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BLOG

Crypto-Assets: Implications for Consumers, Investors, and Businesses – U.S. Department of the Treasury

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On September 16, 2022, the U.S. Department of the Treasury (Treasury), the Department of Justice (the DOJ), and other U.S. government agencies released eight highly anticipated reports[1] (the Reports) on different aspects of digital asset regulation, setting forth the agencies' respective legislative, regulatory, and policy recommendations and priorities. The Reports were issued in response to White House Executive Order 14067 on Ensuring Responsible Development of Digital Assets (the Executive Order), which calls for a whole-of-government alignment of the federal government's approach to digital assets.

The Reports confirm the Biden-Harris Administration's acknowledgement that digital assets have potential benefits and are likely to remain a component of the U.S. financial system, but that the proliferation of the asset class presents unique risks that should be addressed. While the Reports provide some insight into the Administration's thinking about digital assets and articulate some recommendations and "calls to action," many significant regulatory questions remain unaddressed.

This post summarizes Treasury's Report on the opportunities and risks associated with crypto-assets and its recommendations to protect U.S. consumers and businesses.

Crypto-Assets: Implications for Consumers, Investors, and Businesses

In the Executive Order, the Biden Administration acknowledges that continued expansion of crypto-based technology could have profound implications for the users of digital assets—namely, consumers, investors, and businesses. In this Report, Treasury reviews current digital asset markets and trends that inform the potential opportunities and risks associated with their use. Treasury also discusses the implications of these opportunities and risks for consumers, investors, and businesses, considering those aspects affecting populations vulnerable to disparate impacts and proposing a multi-prong recommendation to address these risks.

Crypto-Asset Market Trends, Uses, and Opportunities
As of August 20, 2022, the market capitalization of Bitcoin was approximately $404.8 billion. Moreover, there has been an exponential growth in the number of coins and tokens, with an estimated handful of crypto-assets in 2013,

to more than 2,800 by the end of 2019, and to nearly 10,400 at the beginning of 2022. With this rapid growth, the number of digital asset trading platforms proliferated, significantly expanding the possibility for consumers, investors, and businesses to engage in an ever-changing variety of financial and non-financial activities.

Treasury explains that, despite the rapid expansion of digital assets, the uses of these products can be classified into the following broad categories:

- Crypto asset-based alternatives to traditional financial products and services;
- Financial market and payment system infrastructure; and
- Potential cases for other consumer and commercial uses by individuals and businesses, for example, non-fungible tokens (NFTs), gaming, records, identity, and supply-chain management.

Risks and Exposures for Consumers, Investors, Businesses
Existing use cases of digital assets and their potential opportunities come with risks, which Treasury categorizes into three groups: (1) conduct risks, including product, investor, consumer, and business protection; (2) operational risks, including the technology-specific risks of crypto-assets and systems; and (3) risks arising from crypto-asset intermediation.

Some of the risks are unique to digital assets while others are simply a form of risk already present in traditional finance markets that are heightened due to the specific attributes of crypto-assets. The lack of transparency, the uncertain regulatory environment, and the fact that crypto-assets have relatively novel and rapidly developing applications can give rise to fraud, theft, scams, abusive market practices, disclosure gaps, criminal activity, and operational failures. The unique features of the crypto-asset ecosystem can also make it attractive for unlawful activity–ongoing development and evolution of the underlying technology, pseudonymity, irreversibility of transactions, and the current asymmetry of information between issuers of crypto-assets and consumers and investors foster an environment ripe for misuse.

Despite efforts from regulatory authorities, chiefly including the Federal Reserve, Federal Deposit Insurance Corporation (FDIC), DOJ, and Commodity Futures Trading Commission (CFTC), Treasury explains that consumers, investors, and businesses remain exposed to risk that either arises from bad actors or occurs as a result of the products and services not being in compliance with regulatory requirements, regardless of intent.

Treasury notes that risks arise from non-compliance with the following:

- Extensive non-disclosure requirements for registered exchanges, products, and intermediaries that are designed to provide investors and customers with material information; and
- The requirements around market conduct that are designed to provide fair, orderly, and efficient markets.

Treasury discusses the disparate impact of the aforementioned risks for more vulnerable populations, which include low-income individuals; communities that have been historically excluded from the financial system or subject to discrimination in accessing financial services or wealth-building opportunities; and unbanked and underbanked populations. While digital assets may present opportunities to expand access to financial services, some of these populations may be more exposed to the volatility and risks of crypto-asset investing; others may be at greater risk of being preyed upon by targeted marketing, fraud, and scams; and still others may be more limited in their capacity to recover from financial harm. Treasury cites a survey from the Federal Reserve Board finding 29% of respondents who held crypto-assets for investment purposes had an annual household income of less than $50,000, stressing the urgency in examining and responding to the potential disparate impacts of crypto-asset activities.

Recommendations

In view of the risks and opportunities associated with crypto-assets, Treasury sets forth certain actions to be taken in the interim while stakeholders continue to deliberate on legislative proposals on the subject to protect U.S. consumers and businesses:

Recommendation 1 – Expand and Increase Investigations and Enforcement, and Cross-Agency Coordination: U.S. regulatory and law enforcement agencies should vigilantly monitor the crypto-asset sector for unlawful activity, aggressively pursue investigations, and continue to bring civil and criminal actions to enforce applicable laws and protect consumers, investors, and the market. Treasury additionally calls for coordination of law-enforcement officials and regulators to combat fraud, deter unlawful behavior, and improve practices in crypto-asset markets, in addition to sharing information regarding fraudulent, misleading, or manipulative market practices they are observing and investigating to ensure broad and consistent enforcement and supplement private sector analytic tools.

Recommendation 2 – Provide Guidance: U.S. regulatory agencies should continue using existing authorities to issue supervisory guidance and rules, as needed, to address emerging risks in crypto-asset products and services for consumers, investors, and businesses. Agencies should collaboratively promote consistent and comprehensive oversight of crypto-assets. Given significant interest of individual consumers, investors, and populations vulnerable to disparate impacts in crypto-assets, regulations should issue guidance, interpretations, and rulemaking related to crypto-assets in plain language.

Recommendation 3 – Access to Trustworthy Information: U.S. authorities should work individually and through the Financial Literacy and Education Commission to ensure that U.S. consumers, investors, and businesses have access to consumer-friendly, consistent, and trustworthy information on crypto-assets. Such materials should highlight risks associated with use of crypto-assets; identify and warn against common practices employed by perpetrators of fraud, thefts, and scams; and provide information on how to report unlawful practices.

Digital Assets & Blockchain Technology Group
Winston's cross-practice Digital Assets and Blockchain Technology Group provides accurate and efficient advice that helps clients navigate existing and developing legal challenges surrounding blockchain technologies. Our team draws upon experience from lawyers in our corporate, securities, tax, litigation, regulatory, and intellectual property practices, as well as others, to advise clients from startups and DAOs to the largest financial services firms in the world.

For more insight on the Reports, read our full briefing: The Future of Digital Assets Regulation in the United States.

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[1] The complete Reports mandated by President Biden's Executive Order and issued by Treasury, DOJ, and White House explored in this Winston Alert can be located at the following links:

- Action Plan to Address Illicit Financial Risks of Digital Assets issued by Treasury
- Crypto-Assets: Implications for Consumers, Investors and Businesses issued by Treasury
- The Future of Money and Payments issued by Treasury
- Climate and Energy Implications of Crypto-Assets in the United States issued by the White House
- Policy Objectives for a U.S. Central Bank Digital Currency System issued by the White House
- Technical Evaluation for a U.S. Central Bank Digital Currency System issued by the White House
- The Role of Law Enforcement in Directing, Investigating, and Prosecuting Criminal Activity Related to Digital Assets issued by the DOJ
- Responsible Advancement of US Competitiveness in Digital Assets issued by the U.S. Department of Commerce

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