July 5, 2022

Diane Farrell
Deputy Under Secretary for International Trade
International Trade Administration
Department of Congress
1401 Constitution Ave. NW
Washington, DC 20230

Re: Developing a Framework on Competitiveness of Digital Asset Technologies

Dear Ms. Farrell,

The Securities and Financial Markets Association appreciates the opportunity to respond to the Department of Commerce's Request for Comment ("RFC") "Developing a Framework on Competitiveness of Digital Asset Technologies."[1] SIFMA and its members support the development of safe, regulated, digital asset markets, and are encouraged by the work underway as directed by the Executive Order 14067 of March 9, 2022, "Ensuring Responsible Development of Digital Assets" (hereafter "Executive Order").[2] This effort is a valuable step to understand the policy and regulatory frameworks necessary so that the United States can maintain a leadership role in responsible digital assets innovation, and more generally ensure that it retains the same leadership role in digital asset capital markets as it has in the "traditional" capital markets space.

[1] "Developing a Framework on Competitiveness of Digital Asset Technologies," A Notice by the International Trade Administration on 05/19/2022 https://www.federalregister.gov/documents/2022/05/19/2022-10731/developing-a-framework-on-competitiveness-of-digital-asset-technologies

[2] "Ensuring Responsible Development of Digital Assets," A Presidential Document by the Executive Office of the President on 03/14/2022, available at https://www.federalregister.gov/documents/2022/03/14/2022-05471/ensuring-responsible-development-of-digital-assets

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

In its RFC, the Department of Commerce outlined an insightful range of questions on the development of the digital assets sector in the U.S. and its competitive position. In our response, SIFMA will focus on four broad themes in these questions: 1) the competitiveness of the U.S. digital assets sector; 2) the comparison with "traditional' financial services, in particular what "traditional" financial services can offer digital asset markets; 3) the role of Central Bank Digital Currencies ("CBDCs") and key considerations around a potential U.S. CBDC; and 4) issues around interoperability and standards as digital asset markets develop.

1. Competitiveness of the U.S. Digital Assets Sector[3]

The U.S. regulatory environment is a key factor impacting the development of digital assets services and markets in the United States, the competitiveness of U.S. firms and markets vis-a-vis other jurisdictions, and the prospects for the U.S. to retain leadership in this sector. An integrated, comprehensive regulatory framework which is accommodating of evolving technology and new operating models and products and services has been a key strength for U.S. capital markets since the 1930s and developing a similar structure for digital assets will be crucial. This is particularly the case given the focus of certain other countries in developing comprehensive digital asset regulatory frameworks with the explicit goal of establishing international leadership in these markets.

We would like to highlight several key areas in which the U.S. regulatory environment could be improved to better help the development of digital assets sector: 1) improving regulatory coordination; 2) adopting a technology neutral approach to regulation; 3) addressing specific regulations which pose obstacles to innovation; and 4) incorporating lessons from regulatory initiatives in other countries.

Improving regulatory coordination

A clear regulatory framework is important for meaningful involvement of all financial institutions in this sector. SIFMA supports the development of a regulated ecosystem for digital assets, which have the potential to serve an important role in the financial system more generally.

[3] SIFMA's comments in this section are broadly a response to the following three questions as from the RFC:
2.) What obstacles do U.S. digital asset businesses face when competing globally? How have these obstacles changed over the past five years and are any anticipated to disappear? Are there clearly foreseeable new obstacles that they will face in the future? What steps could the U.S. government take to remove, minimize, or forestall any obstacles?
(3) How does the current U.S. regulatory landscape affect U.S. digital asset businesses' global competitiveness? Are there future regulatory shifts that could support greater global competitiveness of U.S. digital asset businesses? How does the U.S. regulatory landscape for digital assets compare to that in finance or other comparable sectors?
(4) What are the primary challenges to U.S. technological leadership in the digital assets sector?

One necessary aspect of a comprehensive regulatory approach is clarity regarding the permissibility of digital asset-related activities for banks and bank holding companies. Thus far, the U.S. federal banking agencies have not issued across-the-board, comprehensive guidance on the topic. U.S. market regulators similarly appear to be developing their respective policy views, with the principals of U.S. market regulators recently opining on the potential application of market regulation to stablecoins and other cryptoassets, cryptoasset trading platforms and decentralized finance platforms. Banking organizations and other market participants would benefit from clear rules of the road regarding which regulatory structures apply to which activities and entities as well as the applicable requirements.

Thus, another necessary aspect of a comprehensive regulatory approach is that it be consistent and coherent. Overlapping, inconsistent or unclear requirements among regulators will impede the ability of regulated institutions to actively participate in cryptoasset activities and responsible innovation, whereas a clearly defined and internally consistent regulatory framework would enable banking organizations and others to participate in technological innovation, help ensure a level playing field and enable cryptoasset-related products to be offered more widely and in a safe and sound manner. Banking and market regulators, both in the United States and internationally, should work collaboratively to establish such a framework.

Technology Neutral Regulation

We encourage policy makers to embrace a technology-neutral approach to regulation of digital asset markets and infrastructure that focuses on the relevant risks, and not the specific technology used to record or transfer digital assets. This approach should allow market participants to develop policies, procedures, and best practices that may be customized to different types of digital assets and/or related technologies and provide flexibility for financial services firms to address issues unique to different forms of digital asset securities and digital asset securities offerings.

Technology neutral regulation is also important given that digital asset markets and their underlying digital ledger technology (“DLT”) will continue to evolve and develop, and any changes to rules to reflect the adoption of DLT today should be technology agnostic and “future proof.”

Regulators are looking at DLT and its applications in markets at a time when the technology and the technology providers that support it are developing rapidly. Given the ongoing changes in the technology landscape, regulation needs to be designed to allow for the evolution of the technology, such that regulations do not lock in any one provider or technology configuration. Regulation should not result in the market being locked into vertically integrated technology monopolies.

Specific Regulatory Issues that Create Challenges for Digital Asset Innovation

As we encourage the U.S. regulatory and policy making communities to approach new digital asset regulation guided by these considerations, we also would like to highlight several areas where existing U.S. regulations/guidance pose a serious obstacle to the development of digital asset markets in the United States and the competitiveness of U.S. firms.

The challenges posed by these regulations to responsible innovation also highlight the degree to which the restrictions they create are not necessary to meet the broader regulatory objectives such as investor protection, market quality, and the safety and soundness of financial institutions, from both prudential and technological / operational risk management perspectives. We encourage policy makers to look at these regulatory challenges and identify solutions to them that will enable the U.S. to retain its leadership and competitiveness in the development of digital asset markets.

As regulated financial institutions have worked to understand the opportunities in digital assets markets and blockchain infrastructure over the last years, SIFMA has released a number of white papers and comment letters outlining our members' position on effective regulatory frameworks. We refer to these papers below at a high level as a way of highlighting some of the areas in which the current U.S. regulatory structure poses challenges for the competitiveness of the United States in digital asset markets. We encourage the Department of Commerce to review these letters and position papers in full, as they explore in greater depth the ways in which current regulatory requirements are practical impediments to the development of U.S. digital asset markets and hold back the competitiveness of U.S. firms in these markets.

- ***Securities and Exchange Commission Staff Accounting Bulletin 121***

A recent Securities and Exchange Commission ("SEC") staff accounting interpretation affecting the accounting treatment of crypto assets held in custody by reporting entities, including regulated banks, raises significant process, policy, and related concerns, and as written would present major obstacles to the involvement of regulated financial institutions in these markets, particularly by impeding the development of custody services in digital assets.

In late March 2022, SEC staff issued Staff Accounting Bulletin ("SAB") 121.[4] SAB 121 reflects the staff's view on accounting for obligations to safeguard crypto assets an entity holds for its platform users. SEC staff determined that, because of risks particular to crypto-assets, entities covered by SAB 121 should record a liability and corresponding asset on their balance sheets at fair value and include particular disclosures regarding the entity's safeguarding obligations for crypto-assets held for its users. The staff

[4] Securities and Exchange Commission
Staff Accounting Bulletin No. 121, available at: https://www.sec.gov/oca/staff-accounting-bulletin-121

highlights technological, legal, and regulatory risks associated with safeguarding crypto-assets and an increased risk of financial loss as support for the position taken in SAB 121.

Although we understand the concern of the SEC for the protection of client assets, the mitigation of potential technology risks associated with DLT infrastructure, and disclosure to investors, we believe that these risks are sufficiently mitigated for banking organizations because of the stringent regulatory and supervisory frameworks within which they operate. Applying the on-balance sheet recognition requirements of SAB 121 to banking organizations would effectively make it economically impractical for banks to custody digital asset securities owing to, among other things, vastly increased capital and leverage charges that would be incurred by reflecting these assets on balance sheet.

Unless SAB 121 is significantly revised or clarified, its application to regulated banking organizations would disincentivize such entities from offering digital asset custody services – a key pillar of the creation of a mature, safe and regulated U.S. digital assets sector. SIFMA has submitted several letters to the SEC as well as to the Department of the Treasury and U.S. prudential regulators outlining the challenges created by SAB 121 and why we believe SAB 121 is inconsistent with the current regulatory treatment of custody services.[5]

- ***SEC Digital Asset Custody Regulation***

The ability to safely custody securities on behalf of clients is foundational for broker dealer participation in securities markets so they can meet existing investor protection requirements, such as the requirements of Rule 15c3-3 under the Securities Exchange Act of 1934 (hereinafter the "Customer Protection Rule" or "Rule 15c3-3"). However, broker-dealers face challenges in meeting these requirements for new activities with digital asset securities (i.e., securities which are natively issued on blockchain infrastructure).

In late 2019, the SEC proposed a safe harbor framework under which broker dealers could meet Rule 15c3-3 custody requirements, provided they meet the circumstances set forth in the safe harbor, including confining all digital asset securities activities to a ring-fenced special purpose broker dealer ("SPBD").[6]

[5] SIFMA and ABA provided comments to the U.S. Securities and Exchange Commission's (SEC) Office of the Chief Accountant (OCA) and Division of Corporation Finance regarding SAB 121, June 27, 2022, available at https://www.sifma.org/resources/submissions/update-on-efforts-to-implement-staff-accounting-bulletin-no-121/ SIFMA, ABA and BPI provided comments to the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Federal Reserve Board (FRB) regarding the issues arising from the new Staff Accounting Bulletin No. 121, June 23, 2022, available at https://www.sifma.org/resources/submissions/sifma-aba-and-bpi-on-staff-accounting-bulletin-no-121/

[6] See Custody of Digital Asset Securities by Special Purpose Broker-Dealers, Exchange Act Release No. 90788 (proposed Dec. 23, 2020).

Notably, SPBDs would be required to limit their business exclusively to "dealing in, effecting transactions in, maintaining custody of, and/or operating an alternative trading system for digital assets securities."[7]

SIFMA does not believe SPBDs are necessary for the digital asset security activities, as traditional broker-dealers can develop appropriate operational procedures to establish that digital asset securities are sufficiently within their control and do not pose extraordinary risks. Moreover, by and large, the risks for digital asset securities are the same as the risks of traditional securities, such as loss of value through market risk.

Both traditional securities and digital asset securities will be in place for the foreseeable future. Attempting to isolate risk via the establishment of an SPBD may not support the long-term objectives of building the industry capability and insights required to manage a mainstream offering that includes both methods of recording securities – it merely continues the bifurcation seen in the marketplace today between regulated broker-dealers and digital asset service providers.

The creation of SPBDs would also increase costs, as duplicative structures would need to be created. SPBDs would be unable to leverage the benefits of established controls and risk management protocols already in place, tested, and relied on at existing broker-dealers. It would disadvantage investors by requiring them to open multiple accounts with multiple broker-dealers depending on the assets they own, concentrate risk in a narrow category of securities, and pose clearance and settlement challenges.

Absent a more effective framework for meeting 15c3-3 requirements, broker dealers will be challenged to enter digital asset security markets, particularly as meeting custody requirements is foundationally important.

For a further discussion of the challenges presented by the inability of broker dealers to custody digital assets securities within their primary entities, we encourage staff to refer to SIFMA's comment letter on the SEC's SPBD proposal and a blog post we published on the issues around digital asset securities and their custody.[8]

[7] See Custody of Digital Asset Securities by Special Purpose Broker-Dealers, Exchange Act Release No. 90788 (proposed Dec. 23, 2020).
[8] SIFMA provided comments to the SEC on Custody of Digital Asset Securities by Special Purpose Broker-Dealers, May 20, 2021, available at: https://www.sifma.org/resources/submissions/custody-of-digital-asset-securities-by-special-purpose-broker-dealers/
"Q&A: Digital Asset Securities", May 20, 2021, available at https://www.sifma.org/resources/news/qa-digital-asset-securities/

- ***Clarity Around the Prudential Treatment for Crypto-Assets***

One key obstacle facing regulated financial institutions who wish to work with digital assets, and in particular crypto assets, is the lack of an appropriate capital and liquidity treatment of certain crypto-asset exposures. Given the pace of evolution and client demand for crypto-assets, it is imperative to have a clear framework on the appropriate capital treatment for exposures to these assets. Among other things, any framework for crypto-assets ought to be principles-based rather than highly prescriptive, reflecting the dynamic and evolving nature of these markets. It should also distinguish between well-established crypto-assets traded in highly liquid markets and those traded in less liquid markets, at least in terms of the recognition of hedging.[9]

We appreciate the ongoing active and open dialogue between key regulators and market participants that has been occurring since the publication of the Basel Committee on Banking Supervision's ("BCBS") first discussion document on this subject in 2019 (with its first formal consultation being issued in 2021 and second consultation in June 2022).[10] However, this project is a multi-year effort which may take some time to complete. Considering the rapidly developing nature of digital asset markets, we recommend that the U.S. consider adopting an interim framework to allow regulated entities to participate in these markets while the broader BCBS process is ongoing.[11]

Lastly, we also recommend further collaboration of U.S. agencies and government departments with international bodies when establishing an appropriate prudential treatment for crypto-assets. Inconsistency among domestic and global treatments may cause inadvertent consequences for financial institutions. For example, the potential impact of SAB 121 on banking organizations (as discussed above) in combination with other prudential treatments of crypto-assets could further complicate the ability of U.S. banking entities to participate in the digital asset industry. It is therefore critical that the

[9] These points are discussed in more detail in our joint trades letter to the BCBS. See Global Financial Markets Association (GFMA), Financial Services Forum, Futures Industry Association (FIA), Institute of International Finance (IIF), International Swaps and Derivatives Association (ISDA), and Chamber of Digital Commerce Joint Letter in response to the Basel Committee on Banking Supervision's Consultative Document on the Prudential Treatment of Cryptoasset Exposures, September 20, 2021. Available at: joint-trades-bcbs-prudential-treatment-of-cryptoasset-exposures-response.pdf (gfma.org).

[10] See Basel Committee on Banking Supervision, "Consultative Document: Second consultation on the prudential treatment of cryptoasset exposures," June 2022. Available at: Second consultation on the prudential treatment of cryptoasset exposures (bis.org). See also Basel Committee on Banking Supervision, "Consultative Document: prudential treatment of cryptoasset exposures," June 2021. Available at: Consultative document - Prudential treatment of crypto-asset exposures (bis.org). For the original discussion document, see Basel Committee on Banking Supervision, "Discussion paper: Designing a prudential treatment for crypto-assets," December 2019. Available at: Discussion paper - Designing a prudential treatment for crypto-assets (bis.org).

[11] For more on this point, see SIFMA, "Comments in Response to the Consultative Document on the Prudential Treatment of Cryptoasset Exposures," September 20, 2021. Available at: SIFMA provides comments on the Consultative Document on the Prudential Treatment of Cryptoasset Exposures.

establishment of frameworks and treatments for crypto-assets be aligned, and considered holistically, across domestic and global regulators, standards-setters and market participants.

- ***Resolving Definitional and Jurisdictional Ambiguity***

Financial institutions in the U.S. face additional challenges in understanding foundational definitional and jurisdictional issues around digital assets. Open questions and ambiguity on the principles which guide the classification of digital assets (such as when digital assets and products which are based on them would be considered securities, commodities or something else) create challenges for firms as they plan new products and infrastructure with respect to the regulatory frameworks that could govern them. Regardless of the ultimate resolution of these questions, the development of U.S. digital asset markets will be supported by clear approaches to this issue which are grounded in consistency in approaches across regulators and rulesets. The principles of "same risk, same regulation" should guide future resolution of these challenges.

Lessons from Other Jurisdictions and Preserving the Leadership of U.S. Regulatory Frameworks

In contrast, a number of European and Asian jurisdictions have taken specific steps to support the development of regulated digital asset markets and to encourage participation of regulated financial institutions in digital asset markets, such as by releasing new frameworks which expand regulatory frameworks to cover digital assets and removing impediments in existing securities law.

We point to these international experiences not to advocate for the U.S. to model its regulations on any particular foreign regulatory regime, but to stress that the U.S. needs a holistic framework to approach emerging digital asset markets. Examining these international experiences highlights the need for a comprehensive approach to bringing digital assets within the regulatory perimeter; and that is what we encourage U.S. policy makers to emulate, as opposed to any specific policy framework found in other jurisdictions. Lessons from these experiences and new regulatory frameworks can help inform U.S. policy makers as they develop new rules in the context of the existing U.S. regulatory regime which bring appropriate level of oversight and supervision to digital asset markets.

Internationally, key examples of these efforts to develop a forward looking, comprehensive digital assets regulatory framework include the PACTE Law (2019) in France; Germany's Electronic Securities Act (2021); the EU's recent Regulation on Markets in Cryptoassets (MiCA), Singapore's release of the Payment Services Act (PSA) (2019) combined with its ongoing regulatory engagement to ensure it provides the right level of oversight to evolving crypto-asset marketplaces; as well as the ongoing policy process underway in the UK to support the development of digital and crypto-assets markets.

Building on the Competitive Advantages of the U.S. Regulatory System

As policy makers think about the role of regulation in supporting the development of digital asset markets and the competitiveness in the U.S., we want to stress the extent to which the leadership of the U.S. in traditional financial markets has been underpinned by the strengths of its regulatory system. We should be building on our leading regulatory framework and expanding it so the U.S. can retain leadership in the digital assets and infrastructure space, as appropriate from a risk perspective

The U.S. has benefited from a unified regulatory framework since the 1930s. European and Asian countries learned from this and have been developing similar frameworks in traditional securities in recent decades and are now doing so in the digital assets place.

As firms work to build new digital asset services on these foundations of the world-leading U.S. financial sector space from infrastructure, institutional, and markets perspectives, policy makers should also be integrating these new assets and infrastructures within our existing regulatory frameworks.

2. What "traditional" financial services can offer the digital assets sector[12]

Participation of "traditional" financial services firms in the digital asset sector offers a broad range of benefits to reduce risk and increase transparency in digital asset markets. From a markets and oversight perspective, regulated financial institutions' participation can help improve digital asset market quality and provide greater transparency to regulators and supervisors. Traditional financial institutions also offer a proven track record of responsible innovation, and new digital asset ventures can draw on their established and robust frameworks for technology and operational risk management, as well as existing client suitability frameworks and anti-money laundering (AML) and know-your-customer (KYC) procedures.

Track record of responsible innovation

Banks and broker-dealers have a track record of bringing expertise, consumer protection standards and strong risk management practices to nascent technologies (e.g., mobile banking and trading and remote capture for retail banking and securities customers) and can do so for digital assets as well.

Regulated financial institutions also have found innovative and low-cost ways to provide exposure to certain markets for retail clients that were previously inaccessible (e.g., self-directed brokerage accounts

[12] SIFMA's comments in this section are broadly a response to the following question in the RFC: (12) What factors and conditions, if any, that have driven and sustained the global leadership of U.S.-based legacy financial institutions will foster the same leadership for U.S. digital asset businesses? If there are no common factors, what factors and conditions will differentiate global competitiveness for U.S. digital asset businesses?

with access to a broad range of investment and exchange-traded funds ("ETFs")). These products maintain strict limits and ensure that customer activity is both traceable and reportable.

The same expertise and safety could be extended to the offering of digital asset related products and services (e.g., investment funds, custody and payments). These types of activities provide banks with fee-based revenues, similar to current product and service offerings, and limit activity that could compromise market stability (e.g., by reducing the availability for retail clients to trade on leverage, which has been a driver of Bitcoin ("BTC") volatility).

Regulatory Transparency into Digital Asset Markets

Banks and broker-dealers are also supervised and examined on an ongoing basis by numerous regulators globally. For example, bank supervisors not only receive periodic reports from the institutions they supervise, but they also have access to information on an ongoing basis, both as a result of the examination and onsite supervisory process and through formal and informal data calls. As a result, activities conducted within a regulated bank are fully transparent to supervisors and supervisors can use information regarding that activity to inform analyses about potential financial stability concerns, as well as regarding conduct matters.

In contrast, without opportunities for the meaningful involvement of regulated banks in the cryptoasset space, consumers and institutional clients will seek crypto-asset-related products and services from nonbank financial intermediaries. This result would have the effect of concentrating risk in unregulated sectors of financial services, while fragmenting existing customer relationships among banking service providers.

Operational and Technology Risk Frameworks Already in Place

Regulated financial institutions already have robust frameworks in place for the management of operational and technology risk. These frameworks are robust and informed by the expectations of regulators in the U.S. and cover the full lifecycle of technology development, from the development of new products to their integration within existing internal control frameworks, and to structures for understanding and managing vendor risk internal controls. These risk frameworks have supported prior waves of responsible innovation, as noted above. Greater participation by "traditional" financial institutions in digital asset market will ensure that their development of new products and infrastructure will occur within these robust risk management frameworks and will raise the overall level of maturity and expectations of resiliency across the broader digital assets sector.

Additionally, as discussed below, regulated financial institutions draw on a range of established industry voluntary standards (such as those developed by the National Institute of Standards and Technology

("NIST")) for understanding and managing technology and cyber risk, which can be leveraged for the development of new digital assets infrastructure and services.

AML and KYC Programs Already in Place

Similarly, regulated financial institutions already have robust programs in place for anti-money laundering (AML) and know-your-customer controls. To the degree these institutions are a venue for customers to participate in digital asset markets, these existing controls would provide oversight. Greater regulated financial institution participation would also increase opportunities to develop digitally native solutions for meeting these requirements for those asset types where anonymity has been of greater concern in their current form (such enhanced due diligence practices through the use of "hosted wallets").

Reduced Volatility in Digital Asset Markets

As digital asset markets continue to grow, banks can play a pivotal role in ensuring liquidity, transparency and operational resilience of the market. This result would be accomplished, in part, by providing clients (including institutional clients) with access to risk management tools including hedging products (e.g., futures contracts linked to certain cryptoassets). Empirical analysis shows that the ability to hedge is central to reducing the volatility within a given asset class.[13] Currently, it appears that a key concern of regulators as it relates to bank involvement in cryptoassets is the volatility of the underlying assets; however, regulated financial institutions are well positioned to both risk-manage and reduce the overall volatility of this market.

Mature Regulatory Framework and Common Regulatory Platform

As discussed above, incorporating digital assets with the existing capital markets regulatory frameworks offers a range of advantages and builds on decades of experience. The U.S. regulatory framework covers the full lifecycle of many types of digital assets, from issuance to trading, to clearance and settlement to client suitability and investor protection. This existing regulatory framework places customer protection, market quality, and safety and soundness forefront – integrating digital asset activities within this framework will ensure they are held to the same high standards.

[13] Global Financial Markets Association (GFMA), Financial Services Forum, Futures Industry Association (FIA), Institute of International Finance (IIF), International Swaps and Derivatives Association (ISDA), and Chamber of Digital Commerce Joint Letter in response to the Basel Committee on Banking Supervision's Consultative Document on the Prudential Treatment of Cryptoasset Exposures, September 20, 2021. Available at: joint-trades-bcbs-prudential-treatment-of-cryptoasset-exposures-response.pdf (gfma.org).

3. Central Bank Digital Currencies (CBDCs)[14]

SIFMA appreciates the interest of U.S. policy makers in the potential for a digital dollar, and the broad range of approaches to understanding its potential impacts, from the Federal Reserve Board's January 2022 discussion paper "Money and Payments: The U.S. Dollar in the Age of Digital Transformation" to direction provided in the March 2022 Executive Order for a broad inter-agency review of a potential U.S. CBDC.[15] In light of the many experiments, pilots, and proof of concept experiments with CBDCs occurring internationally, it is encouraging to see the U.S. taking part in the process of exploration and analysis. This process will foster public discussion of this important topic and generate engagement with a wide range of stakeholders that would be impacted by the introduction of a U.S. CBDC.

Before undertaking what would be "a highly significant innovation in American money,"[16] policymakers need to be clear on why a U.S. CBDC is needed and what problems it would address. Much qualitative and quantitative analyses still need to be conducted in the coming years to properly evaluate whether the costs of this significant change to our existing system of money would outweigh the benefits, particularly given the high degree of efficiency and reliability of existing payments systems for both institutional actors and consumers.

These analyses should include, but would not be limited to, an evaluation of the effects of different types of CBDC systems on financial stability and the implementation of monetary policy; on key short-term funding markets; on existing payments systems, with which any CBDC would need to be interoperable; on consumer privacy; as well as on anti-money laundering (AML) and sanctions regimes.

Given that much more study needs to be undertaken to properly understand these benefits and costs, we do not take a position on the desirability of adopting a U.S. CBDC in this response.

Rather, we want to highlight the potential impacts of a U.S. CBDC on the capital markets. Given that 73 percent of all U.S. economic activity is funded through capital markets activities, it is vital that capital markets impacts be a central consideration for policymakers considering adoption of a U.S. CBDC.

This focus on the capital markets has also led us to spend more time examining the design and potential use cases for a "limited purpose" or "wholesale" CBDC ("wCBDC") that would be used for institutional financial transactions rather than a more widely available public "retail" CBDC ("rCBDC"). As we discuss in our response to the Federal Reserve, there are several potential capital markets use cases for wCBDC,

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[14] SIFMA's comments in this section are broadly a response to the following question in the RFC: (7) What impact, if any, will global deployment of central bank digital currencies (CBDC) have on the U.S. digital assets sector? To what extent would the design of a U.S. CBDC (e.g.,disintermediated or intermediated, interoperable with other countries' CBDCs and other domestic and international financial services, etc.) impact the sector?

[15] "Money and Payments: the U.S. Dollar in the Age of Digital Transformation" Jan. 2022, available at: https://www.federalreserve.gov/publications/files/money-and-payments-20220120.pdf, hereinafter Federal Reserve Discussion Paper

[16] Federal Reserve discussion paper, p. 3.

many of which have already been the subject of tests and experimentation. These use cases highlight some of the potential benefits of wCBDC, particularly in the cross-border payments space; they also help us better understand important policy and design tradeoffs that would need to be considered prior to implementation.

Although we are not yet able to opine on the desirability of adopting a U.S. CBDC, we do believe that if policymakers were to move forward with adoption at some future point, the primary focus should be on wCBDC, at least initially. This would allow further time to consider and evaluate the risks that a more widely available rCBDC may present. A wCBDC would be less disruptive to the financial system and financial stability than a rCBDC; it would provide a testing ground for experimentation of key systems amongst a small group of sophisticated and established financial actors; and has more proven and obvious use cases than a rCBDC. A wCBDC would also be less politically fraught, raising fewer concerns around issues such as consumer privacy than a rCBDC. A wCBDC may also be helpful in preserving the U.S. dollar's status as a reserve currency and as the predominant currency for international financial transactions in a way that a rCBDC would not.

Furthermore, such analyses should include a careful review of whether the goals of a CBDC might best be accomplished through regulated commercial models which are already available or under development. Analysis should cover a broad range of models which could meet the objectives that policymakers seek to achieve through a potential digital dollar. For example, these could include various systems of private tokens, tokenized cash, bank-minted tokenized deposits referencing fiat currency on blockchain, or the Regulated Liability Network (RLN) proposal to tokenize central bank, commercial bank, and electronic money on the same chain to deliver a next generation digital money format based on national currency units.[17] For example, as proposed, these "RLN tokens" could be readily exchanged with existing account-based forms. Policymakers should explore if and how these alternative technology configurations could meet the objectives of a CBDC, such as the instant movement of value 24/7 either domestically or internationally, integrated into other digitized processes, and serve as "programmable money" insofar as payments can be automated or made conditional on events.

Beyond these general points, we make the following recommendations. We cover them in greater depth in our response to the Federal Reserve Board's January 2022 discussion paper, and we encourage Commerce Department staff exploring this issue to review them there for a more fulsome discussion of these key design considerations in light of capital markets specific issues.[18]

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[17] *See* The Regulated Liability Network (RLN) Whitepaper, at https://www.citibank.com/tts/insights/articles/article191.html

[18] SIFMA comment letter in response to the Federal Reserve Board discussion paper "Money and Payments: The U.S. Dollar in the Age of Digital Transformation Discussion Paper on a Potential U.S. Central Bank Digital Currency (CBDC)," May 20,2022, available at: https://www.sifma.org/wp-content/uploads/2022/05/SIFMA-FRB-CBDC-White-Paper-Response-May-2022.pdf

- ***Access:*** in addition to our view that a wCBDC ought to be the primary focus of policymakers initially, we recommend that direct access to any wCBDC be restricted to institutions that are subject to a framework of regulation and supervision that is comparable to that currently in place for institutions with access to Federal Reserve master accounts and services. Policymakers could also consider whether the imposition of activities restrictions on non-bank institutions would be warranted.

- ***Legal Status:*** it is crucial that the legal status and treatment of any U.S. CBDC (whether under statute and/or through regulation) be made equivalent to the legal status of legacy fiat currency, and that both be fungible with one another. There should also be clarity and consistency regarding key terminology, particularly as it pertains to CBDC "tokens."

- ***Prudential Treatment:*** Any U.S. CBDC should be treated in an analogous fashion to other central bank money under international prudential standards and domestic rules, particularly with respect to capital, liquidity, and reserve requirements.

- ***Risk Management:*** wCBDCs should be incorporated into existing risk management processes and solutions for clients and policymakers should avoid imposing any new, additional risk charges on financial institutions handling wCBDCs. However, wCBDC design and implementation should bear in mind considerations related to operational risk, credit and liquidity risk and cyber risk, and adopt design features to minimize them.

- ***Domestic and Cross Border Interoperability*:** wCBDCs ought to be able to operate alongside legacy instruments and systems rather than replace them in order to both minimize disruptions to the financial system and given that legacy systems have become significantly more efficient in recent years. Planning for interoperability will require coordination with market participants, infrastructure providers, and the regulators who oversee them domestically. International coordination between regulators will be vital in order to realize the potential benefits of multi-CBDC ("mCBDC") arrangements, which *may* include faster, cheaper and more reliable cross-border payments.

- ***Programmability*:** the potential for wCBDCs to be embedded with logic, or programmability, offers the potential for innovation and new functionality. However, programmability features need to be developed so they do not impair the fungibility of central bank money or introduce operational risk.

- ***Public-Private Partnerships:*** it is crucial that policy making in this area occur in close collaboration between financial institutions, regulators and supervisors and other important government actors whose supervisory functions and regulations could be impacted by a wCBDC. This partnership with market participants and infrastructure providers should extend from the research and decision-making phases through the design and testing of any future wCBDC.

- ***Privacy:*** a wholesale environment does not raise the same sorts of privacy concerns that a rCBDC would. However, privacy concerns are not completely absent from the design of a wCBDC and privacy oriented mitigants need to be embedded from the outset even in a wCBDC system.
- ***Product Specific Considerations*:** it is crucial that not only the general impacts of CBDC be considered, but also the impact of different types of CBDC on specific capital markets products and processes. The review and analysis and potential design process should closely examine how CBDCs (particularly wCBDC) would impact products and process such as securities settlement, the mechanics of monetary policy operation, FX markets and infrastructure, funding models, and cross-border payments.
- ***Securities Settlement*:** wCBDCs have the potential to allow for new settlement models and potentially faster settlement for some transactions. However, the potential impacts of wCBDCs on securities settlement must not be viewed in isolation from broader settlement processes and securities markets operations. wCBDC would be neither necessary nor sufficient for the development of new settlement models, and the experiences of pilot programs for faster settlement cannot be generalized to the markets as a whole, where major challenges exist for settlements on timeframes shorter than T+1.

4. Standards and Interoperability[19]

The development of the U.S. digital assets sector is not only driven by the evolution of markets and infrastructure, but by the development of the underlying blockchain technology and shared industry approaches to implementing it. As underlying blockchain technology itself rapidly evolves, there will be an ongoing process of ensuring these DLT infrastructure and services can interact with each other and be understood and managed using common frameworks. The interoperability of DLT platforms needs to be a key consideration, and existing industry standards can be applied to provide frameworks for market participants and technology providers as they develop new digital asset services and integrate them within their existing risk management and control frameworks.

Interoperability

To realize the greatest benefit of digital asset technology, interoperability needs to be a key design consideration. Although ultimately interoperability is driven by the design choices of the users and

[19] SIFMA's comments in this section are broadly a response to the following questions in the RFC: (15) To what extent do new standards for digital assets and their underlying technologies need to be maintained or developed, for instance those related to custody, identity, security, privacy, and interoperability? What existing standards are already relevant? How might existing standardization efforts be harmonized to support the responsible development of digital assets? And (17) To what extent will interoperability between different digital asset networks be important in the future? What risks does a lack of interoperability pose? And what steps, if any, should be taken to encourage interoperability?

developers of digital asset services and infrastructure, policy makers have an important role to play in ensuring that interoperability is a foundational element of DLT infrastructure development.

Broadly, policy makers can support interoperability in two key areas. First, by making interoperability forefront in CBDC experimentation, stressing both interoperability between CBDC programs internationally and ensuring that a new CBDC infrastructure is interoperable with existing industry infrastructure. Second, by ensuring that emerging policy frameworks for digital assets understand the importance of interoperability and do not lock market participants into specific technology configurations with overly technically prescriptive approaches to regulation.

Interoperability in CBDC Design - Interoperability among CBDCs

As policy makers in the US examine the potential for a digital dollar, there needs to be close coordination with other central banks and monetary authorities as they carry out their own CBDC explorations and pilots. Future CBDC interoperability requires convergence in design choices, and there are serious consequences of central banks making irreconcilable design choices.

Cross border interoperability is critical for wCBDC users in international markets and needs to be supported by an operating model which effectively deals with the range of multi-sovereign dynamics of an multi-CBDC (mCBDC) network. Without this cross-border functionality, a purely domestic wCBDC would not be well positioned to support international business.

Although there are a number of open questions around the appropriate design models that could support CBDC interoperability and mCBDC arrangements, we encourage policy makers to take into account these considerations from the outset of any CBDC analysis and design process.

There have been a number of international pilots and proof of concept exercises exploring the design choices and infrastructure that can support mCBDC arrangements, such as Project Dunbar, Project Jura, and Project “Inthanon Lionrock to mBridge,” which we discuss at greater length in our response to the Federal Reserve Board’s CBDC paper.

In addition to the specific design considerations these projects raise, they also highlight critical importance of central banks and policy makers collaborating across borders in the early stages of CBDC exploration to understand how interoperability would work, both at a general technical level and in the context of specific capital markets products and infrastructure. This should be supported with private sector engagement, which has been a key part of a number of mCBDC pilots and experiments internationally.

Interoperability in CBDC Design - Interoperability of CBDCs with existing infrastructure

Any CBDC ought to be able to operate alongside legacy instruments and systems rather than replace them in order to minimize disruptions to the financial system and given that legacy systems have become significantly more efficient in recent years.

The potential gains in efficiency and risk reduction from development of wCBDCs would be easier to realize if there is smooth interoperability with existing infrastructure, such as the ability to transfer balances between a wCBDC and traditional central bank reserve balances. This of course recognizes that new processes and infrastructure which build on the functionality offered by wCBDCs will likely gradually expand from smaller pilots in specific market segments. These pilots will often occur in partnership with existing infrastructure providers, who may handle multiple parts of the process using existing infrastructure even as new features are added.

Interoperability will need to be built across multiple dimensions, including in the design of the wCBDC framework, its operating standards and protocols, and its technology architecture. wCBDC design needs to consider interoperability with a broad range of existing systems and infrastructure platforms. These must include, but are not limited to, existing and new wholesale payment instruments and systems; the broader capital market ecosystem and financial market utilities; cross-border foreign exchange systems; local rCBDC systems and local wCBDC systems; and ideally, cross-border and mCBDC arrangements.

Jurisdictions implementing CBDCs need to consider the broad spectrum of sovereign currency and liabilities and how they will interoperate; standards for intermediaries operating CBDCs may be necessary to ensure interoperability with existing payments systems. Designing for interoperability should be based on a partnership between market participants and infrastructure providers together with government agencies from the outset.

Supporting the Interoperability of Digital Asset Infrastructure

It is critically important that as digital asset networks develop they have interoperability between them. Without interoperability, the sector will end up with fragmented systems. Fragmentation will have a range of negative consequences, including with limited liquidity in individual DLT systems and platforms, introduce risk, and generally hamper the broader development of and adoption of digital assets and DLT infrastructure.

The lack of interoperability could introduce new technology and cyber risks, particularly considering the plurality of DLT platform and configurations. Fragmentation of DLT infrastructure would also create challenges for interoperability between existing centralized infrastructure models and new DLT architectures.

Emerging policy frameworks should stress the importance of interoperability as developed by market participants. This can be done adopting technologically neutral approaches which do not constrain interoperability among technology configurations, both and now in the future as technology continues to develop so we aren't locked into technology configurations based on point in times regulatory decision.

Standards

Standards will ultimately be valuable in driving the scalability and liquidity of digital asset markets. However, specific technical standards may be premature until we have more commonality on what they are trying to achieve, and there is more maturity on industry expectations on how digital assets markets will be structured and what infrastructure configurations they will be built on. Additionally, it is key to differentiate between general standards and technical standards.

As the industry works to develop and expand DLT infrastructure, we believe there are opportunities to build on existing National Institute of Standards and Technology (NIST) voluntary technology standards. These standards are widely understood and adopted within the financial services industry, and there are likely opportunities to build on them. As firms look to develop common practices for the security and safety of digital asset services and infrastructure, we encourage the Commerce Department and NIST to explore how those existing standards could be expanded to provide guidance for DLT based services Leveraging existing NIST standards builds on frameworks that already have common industry support and are already informing technology and systems development. Expanding them to align with the unique functionality of DLT would help provide common baselines which can be compared across market participants and reduce risk, while remaining technologically neutral. More broadly, the availability of commonly understood and adopted standards will support regulatory objectives in demonstrating that technology risk around new digital asset infrastructure is being understood and addressed

Firms today are trying to build off existing standards in developing their emerging DLT services, but the alignment is not exact. A collaborative process between financial services firms, technology providers, and NIST could help guide the process of expanding these standards to support the digital assets sector. Standards that could be expanded could include likely include:

- Federal Information Processing Standards (FIPS)[20]
- NIST Cybersecurity Frameworks[21]
- NIST Privacy Framework[22]

[20] https://www.nist.gov/standardsgov/compliance-faqs-federal-information-processing-standards-fips
[21] https://www.nist.gov/cybersecurity
[22] https://www.nist.gov/privacy-framework

We appreciate the opportunity to respond to this Request for Comment, and the leadership of the Commerce Department in ensuring the continued global leadership of the United States in the emerging digital assets sector. We would be pleased to speak further with you about our recommendations, SIFMA members' perspective on the future role of "traditional" financial institutions in the digital assets sector, the regulatory challenges we face and how to overcome them, and our key considerations around any potential U.S. CBDC among other topics. We also encourage Commerce Department staff to refer to the SIFMA comment letters and position papers cited above which provide a more in-depth exploration of these issues and our members' perspective on them.

Please reach out to Charles De Simone Managing Director, Technology and Operations (cdesimone@sifma.org) and Peter Ryan, Head of International Capital Markets and Prudential Policy, (pryan@sifma.org) with any questions or to discuss further.

Sincerely,

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