have held hearings on digital assets, including CBDCs. While lawmakers frequently note digital assets' innovation potential, hearings on digital assets have also invariably featured calls for regulation and heard concerns regarding digital assets' use in illegal and illicit activities and the negative environmental impacts of energy-intensive proof-of-work cryptocurrency networks. NAFCU anticipates that both the House and Senate will continue to hold hearings on digital assets in 2022 and beyond.

A Digital U.S. Dollar

CBDC advocates in Congress variously cite the potential for a digital U.S. dollar to support greater financial inclusion, increased payment transactions speed and security, decreased payment transaction costs, and the need to protect the U.S. dollar's preeminence as the world's reserve currency, particularly in light of China's testing its e-CNY. In the House, both the *Central Bank Digital Currency Study Act* and the *21st Century Dollar Act* (H.R. 2211 and H.R. 3506, respectively) mention China's CBDC pilot and would require federal agencies to study the likely financial market impacts of a digital U.S. dollar's introduction and relevant macroeconomic policy

considerations. In the Senate, S. 2543, *A bill to require a study on the national security implications of the People's Republic of China's efforts to create an official digital currency*, would require federal agencies to study the likely impacts of a Chinese CBDC on the United States' national security, and S. 2864, *A bill to require the Secretary of the Treasury to submit to Congress a report on virtual currencies and global competitiveness*, would require the Treasury to further study- and report on public and private industry uses of digital assets and related technologies.

Stablecoin Innovation and Protection Act of 2022

U.S. Representative Josh Gottheimer (D-NJ) introduced the *Stablecoin Innovation and Protection Act of 2022* on February 14, 2022. Under the proposed legislation, a "qualified stablecoin" is any cryptocurrency or other privately-issued digital financial instrument that is redeemable, on demand, on a one-to-one basis for U.S. dollars and is issued by either an insured depository institution or a nonbank qualified stablecoin issuer. The proposed legislation clarifies that a "qualified stablecoin" is neither a security nor a commodity for the purposes of federal or state laws. Nonbank qualified stablecoin issuers would be subject to OCC regulation and oversight and required "to maintain collateral in an amount equal to 100 percent of the value of [the issuers'] outstanding qualified stablecoins." The OCC would be charged with more fully defining what types of collateral a nonbank qualified stablecoin issuer could maintain to meet the requirement and outlining permissible collateral portfolio compositions. Nonbank qualified stablecoin issuers would be required to deposit any cash collateral in segregated accounts maintained at insured depository institutions.

In its present form, the proposed legislation does not set any collateral requirements for insured depository institution qualified stablecoin issuers and would leave their regulation to their present prudential regulators. Notably, the proposed legislation seemingly excludes credit unions, like the PWG's Report on Stablecoins, by limiting the definition of "insured depository institutions" to those banks and savings associations covered by the FDI Act. Beyond adopting this unnecessarily restrictive definition, the proposed legislation would also establish a qualified stablecoin federal deposit insurance program operated solely by the FDIC.

Other Legislation

Lawmakers generally more critical of digital assets have introduced bills to improve the government's understanding of digital assets and related technologies with a focus on national security and expanding prudential regulators' authorities. H.R. 296, the *Financial Technology Protection Act*, for example, would establish an independent task

force to research and annually report on the use of cryptocurrencies to finance terrorism and facilitate other criminal activities. H.R. 4741, the *Digital Asset Market Structure and Investor Protection Act*, would expand the CFTC's and SEC's respective jurisdictions over a broad range of digital assets, provide that certain digital assets are monetary instruments under the BSA, and require transactions not on public ledgers to be reported.

The below bills were passed in the House of Representatives with strong bipartisan support and await further action in the Senate:

- H.R. 1602, the *Eliminate Barriers to Innovation Act of 2021*, would require the SEC and the CFTC to establish a working group to study existing regulations and make recommendations on fairness, cybersecurity, and the reduction of fraud and manipulation in the digital asset market.
- H.R. 3723, the *Consumer Safety Technology Act*, would require the Department of Commerce to conduct a study on potential uses of blockchain technology to reduce fraud and promote consumer protections, as well as identify federal blockchain regulations that could be modified to promote innovation. The bill would also require the Federal Trade Commission to report on its efforts to combat unfair or deceptive trade practices related to digital assets.

Other recently introduced legislation touches on a broad range of digital asset issues. The *Blockchain Promotion Act*, bipartisan legislation introduced in both the House and Senate (H.R. 3612 and S. 1869), focuses on developing the federal government's understanding of DLT and its potential uses in federal agencies. The *Virtual Currency Consumer Protection Act of 2021* and the *US Virtual Currency Market and Regulatory Competitiveness Act of 2021* (H.R. 5100 and H.R. 5101, respectively) would direct the CFTC to recommend regulatory changes to prevent digital asset markets' manipulation and streamline regulations to promote competition and innovation.

CONCLUSION

This Digital Asset Issue Brief is intended to provide readers a fuller understanding of the most impactful types of digital assets, how different digital asset networks are designed and operated, how various digital assets are and can be used, and how regulators and lawmakers are approaching digital assets' early regulation. Just as digital assets' rapid evolution and proliferation will require continuing digital assets education, this Issue Brief will require regular, and sometimes significant, updates. This

Issue Brief will serve as a useful primer and resource for credit unions entering, or considering entering, the digital assets space and will be supplemented with in-depth analysis and communication from NAFCU's award-winning advocacy team. While NAFCU does not intend to track every digital asset innovation, application, or discussion, NAFCU is committed to being the premier resource for information on digital asset issues most important to credit unions.