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Treasury Secretary Delivers Key Remarks on Digital Assets Regulation - Three Takeaways

Janet Yellen, Secretary of the Treasury and former chair of the Federal Reserve, delivered remarks on digital assets policy, innovation, and regulation late last week. Her remarks addressed President Biden's March Executive Order on Ensuring Responsible Development of Digital Assets (Executive Order) and the broader development of US digital assets regulation, including cryptocurrency, stablecoin, and central bank digital currency (CBDC).

Secretary Yellen's remarks included the following five broad structural themes. First, the U.S. financial system benefits from responsible innovation. Second, when regulation fails to keep pace with innovation, vulnerable people often suffer the greatest harm. Third, regulation should be based on risks and activities, not specific technologies. Fourth, sovereign money is the core of a well-functioning financial system and the US benefits from the central role the dollar and US financial institutions play in global finance. Fifth and finally, we need to work together to ensure responsible innovation. These five themes provide an informative sense of how Treasury views digital assets regulation and the development of frameworks to address digital assets. In addition, Secretary Yellen's remarks provided a more detailed look at the risks and benefits that are top-of-mind as well as indications of how Treasury may shape the regulation of digital assets going forward. Three key takeaways from the remarks are addressed below.

1. Reducing risk through regulation

As the Secretary noted, "digital assets have grown explosively, reaching a market cap of $3 trillion last November from $14 billion just five years prior." This meteoric rise has generated a range of new financial "possibilities and risks." Throughout her remarks, the Secretary discussed various types of risks concerning digital assets, including systemic risk (which can contribute to economic instability), illicit finance risk (fraud, theft, privacy and data breaches, and unfair and abusive practices), and national security risk (tax evasion, money laundering, and avoiding sanctions). As Secretary Yellen noted, these types of risks are not specific to digital assets and are inherent in many types of financial dealings. For example, the Secretary alluded to the Global Financial Crisis where "shadowbanks [and] subprime mortgage-backed securit[ies]" allowed dangerous levels of risks to accumulate, which led to significant economic distress. In short, while the technology driving digital assets may be new, many of the issues digital assets present are not, and existing regulatory frameworks can serve to guide the development of the digital assets space.

The Secretary discussed that the prices of "cryptocurrencies have been quite volatile, which has inhibited their widespread use in payments," and that the "adoption of cryptocurrencies for payments may be further inhibited by high fees and slower processing times than those associated with other forms of payment." Stablecoins (a type of cryptocurrency pegged to a stable source of value) may also be susceptible to instability, especially in times of economic stress. For example, the Secretary noted that "a stablecoin run occurred in June 2021, when a sharp drop in the price of the assets used to back a stablecoin set off a negative feedback loop of stablecoin redemptions and further price declines."

While the Secretary's comments could be perceived as negative at first blush, her overall tone was instead pragmatic. She acknowledged that the "growth in digital services has opened a world of possibilities" and said that "digital assets may be new, but many of the issues they present are not." For instance, she highlighted that though "inconsistent and fragmented oversight" currently hinder stablecoins, federal agencies and Congress are already working to "advance legislation to help ensure stablecoins are resilient to risks that could endanger consumers or the broader financial system." In short, the takeaway is that digital assets, like financial innovations more broadly, require regulatory frameworks "designed to support responsible innovation while managing risks."

2. The prominence of the US dollar and the complex considerations around potential development of a US CBDC

The US dollar is the reserve currency and the "mostly widely used currency for global trade and finance." The Secretary explained that the US dollar's prominence developed through a "dynamic process that took place over centuries" and "is strongly supported by US institutions and policies; US economic performance; open, deep and liquid financial markets; rule of law; and a commitment to a free-floating currency." Further, the Secretary emphasized that American citizen's "derive significant economic and national security benefits from the unique role the dollar and US financial institutions play in the global financial system." Given the prominence of the US dollar and its inherent benefits, the Secretary stressed that considerations of a CBDC must be viewed "in the context of the central role the dollar plays in the world economy."

President Biden's Executive Order requires agencies, including Treasury, to consider "the potential implications of a United States CBDC," including "design and deployment options" and "assessments of possible benefits and risks for consumers, investors, and businesses; financial stability and systemic risk; payment systems; national security; the ability to exercise human rights; financial inclusion and equity; and the actions required to launch a United States CBDC if doing so is deemed to be in the national interest." In her remarks, the Secretary said she does not yet know the conclusions they will reach regarding a potential CBDC. That said, the Secretary did make the important point that, in her view, "issuing a CBDC would likely present a major design and engineering challenge that would require years of development, not months."

3. Tech neutrality as it relates to the benefits and risks of digital assets

"Tech neutrality" has been a watchword adopted by federal agencies pursuing digital assets regulation. In her remarks, the Secretary said that "wherever possible, regulation should be "tech neutral." The basic concept of "tech neutrality," in this context, is that many types of risks and benefits can be similarly regulated regardless of the technology used. As Secretary Yellen explained by way of example, "the principle of tech neutrality is […] applicable to concerns related to tax evasion, illicit finance, and national security – topics that are particularly pertinent in the world today. It's illegal to evade taxes, launder money, or avoid sanctions. It doesn't matter whether you're using checks, wires, or cryptocurrency." The Secretary also highlighted that the federal government is already "updating [its] rules and guidance to clarify the application of our Anti-Money Laundering and Countering the Financing of Terrorism framework to the digital asset ecosystem."

Given the diversity of different types of digital assets, greater regulatory clarity regarding "tech neutrality" will be needed from federal agencies, Congress, and the federal government more broadly. Treasury appears ready to keep tech neutrality top-of-mind as it works towards shaping the regulation of digital assets.

4. Conclusion

Secretary Yellen's remarks reflect a pragmatic and measured approach to digital assets regulation. As she states "in my view, the government's role should be to ensure responsible innovation – innovation that works for all Americans, protects our national security interests and our planet, and contributes to our economic competitiveness and growth." Secretary Yellen addresses that there are divergent views when it comes to digital assets, where "some proponents speak as if the technology is so radically and beneficially transformative that the government should step back completely and let innovation take its course" and others "see limited, if any, value in this technology and associated products and advocate that the government take a much more restrictive approach." The Secretary's remarks suggest that Treasury seems to be taking a more middle-of-the-road approach when it comes to digital assets, advancing the development of regulatory frameworks "designed to support responsible innovation while managing risks."

Treasury is only one of several agencies that will play a key role in the development of digital assets regulation. Others include the SEC, FTC, CFTC, Federal Reserve, FDIC, and OCC. That said, leveraging existing regulatory frameworks to help address the risks and benefits of digital assets, addressing risk without unnecessarily limiting innovation, and promoting tech neutrality are surfacing as common themes in the regulation of digital assets, and it will be interesting to see the role they play as agencies and Congress continue to address and regulate this developing field.

If of interest, please find our previous alerts on the development of digital assets regulation:

- Forthcoming Bipartisan Legislation Regulating Digital Assets – March 28, 2022
- Congressional and Federal Agency Action Following Executive Order on Digital Assets Policy and Regulation – March 14, 2022
- Announced Cryptocurrency Executive Order Will Shape Federal Regulations for the $3 Trillion Digital Assets Market – March 9, 2022

If you have any questions concerning federal agency or Congressional action regarding the development of digital assets regulation and policy, please do not hesitate to reach out to Kilpatrick Townsend's Government and Regulatory practice contacts Stephen Anstey at sanstey@kilpatricktownsend.com or John Loving at jloving@kilpatricktownsend.com.

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