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Key Takeaways – Digital Assets (Cryptocurrencies, Stablecoins, Tokenization, and CBDCs)

by Stephen M. Anstey , Michael J. Breslin

With the rapid expansion and adoption of digital assets (cryptocurrencies, stablecoins, tokenized assets, and central banks digital currencies), companies of all types are being asked to address and interact with this growing sphere. These interactions, while increasingly necessary, are complicated by opaque compliance requirements, evolving regulations, pending legislation, shifting global standards, and increasing use cases.

This piece provides key takeaways arising from our previously published articles on the digital assets sphere: *The State of Digital Assets Regulation and Foundational Terminology* (the fifth most read article on JD Supra in January, 2023) and *A Brief Primer on Cryptocurrencies, Stablecoins, Tokenization, and Central Bank Digital Currencies* (the twelfth most read article on JD Supra in April, 2023).

1. Digital Assets Compliance is Already Critical

There is a common misconception that because of their novelty and in the absence of digital assets specific regulation digital assets are unregulated. This is not the case. Paradoxically, the lack of comprehensive digital assets specific regulation has led varying aspects of these assets to fall under the ambit of numerous U.S. regulatory agencies, including the SEC, CFTC, Treasury, Commerce, IRS, Fed, FDIC, and OCC. To date, the SEC, CFTC, and other regulatory agencies have brought numerous enforcement actions against entities in the digital assets space for violations of the Securities Act, the Securities Exchange Act, the Bank Secrecy Act (including Anti-Money Laundering and Countering The Financing Of Terrorism), Know-Your-Customer Procedures, and the Commodity Exchange Act. Agencies have also issued warnings concerning digital assets, including a recent SEC Investor Alert regarding *Exercising Caution with Crypto Asset Securities* and two Joint Statements by the Federal Reserve, FDIC, and OCC, one titled, a *Joint Statement on Crypto-Asset Risks to Banking Organizations* and the other a *Joint Statement on Liquidity Risks to Banking Organizations Resulting from Crypto-Asset Market Vulnerabilities*. Companies that are directly, and even tangentially, involved in the digital assets sphere should ensure that they have developed and are utilizing necessary compliance standards and procedures.

2. U.S. Regulation and Legislation Specific to Digital Assets Continues to Develop

Although certain U.S. regulators maintain that existing regulations and regulatory authority is sufficient to govern digital assets, this has not precluded the ongoing development of digital assets specific regulation and legislation or the amendment of existing regulations to effect digital assets. For example, the SEC recently published a proposed rule titled *Safeguarding Advisory Client Assets* which would amend custody rules as well as certain related recordkeeping and reporting obligations. Among its amendments, the proposed rule states that "most crypto assets are likely to be funds or crypto asset securities covered by the current [custody] rule[,]" and that "to comply with the proposed rule, an adviser with custody of client crypto assets would generally need to ensure those assets are maintained with a qualified custodian that has possession or control of the assets at all times in which the adviser has custody." Far reaching legislation that would define and regulate entire digital asset types has also been advanced. For example, the U.S. House Financial Services Committee recently published a "bill to provide requirements for payment stablecoin issuers, research on a digital dollar, and for other purposes." The proposed bill would provide significant stablecoin regulatory authority to the Fed and banking regulators, impose a two-year moratorium on new "endogenously collateralized stablecoins," and require the government to conduct a study and briefing for Congress on the U.S. issuing a central bank digital currency. The digitals assets regulation and legislation being developed in the U.S. will shape the course of and use cases for these assets going forward. As such, those effected by digital assets should be actively monitoring and taking part in the development of pertinent regulation and legislation.

3. Tokenized Assets (Tokenization) Will Significantly Expand the Digital Assets Sphere

Asset tokenization is the "process of digitally representing an existing real asset (e.g., securities, real estate, commodities, art, etc.) on a distributed ledger, [and] involves a public or private ledger that links the economic value and rights derived from these real assets with digital tokens." Because tokenized assets represent existing assets, tokenization has the potential to bring many of the benefits of digital asset technology (efficiency, transparency, fractionalization, and decentralization) to various industries. Tokenized assets are estimated to represent $5 trillion in value by 2030, and effect numerous sectors, including finance, energy, tech, media, supply chain and logistics, retail, healthcare, real estate, transportation, and manufacturing. While tokenization has the potential to bring new benefits to these sectors it also presents new challenges. From a regulatory and compliance standpoint, entities utilizing digital assets should be aware that federal agencies have signaled regulatory intent to group tokenized assets with cryptocurrencies, stablecoins, and similar types of digital assets. This means that tokenized assets, regardless of the underlying asset being tokenized, will potentially be governed by the SEC, CFTC, Treasury, or other relevant agencies.

4. CBDCs Will Affect Payments, Clearing, and Settlement on a Global Scale

Central Bank Digital Currencies (commonly referred to as CBDCs) "refer to a form of digital money or monetary value, denominated in the national unit of account, that is a direct liability of the central bank." Put another way, a CBDC "is a digital form of a country's sovereign currency." Many of the world's most significant economic players are actively developing CBDCs. China has already launched its CBDC, the digital Yuan, while Japan, India, Russia, Thailand, Malaysia, South Korea, and the United Arab Emirates have all established pilot phase programs for a potential launch of their respective CBDCs. Further, the U.S., EU, Australia, and UK are also actively exploring issuing their own CBDCs. CBDCs bring unique regulatory and technological challenges as it relates to payments, clearing, and settlement. Companies will be tasked with processing and tracking CBDC transactions, meeting a given nation's CBDC regulatory requirements, and facilitating payments between different CBDCs as well as countries with CBDCs and those utilizing traditional fiat currency.

5. Distributed Ledger Technology Use Cases Continue to Develop

Distributed ledger technology "such as blockchain technology, uses independent digital systems to record, share and synchronize transactions, the details of which are recorded simultaneously on multiple nodes in a network." Distributed ledger technology underlies and supports virtually all digital assets, and is "used to identify ownership of both [nonfungible tokens, including tokenized assets] and fungible tokens, such as cryptocurrency [stablecoins, and CBDCs]." That said, distributed ledger technology use cases extend beyond digital assets, with the technology actively being explored across the energy, supply chain, climate change, fintech, accounting, legal, medical, and broader financial sectors. Given the inextricable relationship between distributed ledger technology and digital assets, legislators and agencies seeking to regulate the digital assets field are also taking action concerning distributed ledger technology. As such, those entities seeking to utilize distributed ledger technology should closely monitor the development of regulation and legislation concerning digital assets as such government action is likely to affect distributed ledger technology more broadly.

In sum, cryptocurrencies, stablecoins, tokenized assets, CBDCs, and the distributed ledger technology that supports these assets, have the potential to significantly impact industries, nations, and the global economy. As such, those working in, or affected by, the digital assets or distributed ledger technology spheres should be cognizant of existing applicable regulatory requirements, implementing necessary compliance frameworks, the development of specific regulation and legislation, novel payment structures, and enforcement risks.

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Kilpatrick Townsend's Digital Assets Regulation Blog

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