August 8, 2022

Hon. Nellie Liang
Under Secretary for Domestic Finance
Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, D.C. 20220

Re: Ensuring Responsible Development of Digital Assets

Dear Under Secretary Liang:

The Securities and Financial Markets Association ("SIFMA") appreciates the opportunity to respond to the Treasury Department's Request for Comment ("RFC") on "Ensuring Responsible Development of Digital Assets."[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, entitled "Ensuring Responsible Development of Digital Assets" (hereafter "the Executive Order").[2] This effort is an important step towards a better understanding of the evolving digital assets marketplace and its prospects; how responsible innovation can serve investors; and more generally how the United States can ensure that it retains the same leadership role in digital asset capital markets as it has in the "traditional" capital markets space.

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[1] 87 Fed. Reg. 40881, "Ensuring Responsible Development of Digital Assets," A Notice by the Treasury Department, July 8, 2022. Available at: https://www.federalregister.gov/documents/2022/07/08/2022-14588/ensuring-responsible-development-of-digital-assets-request-for-comment.

[2] "Ensuring Responsible Development of Digital Assets," A Presidential Document by the Executive Office of the President, March 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 Treasury Department outlined an insightful range of questions on the development of the digital assets sector in the U.S. and its impact on the broader capital markets and investors. In our response, SIFMA will focus on two broad themes underlying these questions: 1) the opportunities digital assets offer, looking at the benefits which regulated financial institution participation can provide to the development of these markets as well as introducing some of the use cases that market participants are developing; and 2) the risks in the digital asset sector, looking at the how SIFMA members understand and approach risk in the digital asset sector, and a discussion of some specific risks that we see shaping its development, with a particular focus on their policy and regulatory context.

Beyond our response to this RFC, SIFMA has been actively engaged in a range of key policy and regulatory questions shaping the development of digital asset markets and regulated financial institutions' participation in them. A number of public documents lay out our thinking on key topics in this space, including:

- Our response to the Basel Committee on Banking Supervision's first consultation on the prudential treatment of crypto assets[3];
- Our response to the Federal Reserve Board's discussion paper on the potential introduction of a U.S. central bank digital currency ("CBDC")[4];
- Our recent response to the Commerce Department's RFC on "Developing a Framework on Competitiveness of Digital Assets Technologies"[5];
- Our letter to the U.S. Treasury and the prudential regulators on Staff Accounting Bulletin 121 ("SAB 121"), which was issued earlier this year by the staff of Office of the Chief Accountant of the Securities and Exchange Commission ("SEC")[6];

[3] 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).

[4] SIFMA response to the Board of Governors of the Federal Reserve System discussion paper "Money and Payments: The U.S. Dollar in the Age of Digital Transformation," May 20, 2022. Available at: SIFMA provided comments on Fed CBDC Discussion Paper.

[5] SIFMA response to the U.S. Department of Commerce Request for Comment on Developing a Framework on Competitiveness of Digital Asset Technologies, July 5, 2022. Available at: Developing a Framework on Competitiveness of Digital Asset Technologies (sifma.org).

[6] American Bankers Association, Bank Policy Institute, and SIFMA letter to the U.S. Department of Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency regarding Staff Accounting Bulletin No. 121 issued by the staff of the Office of the Chief Accountant of the Securities and Exchange Commission, June 23, 2022. Available at: SIMFA ABA BPI on SAB 121 (sifma.org). Note that other communications have been submitted to the SEC directly on this matter.

- Our response to the SEC's framework for the custody of digital asset securities released in 2020,[7] our white paper on security tokens, which examines a range of regulatory and operational considerations for broker-dealers[8]; and
- Our publication that outlines our understanding of the regulatory and legal context for determining when a digital asset is a security[9].

1. Response to Section B: "Opportunities for Consumers, Investors, and Businesses"

Section B(3) of the RFC requests respondents' perspectives on "the main opportunities for consumers, investors, and businesses from digital assets."[10] Digital assets and distributed ledger technology have inspired a range of broad predictions and commentary, ranging from suggestions that their value is purely speculative, to predictions that digital assets are on the cusp of completely transforming existing financial markets.[11] In this response, we would like to discuss in concrete terms how SIFMA member firms understand the benefits of digital assets and their underlying technology. SIFMA would like to highlight two related areas – the benefits of regulated financial institutions' participation in digital asset markets and some illustrative use cases which highlight the potential future role of digital assets in enabling innovation within the capital markets.

a) Benefits of Regulated Financial Institution Participation in Digital Assets Markets and Infrastructure

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.[12] Regulated financial institutions also offer a

[7] SIFMA response to File No. S7-25-20: SEC Statement And Request For Comment 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/

[8] SIFMA, PWC, "Security Tokens: Current Regulatory and Operational Considerations for Broker-Dealers and a Look Towards the Future," November 2020. Available at: Security Tokens: Current Regulatory and Operational Considerations for Broker-Dealers and a Look Towards the Future (sifma.org).

[9] Charles DeSimone, "When is a Digital Asset a Security," *SIFMA blogpost*, July 14, 2022. Available at When is a Digital Asset a Security? - SIFMA - When is a Digital Asset a Security? - SIFMA.

[10] "Ensuring Responsible Development of Digital Assets," A Notice by the Treasury Department, *supra note 1*

[11] Elliot, Douglas, "Are Cryptoassets Tulips or Dot-coms?", available at https://www.oliverwymanforum.com/future-of-money/2022/jan/are-cryptoassets-tulips-or-dot-coms.html

[12] In this context, "regulated" financial institutions refers to market participants whose activities are overseen by the regulatory and supervisory agencies that govern current capital markets participants, such as banking and prudential regulators, securities and commodities regulators, and SROs.

proven track record of responsible innovation, and new digital asset ventures can draw on such institutions' established and robust frameworks for technology and operational risk management, as well as existing client suitability frameworks, anti-money laundering ("AML") and know-your-customer ("KYC") procedures, cybersecurity requirements and data protection processes.

Track record of responsible innovation

Regulated financial institutions such as 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 for retail clients to certain markets that were previously inaccessible (*e.g.,* through self-directed brokerage accounts with access to a broad range of mutual and exchange-traded funds ("ETFs")). These products are subject to controls and ensure that customer activity is both traceable and reportable.

The same expertise and safety should 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 from the examination and onsite supervisory processes and through formal and informal data submissions. Similarly, broker-dealers are subject to extensive oversight and examination including that related to investor protection, capital and custody by the SEC, FINRA and the states. As a result, activities conducted within a regulated financial institutions are fully transparent to supervisors, allowing them to monitor risk taking within individual institutions and providing them with the information necessary to help address potential financial stability concerns.

In contrast, without opportunities for the meaningful involvement of regulated financial institutions in the digital asset space, consumers and institutional clients will seek related products and services from nonbank financial intermediaries which are largely outside the scope of comprehensive U.S. federal regulation, particularly cryptocurrency centric firms that may only be subject to patchwork regulation, such as from state-level money transmitter licensing, oversight from other jurisdictions or maybe no oversight whatsoever. This result would have the effect of concentrating risk in sectors of financial services outside

the scope of comprehensive U.S. federal regulation, while fragmenting existing customer relationships among banking service providers. The recent collapse of an algorithmic stablecoin and its underlying network's ecosystem demonstrated the harm that consumers could face when using volatile products without proper safeguards.[13]

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 informed by the expectations of regulators in the U.S. and in other jurisdictions. They cover the full lifecycle of technology development, from the development of new products to their integration within existing internal control frameworks, including structures for understanding and managing vendor risk internal controls. These risk frameworks have supported prior waves of responsible innovation, as noted above. Regulated financial institutions will ensure that their development of new products and infrastructure in digital asset markets within these robust risk management frameworks, and such institutions' participation will raise the overall level of maturity and expectations of resiliency and sustainability across the broader digital assets sector.

Additionally, 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, as well as frameworks for business continuity planning (BCP). We discuss this particular topic in further detail in our response to the Department of Commerce's RFC for "Developing a Framework on Competitiveness of Digital Asset Technologies."[14]

We will discuss this issue in greater depth in below, when thinking about the risks associated the development of digital assets markets, in response to sections III(C) and III(D) in the RFC exploring risk issues.

AML and KYC Programs Already in Place

Regulated financial institutions already have robust programs in place for AML and KYC controls. To the degree these institutions are a venue for customers to participate in digital asset markets, these existing controls, coupled with advanced distributed ledger analysis technology, could provide oversight and in

[13] Kharpal, Arjun and Browne, Ryan, Cryptocurrency luna crashes to $0 as UST falls further from dollar peg, CNBC, May 13, 2022 4:12 AM EDT (updated May 13, 2022 7L49 PM EDT), *available at:* https://www.cnbc.com/2022/05/13/cryptocurrency-luna-crashes-to-0-as-ust-falls-from-peg-bitcoin-rises.html (last accessed: Aug. 5, 2022).
[14] *Supra* note 5.

some cases provide greater insight in preventing crimes.[15]. Greater regulated financial institution participation would also increase opportunities to develop digitally native solutions for meeting these requirements for asset types whose current features have raised concerns from policy makers from an AML/KYC perspective. For example, financial institutions may apply their experiences with AML/KYC requirements to develop enhanced due diligence practices.

Financial Inclusion

Regulated financial institutions already have robust programs in place to foster financial inclusion. To the degree these institutions are a venue for customers to participate in digital asset markets, these existing programs would provide oversight and bring new participants into the traditional financial system, enabling greater access to savings and investment products, which are critical for true financial inclusion. Greater regulated financial institution participation would also increase opportunities to develop digitally native solutions for meeting requirements to comply with the Community Reinvestment Act (CRA) for those participants who have been unfairly excluded or taken advantage of by unregulated markets and participants in those markets.

Reduced Volatility in Digital Asset Markets

As digital asset markets continue to grow, banks and broker-dealers 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 cryptocurrencies). Empirical analysis shows that the ability to hedge is central to reducing the volatility within a given asset class.[16] Currently, it appears that a key concern of regulators as it relates to bank involvement in digital assets and cryptocurrencies is the volatility of the asset or underlying assets themselves; however, regulated financial institutions are well positioned to both manage those risks and potentially reduce the overall volatility of this market.

Mature Regulatory Framework and Common Regulatory Platform

Application of securities law analysis aside, incorporating digital assets within some of the principles established within existing capital markets regulatory frameworks offers a range of advantages that builds on decades of experience. The U.S. regulatory framework covers the full lifecycle of many assets, which

[15] Blockchain Tracing: The U.S. Government's Newest Tool to Combat Foreign Crime, SIDLEY, (May 20, 2022): *available at:* https://www.sidley.com/en/insights/newsupdates/2022/05/blockchain-tracing-the-us-governments-newest-tool-to-combat-foreign-crime (last accessed Aug. 5, 2022).

[16] 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).

are largely already in a digital format today, from issuance to trading, to clearance and settlement to client suitability and investor protection. This framework is designed to support accurate pre-trade disclosure to customers, fair execution at transparent prices, appropriate market conduct that reinforces fairness of execution and avoidance of manipulative practices, appropriate management and/or avoidance of conflicts of interest, post-trade transparency and operational integrity, with requisite supervisory, control and risk functions to foster appropriate results. This existing regulatory framework places customer protection, market quality, and safety and soundness forefront. Leveraging the principles of this framework for digital asset activities will ensure they are held to the same high standards. We believe regulators should apply the principles established in existing capital markets frameworks to the extent possible to digital assets, consistent with a broader "technology neutral" and "risk-based" approach to regulation in this space (as we discuss below).

b) Digital Asset Use Cases Being Explored by SIFMA Members

It is critical to keep sight of the differences among different types and deployments of digital assets and distributed ledger technologies, respectively. In particular, there is a critical distinction between digital assets, cryptocurrencies, and tokenized assets, as well as the underlying digital ledger technology ("DLT") infrastructure used in various use cases. There are further nuances distinguishing digital assets and other DLT based products and systems in terms of operating models, markets, infrastructure deployment, permissions (or lack thereof), and operational and technological considerations. It is critical for policy makers to be mindful of these differences and to not overgeneralize as to all manifestations of the underlying technology that have created risk-creating speculative assets but also risk-reducing permissioned processes that mitigate core concerns such as settlement risk.

As a starting point, regulators should establish clear definitions that differentiate between the risks and rights conferred by the product (*e.g.,* digital securities, stablecoins, cryptocurrencies). Across the spectrum of digital assets and processes there are many different products used for different purposes, as well as services based upon blockchain technology, with different levels of risk. Similarly, policy makers should take care to avoid arbitrary distinctions between different types of underlying distributed ledger technology configurations, an issue we discuss at greater length below in our exploration of understanding and managing risk. There are meaningful differences in how risk is managed by way of permissioning and other design features, and these differences need to guide regulatory treatment of digital assets and services.

Given this caveat, we would like to highlight several applications of digital assets products and services and introduce at a high level the potential benefits they could offer capital markets participants and the broader economy: blockchain based infrastructure, natively digital security issuance, tokenization of existing financial instruments, cryptocurrencies, central bank digital currencies (CBDCs) and comparable products, as well as cross-border transfers.

Blockchain Infrastructure Applications

First, market participants have explored and are implementing a range of projects which use underlying blockchain technology to improve upon existing industry functions and processes. The focus of these projects is not to create new blockchain based assets, but to make processes around existing assets faster, more secure, or more efficient, or to take advantage of the way which blockchain records provide immutability and greater transparency in data.

These applications include using blockchain based settlement models to allow for faster, more efficient, or more customized settlement of existing "traditional" securities. Similarly, firms are exploring how smart contracts could automate existing industry processes, such as payment or delivery of securities or funds, allowing for faster transactions and greater customization. Other projects explore the potential for blockchain based records to provide an authoritative record of information, showing not just current prices or ownership structures, but also historical developments. Blockchain based "oracles" can be designed to provide common understanding of critical information within a single firm or across a range of participants in a given market, or investors in a common asset or investment vehicle. For example, certain forms of privately held companies feature evolving ownership structures and corresponding valuation levels, which could be tracked using blockchain systems.

On settlement infrastructure, it is key to remember that while blockchain based settlement systems offer the potential for faster settlement models, these solutions need to be implemented and understood in the context of the broader infrastructure that supports securities settlement, and particularly that the potential of ledger-based settlement systems cannot be extended to apply to the general feasibility of faster settlement models for the securities markets as a whole. There is a U.S.-focused industry initiative, led by SIFMA, the Investment Company Institute ("ICI"), and The Depository Trust & Clearing Corporation ("DTCC"), to shorten the settlement cycle for equities and certain other securities to one business day after the trade is executed (T+1). Currently T+1 is expected to be adopted in U.S. markets by 2024.[17] While the industry is transitioning to T+1, it is critical to understand that further accelerations of the settlement cycle to timeframes shorter than T+1, such as T+0, end of day settlement or other same day or instantaneous settlement models are on another scale of complexity and difficulty.

Issuance of Natively Digital Securities

Another area of interest for SIFMA members is the issuance of natively digital securities, which are issued and tracked on blockchain infrastructure. These have been referred to using a range of different terms, including security tokens and digital asset securities. Although they have some similarities with tokenized

[17] The move to T+1 is expected to cover equities, corporates, municipals, and UITs, while Fed eligible securities would be considered out of scope. See SIFMA, Investment Company Institute (ICI), DTCC and Deloitte, "Accelerating the U.S. Securities Settlement Cycle to T+1", December 2021

securities, as discussed below, they are issued natively on blockchain as opposed to being blockchain-based representation of securities which were issued "traditionally." Both types of assets can be viewed as complementary, however.

Natively digital securities offer potential advantages to market participants and can enable a range of innovations in how securities are issued, traded, settled, and serviced. Natively digital securities can be more easily marketed and can also be easier to structure and issue. This can allow for greater customization as well as potentially allowing asset types which were previously not cost-efficient to structure to be offered to investors with the protections provided by securities laws and regulations.

Blockchain based trading and settlement can offer greater speed and efficiency, although it would need to be supported by robust settlement tools on the blockchain network and an-on blockchain network payment option, whether that be tokenized cash, a settlement token or equivalent, or natively digital central bank money (*e.g.*, CBDC). These considerations also apply to already existing assets which are tokenized, as discussed below.

Natively digital securities can also embed the calculations for the security (such as coupon payments) in the asset itself, providing greater efficiency in asset servicing and greater customization to fit either investor demands or the unique features of the economic asset underlying the security. For example, green bond payments could have functionality around tracking climate impacts embedded within the security when it is issued, providing greater transparency to investors.[18]

Tokenization of Previously Issued Securities

In addition to issuing securities natively on a blockchain, firms are also exploring the opportunities offered by tokenizing securities which were already issued "traditionally" using existing industry infrastructure. Under this process, a security holder can create a representation of the security on a blockchain network through the process of tokenization, so that that this representation of the rights to the security can be tracked, traded, and cleared and settled using DLT infrastructure. This process can be managed by a custodian, who ensures that the underlying security is secure and immobilized, using existing industry operations and in compliance with regulations.

Tokenization of existing securities can offer a range of benefits. Tokenization in traditionally opaque markets can improve efficiency and market quality, such as by providing additional liquidity, exposure to broader groups of investors, or more efficient settlement and asset servicing. Tokenization can also offer flexibility in its functionality in areas where existing industry infrastructure cannot, such as highly customized settlement instructions or securities lending or repo transactions on shorter time periods than

[18] Bank of International Settlements "Project Genesis 1.0: Prototype digital platforms for green bond tokenization", report available at https://www.bis.org/about/bisih/topics/green_finance/green_bonds.htm

are currently available. Additionally, tokenized securities can address challenges around cross-border asset transfers.

Tokenization of Non-Security Assets

Non-security assets can also be represented on a DLT network via tokenization. While the resulting token may not meet the definition of a security, it can offer a range of benefits to market participants, infrastructure operators, and end investors.[19]

At the most basic level, tokenized fiat currency offers a vehicle for handling the payment leg of securities settlement on-chain, allowing for the entirety of a transaction or trade (*i.e.*, through settlement and payment) to be carried out on a DLT network, facilitating greater efficiency and potentially faster settlement models. Alternatively, they can be used to support settlement tokens which can be used within a given infrastructure venue. This function has some overlap with the potential role for a CBDC, as discussed below.

Additionally, there are opportunities for tokenization of non-security assets which are difficult to trade or for investors to access in their current form. These include physical commodities (where a token can represent a unit of a physical commodity) as well as other non-financial assets, such as fine art or individual real estate properties. Tokenization of these assets can provide greater accessibility to consumers and investors alike. The tokenization process can also allow investors to purchase pieces of a larger asset through fractionalization *(e.g*. where tokens would each represent 5% of a piece of fine art that would previously only have been purchasable as a single unit), allow a broader range of investors to holds these assets as well as making diversification easier.

Cross Border Transfers

Firms are also exploring how blockchain can support innovation in cross border payments. Beyond discussions of how digital assets might potentially facilitate cross-border payments, there are a range of use cases and potential benefits for handling fiat currencies in cross border transactions via DLT infrastructure. These include faster payments and greater security and auditability of transaction histories, as well as potentially lower costs, broader access, and more robust controls for AML/KYC.

Applications could range from retail person-to-person cross-border payments (such as for remittances or retail e-commerce) to wholesale business-to-business payments (such as those supporting corporate transactions, correspondent banking, or cross border-investments.)

[19] "When is a Digital Asset a Security" SIFMA blog, July 14, 2022, https://www.sifma.org/resources/news/when-is-a-digital-asset-a-security/

However, any cross-border initiatives would need to be anchored in standards to allow for connectivity, both with systems in different jurisdictions and with existing payments and markets infrastructure. Without common standards it will not be possible to achieve the benefits of new forms of cross border payments. Critically, considerations around industry standards and interoperability need to be incorporated from the outset of any project and remain a key consideration throughout all phases of development. Existing industry standards such as ISO 20022 can support this work.

Central Bank Digital Currencies (CBDCs)

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.[20] 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,"[21] policymakers should be clear on why a U.S. CBDC is needed and what problems it would address. Additional qualitative and quantitative analyses 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; key short-term funding markets; existing payments systems, with which any CBDC would need to be interoperable; consumer privacy; as well as 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.

However, in the spirit of the questions contained in the RFC, we want to highlight the potential impacts of a U.S. CBDC on the capital markets. Given that over 70 percent of all U.S. economic activity is funded

[20] "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
[21] Federal Reserve discussion paper, p. 3.

through capital markets activities, it is vital that capital markets impacts be a central consideration for policymakers in considering adoption of a U.S. CBDC.[22]

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, 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 opining 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 than an rCBDC, raising fewer concerns around issues such as consumer privacy. 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.

Any decision around a potential digital dollar needs to be anchored in the specifics of its operations, costs, and interactions with existing products, services, and infrastructure. Evaluation of the merits of a wCBDC must be based on an understanding of how it would interact with the broad range of capital markets infrastructure that would use it's payment functionality (both in the US and internationally) as well as its impact on various capital markets products and processes, ranging from securities settlement to cross border payments to foreign exchange funding and liquidity management impact, combined with the costs of developing and implementing such a system.

Need to Explore CBDC Alternatives

Furthermore, such analyses should include a careful review of whether the goals of a wCBDC 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

[22] "Our Markets" available at https://www.sifma.org/about/our-markets/

systems of private tokens, regulated private digital forms of money such as blockchain based deposits, stablecoins or tokenized deposits.[23] Other potential solutions include Partior, a shared-ledger multi-currency clearing platform that can be transacted 24x7x365 and can utilize smart contracts, or the Regulated Liability Network (RLN) proposal to tokenize central bank, commercial bank, and electronic money on the same chain.[24] Policymakers should explore if and how these alternative technology configurations could meet the objectives of a wCBDC, 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.

Similarly, a review of whether these regulated private forms of money can meet the need that a wCBDC would try to fill, and how they can co-exist with a potential future wCBDCs. Exploration of the potential benefits of these private blockchain based money models must be grounded in the specifics of their operating model, risks, and their regulatory oversight. Similarly, any regulation of these tools needs to be anchored in it's the specifics of the risk of the product and reflecting existing risk management tools.

Beyond these general points, we also make a number of specific recommendations for policy makers to consider as they approach a potential U.S. CBDC. following recommendations. We cover them in greater depth in our response to the Federal Reserve Board's January 2022 discussion paper, and we encourage Treasury 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.[25]

Crypto-assets: Distinctions with other Digital Assets & Benefits of Regulated Financial Institution Participation in Crypto Markets

While it is key to differentiate between different digital assets, as discussed above, perhaps the most important distinction is between purely crypto-assets and other types of digital assets. Policy makers should keep the distinction forefront when making digital asset policy and be cautious to avoid extrapolating risks or technology issues found in crypto assets to the broader world of blockchain based assets and infrastructure. These distinctions are: 1) technological, reflecting the unique features of many of the most common crypto-assets; and 2) regulatory, depending upon how the relevant digital asset is

[23] Examples of blockchain based deposit products include the JPMCoin, further information available at https://www.jpmorgan.com/onyx/coin-system.htm

[24] Partior is currently live with digital M1 (deposit liabilities of a commercial bank) being provided by JP Morgan (USD) and DBS (SGD). Over time, the platform intends to cover a broad set of currencies and multiple providers for each currency. Further information available at: https://www.partior.com/
See The Regulated Liability Network (RLN) Whitepaper, at https://www.citibank.com/tts/insights/articles/article191.html

[25] See 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."

characterized for the purpose of jurisdiction of a given regulator and application of its laws and regulations.[26]

While the risks associated with crypto in many ways differ from those seen in natively digital securities or tokenized assets, crypto asset risks can be understood and managed, and allowing regulated financial institutions to participate in crypto markets may help foster mature risk management, support regulatory oversight, and improve investor protection.

Without the meaningful involvement of regulated financial institutions in the crypto-asset space, consumers and institutional clients will seek crypto-asset-related products and services, which have considerable potential for economies of scale relative to traditional banking and investment 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. As a result of that fragmentation, customers would not have the full opportunity to benefit from the robust consumer and client protections that regulated banks and broker dealers provide

In contrast, allowing regulated financial institutions to engage in activities relating to crypto-assets will offer a range of benefits both to investors and the overall market. As discussed above, regulated financial institutions can offer mature technology and operational risk management programs, KYC and AML controls, data privacy, pre- and post-trade transparency, and experience in hedging and risk management on behalf of clients, combined with a mature set of appropriate supervisory and other controls and a track record of responsible development of products and services that can support further innovations in these areas in light of the unique features of the crypto markets.

Additionally, the public and the regulatory community would benefit from regulated financial institutional involvement in the crypto-asset space because banks and broker-dealers identify, monitor and manage risks from both a prudential and conduct perspective on an ongoing basis.[27]

[26] For an extended discussion of determining how a digital asset is determined to be a security, and a review of regulatory statements on the status of certain crypto assets, please see *De Simone, supra note 8*

[27] 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).

2. Response to Sections C & D: "General Risks in Digital Assets Financial Markets" & "Risks to Consumers, Investors, and Businesses"

In sections C and D, the RFC asks respondents to "identify and describe any risks arising from current market conditions in digital assets and any potential mitigating factors" and to "identify and describe potential risks to consumers, investors, and businesses that may arise through engagement with digital assets."[28] We appreciate the Treasury Department's interest in understanding the development of digital asset markets with a perspective informed by risks, both at the structural and market level and also in terms of risks to end-users. Understanding and managing risk has been a foundational consideration as SIFMA member firms have worked to understand digital assets and the opportunities they offer to regulated financial institutions and their clients. As discussed above, digital assets are only the latest in a series of technological innovations which have been explored and adopted by regulated financial institutions, and responsible innovation has been the guiding principle for SIFMA members as they explore digital asset opportunities, and draws on the establish technology, operational, and market risks frameworks already in place within firms.

Beyond this, we would like to highlight several considerations that shape SIFMA member firms' perspectives on understanding risks in the digital asset space, how to manage these risks, and the regulatory context that shapes them. At a foundational level, the principles of "same activity, same risk, same treatment" and technology neutrality should underpin regulators and policy makers engagement with digital assets. As such, digital assets represent different but not necessarily greater risk, risk that can be well managed by sophisticated and highly regulated financial institutions.

Similarly, it is critical to distinguish among digital asset types when thinking about risk, and not take a broad-brush approach which conflates the risks across digital assets with distinct operating models and that present very different types of risk. Additionally, the industry faces risks from regulatory uncertainty which impede long term planning and innovation, and the related risks from a bifurcated market if regulated financial institutions are precluded from meaningful participation in digital asset markets.

"Same Risk, Same Activity, Same Treatment" and Technologically Neutral Regulation

Treatment of digital assets should be risk-based, based on the principle of "same risk, same activity, same treatment." Regulation should focus on the relevant risks and how they are managed, without regard to the specific parties, products or systems in question.

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

[28] 87 Fed. Reg., 40882.

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 assets and offerings.

Technology neutral regulation is also important given that digital asset markets and the underlying 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." Existing statutes and regulation should be reviewed for whether it is technology neutral and whether it requires amendments to more suitably address changing technology.

Given the Diversity of Digital Assets, Understanding and Managing Risk Must be Grounded in the Specifics of a Given Product or Technology Configuration

The unique features of digital assets do not necessarily result in greater risks compared with "traditional" assets and infrastructure. This distinction is critical when assessing the risk impact of digital asset adoption on both the market as a whole as well as individual investors or market participants. This is based on several key considerations around digital assets: 1) the diversity of digital assets makes it inaccurate to use a broad-brush view of their overall level of risk; 2) DLT functionality does not necessarily mean risks are greater with respect to a digital asset compared to current forms of digital infrastructure, and 3) looking across the lifecycle of a digital asset is necessary to understand the particular facts and circumstances around its risk profile, and the degree to which risks are managed either by established risk management frameworks or through features of the DLT configuration itself.

As discussed above, the financial services industry is exploring a broad range of potential digital assets and supporting infrastructure configurations, which have substantial differences in their operating model and consequently their approaches to risk. For instance, a bearer instrument on a public network may have significant differences that inform the associated operational and regulatory risks when compared to a non-bearer instrument on a permissioned network. Looking at one of the use cases described above, the tokenization of existing securities to support new models of repo transactions, the security is already immobilized at a custodian before it is tokenized, and the market risks associated with the underlying asset are already well understood. Similarly, a model where registered securities are issued natively on a blockchain network could be configured in a way that replicates many of the risk management features of "traditional" securities, such as the use of a transfer agent, a custodian, and central clearing.

Assessing the risk of a given digital asset or service must be based on the specifics of how it is designed and operated. Regulated financial institutions carry out this process when they evaluate a potential new DLT-based product or application. Drawing on their existing processes for evaluating and understanding the risks in new products and technologies, a potential digitization project is reviewed and its risks are assessed on a range of criteria, covering the technology configuration itself, any external technology

providers, the role of counterparties and other infrastructure providers, market dynamics, client suitability, and compliance with existing rules and regulations. To the degree risks are identified, firms then determine how to understand and manage them, and build-in controls to reduce risk. Similarly, policy makers need to anchor regulation of digital assets and services in an understanding of the facts and circumstances of the relevant digital asset or service and avoid broad brush approaches.

Policy makers should also avoid relying on arbitrary distinctions between different blockchain technology configurations, and instead focus on the actual risk exposures of a given product and how they and managed and controlled. For example, while public blockchains entail a set of risks, there are applications built on public blockchains that can manage and reduce risk, such as through the use of permissioning and other controls. Ultimately, managing digital asset risk must be grounded in the specifics of a given product or technology, and regulation of these assets should follow the same approach.

Risks of Creating a Bifurcated Market in Absence of a Robust Regulatory Framework

Without the development of a robust regulatory framework that encourages innovation and regulated financial institution involvement while maintaining regulatory conservatism, there is a risk of the development of a bifurcated financial system. In this scenario, regulated financial institutions are prevented from meaningful participation in the emerging digital assets system, which continues to grow and develop but is dominated by institutions outside the traditional regulatory perimeter. This would have a range of negative consequences for investors and for the overall stability and development of US capital markets.

Bifurcation of the financial markets would ultimately result in weaker regulatory oversight of the digital asset markets and hinder the development of mature risk management and customer protection processes. As discussed above, regulated financial institution participation in digital asset markets offers regulators transparency into these markets, and their participation in the digital asset capital markets is guided by the protective framework established by existing securities and banking regulations, as well as AML and KYC regulations.

Similarly, exclusion of regulated financial institutions in a bifurcated market would prevent them from applying their existing technology risk management and client protection frameworks to the challenges presented by certain new types of digital assets. It would also impede innovation by preventing the development of products which sit at the intersection of “traditional” financial instruments and digital assets. Finally, this scenario would force investors to split their activities between different types of financial institutions when participating in the digital asset and regulated capital markets.

This risk of market fragmentation can also extend to the competitive position of the U.S. capital markets, as a range of other jurisdictions are developing new initiatives to bring digital assets withing an expanded

regulatory framework. Absent action by U.S. policymakers, there is the risk that a bifurcated market between digital assets and regulated capital markets develops in the United States at the same time that other jurisdictions are creating integrated markets. Other jurisdictions are actively partnering with the private sector to understand and exploit the opportunities presented by digital assets and bolster their economic competitiveness.

International pilots between governments and financial sector institutions have covered a range of use cases, ranging from asset tokenization and decentalized funding models (as seen in the Monetary Authority of Singapore's Project Guardian) to issuance, trading and settlement of digital government securities (*e.g.* Project Jura involving the Banque de France, the Swiss National Bank, a private sector consortium, and the BIS Innovation Hub Swiss Centre).[29] Failure by the U.S. to support regulatory modernization and public-private sector partnerships around digital assets can undermine the competitive position of the U.S. capital markets, and challenge the global economic leadership of the U.S, as the market share of digital assets becomes dominated by jurisdictions with more permissive approaches.

We discuss these potential challenges to the competitiveness of the U.S. capital markets in greater depth in our response to the US Department of Commerce's ("RFC") "Developing a Framework on Competitiveness of Digital Asset Technologies."[30]

Public-Private Partnerships and Dialogue are Necessary

Close dialogue and coordination between the public and private sectors are critical to support responsible innovation in the digital assets market. Many of the issues and challenges addressed in this letter – ranging from understanding how the implications of a specific digital asset technology configuration affect its level of risk, to designing new digital asset infrastructure, to understanding the implications of new and existing regulation on digital asset business models – can be addressed by a process of dialogue between financial institutions and policy makers and regulators. This dialogue can address how DLT innovation can meet regulatory goals of safety and soundness, market quality, and customer protection and ensure regulation. Moving beyond regulation, there are opportunities for public-private-partnerships to develop new products and services using DLT.

Risks from Regulatory Uncertainty

[29] "MAS Partners the Industry to Pilot Use Cases in Digital Assets" May 31, 2022, available at https://www.mas.gov.sg/news/media-releases/2022/mas-partners-the-industry-to-pilot-use-cases-in-digital-assets; "Project Jura: cross-border settlement using wholesale CBDC", available at https://www.bis.org/about/bisih/topics/cbdc/jura.htm

[30] SIFMA Response to Department of Commerce's ("RFC") "Developing a Framework on Competitiveness of Digital Asset Technologies." July 5, 2022, available at: https://www.sifma.org/resources/submissions/developing-a-framework-on-competitiveness-of-digital-asset-technologies/

Finally, continued regulatory uncertainty creates risks for financial institutions looking to develop new digital asset offerings. In the absence of regulatory certainty and the resolution of key outstanding regulatory issues, regulated financial institutions will not have the appropriate level of comfort needed to design and build new digital asset infrastructure and develop new products using blockchain networks. Regulatory fragmentation poses a related risk, where lack of coordination among regulators results in conflicting requirements that pose major obstacles to participation in digital asset markets. Regulatory coordination and clarity is particularly urgent given the rapidly evolving nature of the digital assets sector.

We would like to highlight several examples where regulatory uncertainty and lack of regulatory coordination poses challenges for regulated financial institutions as they develop new digital asset offerings. We discuss these in greater depth in comment letters associated with the rules in question, and look forward to exploring them in future elements of the Executive Order response process that focus on regulatory gaps and challenges.

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.[31] 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 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, with appropriate technology controls and disclosure, the risks can be sufficiently mitigated. 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.

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

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.[32]

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").[33] 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."[34]

SIFMA does not believe SPBDs are necessary for the digital asset security activities, as regulated 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

[32] 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/

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

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

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.[35]

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.[36]

[35] 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/

[36] 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).

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).[37] 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.[38]

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 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 that guide the classification of digital assets (*e.g.,* whether digital assets and related products are 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. As we discuss above, the principles of "same risk, same activity, same regulation" should guide future resolution of these challenges.

Policymakers should also bear in mind the range of non-bank regulatory frameworks that currently oversee certain aspects of digital assets markets. While still nascent, many digital asset brokerage and

[37] 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).

[38] 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.

derivatives activities should be regulated at the federal level given existing frameworks. Other developing activities, such as issuing a reserve-backed "payment stablecoin" could be issued under a federal or state regulatory regime with fundamentally comparable regulatory requirements. While remaining cognizant of the differences between activities and regulation across a range of criteria, such as their coverage of different entity types, products, and activities, SIFMA recognizes the ongoing policy debate over how certain digital assets align with the jurisdictional perimeter of regulators. It is critical that any federal regulatory approach follows the principles outlined above, and that any state regulation in this area should be no less stringent than Federal regulation of the same activities, consistent with current regulatory approaches.[39]

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We appreciate the opportunity to respond to this Request for Comment. We encourage the Treasury 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. We would also be pleased to speak further with you about our recommendations, including SIFMA members' perspective on the future role of regulated financial institutions in the digital assets sector, the regulatory challenges we face and how to overcome them, and our recommendations around a potential U.S. CBDC, among other topics. We also look forward to responding to future requests for comment issued by the Treasury Department as part of the ongoing Executive Order process.

Thank you for your consideration of our views. Please do not hesitate to reach out to Charles De Simone, Managing Director, Technology and Operations (cdesimone@sifma.org), Peter Ryan, Managing Director and Head of International Capital Markets and Prudential Policy, (pryan@sifma.org), or me with any questions or to discuss further.

Sincerely,

[39] See "12 U.S. Code Section 1831a - Activities of insured state banks" available at https://www.law.cornell.edu/uscode/text/12/1831a

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