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Digital Assets Banking and Capital Markets Regulatory Digest

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Center *for* Regulatory Strategy US

Table of contents

Introduction 3

Policy primer mark-to-market 4

Classification and reporting of digital assets

- Securities and Exchange Commission's (SEC) Chief Accountant delivers speech on Staff Accounting Bulletin No. 121 5
- Internal Revenue Service releases revised digital asset tax reporting form 6
- Treasury Inspector General publishes report on digital asset tax compliance enforcement 7
- Basel Committee approves disclosure framework for banks' digital asset exposures 8
- Federal Bureau of Investigation publishes 2023 Cryptocurrency Fraud Report 9
- House Financial Services Subcommittee holds hearing on SEC's approach to digital assets 10

Regulating exchanges

- House Financial Services Subcommittee holds hearing on decentralized finance (DeFi) 11

Stablecoin issuance

- Basel Committee approves amendments to its prudential standard to address stablecoin exposures 12

Path to a US central bank digital currency (CBDC)

- North Carolina legislature passes law banning CBDCs 13
- International Monetary Fund issues report on cyber resilience of CBDCs 14

Tokenization of real-world assets

- Basel Committee issues report on distributed ledger risks 15

Contacts 16

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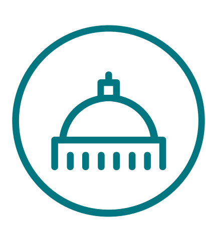
Introduction

As other jurisdictions implement tailored rules for digital assets,[1] US policymakers are increasingly feeling pressure to respond to maintain US competitiveness.[2] While many of these legislative efforts have yet to be fully enacted, regulators and lawmakers are working towards developing further clarity regarding the status of digital assets and providing a regulatory framework for the industry. As a result of these and other forces, we've updated the themes that are anticipated to drive the US policy environment in the future, including the following items:

Market infrastructure under-developed, but evolving: Regulatory clarity regarding digital assets continues to progress. The development earlier this year of the SEC approval of the first bitcoin spot exchange-traded product (ETP)[3] and exchange trading rules to list ether spot ETPs[4] are significant milestones towards market development. The digital asset market infrastructure will likely continue to mature and evolve in the years ahead.

Banks continue to be cautious towards engaging with digital assets: In recent years, regulators have attempted to carefully manage the connection points between the traditional financial system and digital asset ecosystem.[5] International standard-setting bodies have proposed stringent capital treatment measures for digital assets,[6] while federal banking regulators have instituted non-objection processes and special supervisory programs for banks engaging in novel activities.[7] As such, banks may remain cautious about engaging with digital assets, potentially creating an opportunity for nonbank financial companies (NBFCs) to fill the gap.



The future of digital assets invariably tied to upcoming elections: While recent political momentum surrounding digital assets has featured some bipartisan support, the upcoming presidential and congressional elections will likely have an outsized impact on the future of the industry and the infrastructure surrounding it. This is especially true as it pertains to the classification of digital assets and the development of a potential US CBDC. Along with other issues, the future of these issues could hinge on electoral outcomes as lawmaker positions on digital assets continue to fall largely along ideological lines.

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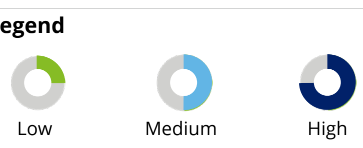
Policy primer mark-to-market

In our *Digital Assets Policy Primer*, we outlined two distinct paths that US regulatory policy could potentially take: with legislation or without legislation. The majority of recent developments are more consistent with our views for a diffused regulatory landscape without tailored legislation; however, there's reason to believe that may be changing. Through these changes, we have identified five policy focus areas.



Topic	Current outlook	Recent advances in regulatory clarity
Classification and reporting of digital assets: While the reporting framework for digital assets is becoming clearer, disputes over the classification of specific assets continue as both regulators and the industry remain litigious. We see a broad shift to tokenization of a range of assets, which is raising a new set of regulatory questions on the underlying technology.	Efforts to classify and regulate digital assets remain a focus around the industry. In the absence of federal legislation, individual states (notably, New York and California) are implementing their own reporting and licensing structures.[8]	
Regulating exchanges: Exchanges face increased regulatory pressures that extend beyond the established asset classification debate and could test their business model. The SEC and other financial regulators are focused on leveling up consumer and investor protections.	Legislators and regulators have continued to increase scrutiny and enforcement of exchanges in recent months, with a growing focus on decentralized finance (DeFi). Recent proposed legislation would further regulate exchanges, as well as new proposed regulations on brokers and exchanges from the US Department of the Treasury and Internal Revenue Service (IRS).[9]	
Stablecoin issuance: The regulatory treatment of stablecoins appears more muddled than ever. The *President's Working Group Report on Stablecoins* recommended a bank regulatory framework,[10] yet enforcement actions and differing legislative proposals may further complicate the regulatory approach.	The fate of stablecoins in the US will likely be closely tied to bills currently under consideration in Congress with some indicators of growing momentum to pass a regulatory framework. In the meantime, agencies are examining the risks that stablecoins could present in the market.	
Path to a US CBDC: Initiatives to modernize the financial system through a US CBDC are still in the early stages. However, there remains significant political resistance to the idea, particularly for retail CBDC.	Issuance of a CBDC has become an increasingly political issue in recent months, with new bills being introduced to slow or even stop research and development of such an instrument. However, there has still not been a firm decision on the pursuit of a CBDC in the US.	
Tokenization of real-world assets: As industry participants continue to explore the development of tokenization, regulators and policymakers continue to study the technology's implications, balancing innovation, investor and consumer protection, and financial stability.	Regulators and lawmakers continue to study the technology behind, and implications of, asset tokenization, including hosting congressional hearings and an industry symposium. Meanwhile, industry participants continue to explore use cases and launch applications, such as the cross-industry Regulated Settlement Network (RSN).[11]	

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SEC Chief Accountant delivers speech on SAB 121

Key summary points

- ***Headline***: On September 9, 2024, the Chief Accountant for the SEC, Paul Munter, discussed digital asset custody arrangements in which entities "should not recognize a liability for an obligation to safeguard crypto-assets held for others" as outlined in Staff Accounting Bulletin No. 121 (SAB 121).
- ***Bank arrangements***: Chief Accountant Munter highlighted an unnamed bank holding company (BHC) that (1) obtained written approval from its state prudential regulator and engaged with its primary federal prudential regulator; (2) held digital assets in a bankruptcy-remote manner in individual blockchain wallets with the customer as the benefit owner; (3) obtained a legal opinion from outside counsel supporting its "bankruptcy-remote" conclusion; and (4) negotiated limited liability of the bank for risks outside its direct control.
- ***Introducing broker-dealer arrangements***: Chief Accountant Munter also highlighted arrangements by an unnamed introducing broker-dealer (B-D) in which (1) neither the introducing B-D, nor its agent(s) held the cryptographic key; (2) the third party providing trade execution and safeguarding services is an agent of the customer; and (3) the introducing B-D obtains a legal opinion from outside counsel supporting several bankruptcy-remote assertions.

Considerations

Engage with regulators and seek approval, where needed

- Engagement with regulators is key when offering novel or complex business services and products, including digital assets.
- Institutions should discuss their specific proposed digital asset safeguarding activities with their prudential supervisors, including a detailed review by the regulators of the entity's governance and risk management practices for those activities.
- Where appropriate, institutions should seek written approval from their prudential regulator and be responsive to any regulatory feedback on necessary governance and controls.

Obtain legal clarity on custody arrangements

- Institutions should obtain an opinion from outside legal counsel that supports the institution's bankruptcy-remote governance structure, in the event of insolvency.
- It is crucially important to have clear legal and contractual arrangements that delineate roles and responsibilities between the digital asset institution, its customers, and any third-party service providers, including any legal obligations to compensate customers in the event of loss or operational failures.

Source: Securities and Exchange Commission, (SEC), Chief Accountant Paul Munter, "Remarks before the 2024 AICPA & CIMA Conference on Banks & Savings Institutions: Accounting for Crypto-Asset Safeguarding Obligations—A Facts-Based Analysis," September 9, 2024.

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IRS releases revised digital asset tax reporting form

Key summary points

- ***Headline***: On August 9, 2024, the IRS released a revised draft version of its digital asset tax reporting form titled 1099-DA "Digital Asset Proceeds From Broker Transactions."
- ***Alignment with final rule***: As discussed in the July 2024 edition of *Digital Assets Banking and Capital Markets Regulatory Digest*, the Department of the Treasury and IRS finalized a rule on reporting requirements for brokers of digital assets. The revised 1099-DA form has been updated to better align with the newly finalized reporting rule with many streamlined features, including:
  - Removal of box to indicate broker type (e.g., kiosk operator, hosted/unhosted wallet provider).
  - Removal of box requiring transaction ID and digital asset address.
- ***Timeline***: Under the finalized tax reporting rule, brokers will be required to report gross proceeds on the sale of digital assets beginning in 2026 for all sales in 2025. Beginning in 2027, brokers will be required to also report information on the tax basis for certain digital assets for sales in 2026.

Considerations

More streamlined reporting, but costs still material

- While the revised 1099-DA form provides for more streamlined tax reporting than previously proposed, brokers should still be prepared to allocate additional resources towards compliance and incorporate the impacts of the additional costs into their strategic planning.
- In the final rule, the Department of the Treasury and IRS estimated it will take, on average, 9 minutes to complete 1099-DA forms for each customer, with the estimated aggregate, annual monetized burden of $148.4 million.

Read Deloitte's publications to learn more

- As previewed in our last edition, Deloitte's tax professionals have developed publications providing in-depth analysis on the final reporting rule and revised reporting form. You can ready more below:
  - Release of final digital asset broker reporting regulations
  - IRS releases updated draft Form 1099-DA

Sources: Internal Revenue Service (IRS), "IRS updates draft version of Form 1099-DA, Digital Asset Proceeds From Broker Transactions; requests comments on form planned for 2025," press release, August 9, 2024; US Department of the Treasury, "US Department of the Treasury, IRS Release Final Regulations Implementing Bipartisan Tax Reporting Requirements for Sales and Exchanges of Digital Assets," press release, June 28, 2024.

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Treasury Inspector General publishes report on digital asset tax compliance enforcement

Key summary points

- ***Headline***: On July 10, 2024, the Treasury Inspector General for Tax Administration (TIGTA) published a report detailing how effectively the IRS identifies income earned from digital asset transactions.
- ***Enforcement challenges***: The report found room for improvement in compliance enforcement, noting that the IRS faces significant challenges in enforcing tax compliance for digital asset transactions due to the anonymity provided by cryptocurrencies and the lack of consistent reporting from trading platforms.
- ***Civil and criminal enforcement disparities***: To date, the IRS has focused primarily on criminal cases, with nearly 400 cases opened by the Criminal Investigation (CI) unit from 2018 to 2023. Civil examination efforts, however, were described as "indirect and negligible," with only a fraction of tax examinations reviewing digital asset transactions.
- ***Recommendations***: While the report's recommendations were redacted, the TIGTA did note that the development of a compliance plan and increased leveraging of data and analytics could help improve tax compliance enforcement.

Considerations

Digital asset tax prosecutions have increased significantly

- IRS CI prosecutions have increased significantly since 2018, both in the number of cases and dollar value of seizures.
- Between 2018–2022, the number of cases recommended for prosecution more than doubled, while the value of seizures increased from $1.5 million in 2018 to approximately $7 billion in 2022.

Potential for further enforcement

- In highlighting the current challenges to the IRS and potential internal agency solutions, the report may lead to greater attention and enforcement of digital asset tax compliance, particularly for civil cases.
- The development of an agency-wide strategic compliance plan could help promote more resources toward civil examinations, along with greater use of data analytics and technology platforms to target high-risk noncompliance areas more effectively.
- Upcoming changes to the tax code, including reporting requirements for digital asset transactions on Form 1099-DA could benefit civil compliance enforcement and examinations as more information becomes available.

Source: Treasury Inspector General for Tax Administration (TIGTA), "Virtual Currency Tax Compliance Enforcement can be Improved," July 10, 2024.

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Basel Committee approves disclosure framework for banks' digital asset exposures

Key summary points

- ***Headline***: On July 3, 2024, the Basel Committee on Banking Supervision (BCBS) approved a finalized disclosure framework for banks' digital asset exposures.
- ***Two-stage materiality definition***: The BCBS is proposing a two-stage definition of materiality for Group 2 digital assets (i.e., non-tokenized assets or stablecoins).
  - **Stage 1** would ascertain whether a bank's exposures are material at an aggregate level (i.e., when a bank's Group 2 exposure limit is equal to or greater than 0.3%).
  - **Stage 2** would be met when a bank's exposure to an individual Group 2 digital asset is >5% of total Group 2 exposures.
- ***Reporting daily averages***: The new disclosure framework sets forth a standard template to disclose digital asset exposures using average daily values in addition to period-end values.
- ***Reporting risks of tokenized assets***: Under the new disclosure framework, banks would report credit and market risks, as well as liquidity requirement, for their Group 1a exposures (i.e., tokenized assets).
- ***Timeline***: The disclosure framework standard has an implementation date of January 1, 2026. However, as BCBS standards are non-binding, it will require individual members to implement in their home jurisdictions.

Considerations

More consistent, cross-border reporting

- The BCBS's disclosure framework offers the potential to improve cross-border reporting of digital asset exposures, thereby providing regulators and the market with greater insights into the connection points between the digital asset ecosystem and traditional financial system.
- The use of common materiality definitions and consistent reporting templates may help to reduce information asymmetries among banks and market participants.
- Regulators may be in better positions to identify and respond to risks within the banking system.
- Financial institutions may be prompted to more carefully consider the risks of their digital asset exposure strategy.
- Market participants may have greater insight into capital flows into digital assets, thereby supporting the exercise of market discipline.

Sources: Bank for International Settlements (BIS), "Basel Committee approves disclosure framework and capital standard for banks' cryptoasset exposures and amendments to interest rate risk in the banking book standard, and agrees to consult on third-party risk principles," press release, July 3, 2024; BIS, "Disclosure of cryptoasset exposures," July 17, 2024.

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FBI publishes 2023 Cryptocurrency Fraud Report

Key summary points

- ***Headline***: On September 9, 2024, the Federal Bureau of Investigation (FBI) released its *Cryptocurrency Fraud Report* for 2023, noting that the agency received more than 69,000 complaints from the public regarding cyber-enabled crime and financial fraud involving the use of cryptocurrency, with over $5.6 billion in reported losses—a significant increase in both the number of complaints and financial losses.
- ***Investment scams***: According to the report, investment scams were the most dominant form of fraud, accounting for more than 70% of all cryptocurrency losses, amounting to a 53% increase year over year.
- ***Other leading fraud taxonomies***: The report highlighted the rise of confidence/romance-enabled scams involving the use of social engineering, along with the use of crypto-currency kiosks to perpetuate fraudulent activities.
- ***Challenges of digital asset crime***: The report noted that decentralization, speed, and the irreversible nature of digital asset transactions make it an attractive vehicle for criminals and create challenges for recovering stolen funds. As such, rapid and accurate complaint reporting are key to assisting law enforcement.

Considerations

Enhancing consumer fraud detection capabilities

- Given the significant increase in cryptocurrency-related fraud, the report found a critical need for enhanced consumer education on the risks associated with cryptocurrency investments. Public awareness campaigns and educational programs can help individuals recognize and avoid common scams.
- The report also noted that financial institutions and technology platforms should invest in advanced fraud detection tools and algorithms to identify suspicious activities early. This includes monitoring for unusual transaction patterns and flagging potential fraudulent schemes.

Strengthening regulatory-law enforcement collaboration

- The report found that improved collaboration between law enforcement agencies, regulatory bodies, and financial institutions is essential, and could lead to more efficient investigations and higher chances of recovering stolen funds.
- Institutions should leverage the report in reviewing their internal policies and procedures for notifying and cooperating with regulatory and law enforcement agencies in the event of consumer fraud.

Source: Federal Bureau of Investigation (FBI), Internet Crime Complaint Center (IC3), "Cryptocurrency Fraud Report 2023," September 2024.

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House Financial Services Subcommittee holds hearing on SEC's approach to digital assets

Key summary points

- ***Headline***: On September 18, 2024, the US House of Representatives' Subcommittee on Digital Assets, Financial Technology, and Financial Inclusion held a hearing on the SEC's regulatory approach to digital assets with witnesses from industry and academia.
- ***Concern over securities determinations:*** Some witnesses expressed concern towards the SEC's determinations of digital asset as securities, which many thought were overly broad and lacked advanced clarity. Determinations are made on a case-by-case basis, often through litigation, which may result in contradictory findings across different jurisdictions.
- ***Consumer risks***: Witnesses discussed the elevated consumer protection risks present in the digital assets space, including the rising number of scams and hacks.
- ***Desire for tailored regulations***: The hearing's witnesses generally agreed on the advantages for tailored digital asset regulations, expressing concerns that regulatory uncertainty may drive innovation and capital offshore. Comparisons were made to the European Union's Markets in Crypto-Assets Regulation (MiCA).

Considerations

Digital asset legislation may come in the next Congress

- The hearing highlighted the continued interest of lawmakers in developing a regulatory path for digital assets.
- While there are limited legislative days remaining in the 118th Congress, the hearing provided some potential previews of areas of concern that are likely to remain in focus when the next congressional term resumes in January 2025.

Distinguishing from securities remains a policy priority

- The hearing underscored the continued uncertainty regarding how to distinguish digital assets from securities, with many witnesses and lawmakers advocating for more regulatory clarity separating digital assets from the public markets' securities framework.
- Closely tied to setting a digital asset regulatory framework will be how to appropriately incorporate greater consumer protections.

Source: US House of Representatives, "Hearing Entitled: Dazed and Confused: Breaking Down the SEC's Politicized Approach to Digital Assets," September 18, 2024

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House Financial Services Subcommittee holds hearing on decentralized finance (DeFi)

Key summary points

- ***Headline***: On September 10, 2024, the US House of Representatives' Committee on Financial Services' Subcommittee on Digital Assets, Financial Technology and Inclusion held a hearing on the future of DeFi.
- ***Market integrity***: Several lawmakers highlighted the high volatility and consumer risk within DeFi markets. In response, some of the hearing's witnesses testified that regulators should apply existing securities laws to DeFi exchanges to better protect consumers and maintain market integrity.
- ***Potential legislative action:*** Two bills were attached to the hearing, which would require the SEC, Commodity Futures Trading Commission (CFTC), and the Secretary of the Treasury to jointly carry out a study on DeFi, as well as require the Secretary of the Treasury to report on privacy-preserving technologies used in connection with digital asset transactions.
    - While the two bills are unlikely to become law in the remaining days of the current 118th Congress, they could signal early movement in the next 119th Congress, which will begin in January 2025.

Considerations

Legal and regulatory uncertainty remains

- The hearing highlighted the extent of regulatory ambiguity for DeFi market participants and the stark differing views among legislators on how to proceed.
- Together, these present an uncertain future for DeFi's growth and adoption as businesses, investors, and consumers may be wary of engaging in an unregulated market without a clear regulatory future.

Focus on customer protection and market integrity

- While regulatory uncertainty remains, stakeholders in the DeFi space should work to improve customer protections and market integrity, including collaborating to establish clear and practical risk management standards.
- DeFi protocols should also engage in customer education on how to protect themselves from scams and better understand their financial risk. This may include use of disclaimers or educational pages that detail fraud taxonomies and leading practices to protect oneself.

Source: US House of Representatives, Committee on Financial Services, Subcommittee on Digital Assets, Financial Technology and Inclusion, "Hearing Entitled: Decoding DeFi: Breaking Down the Future of Decentralized Finance," September 10, 2024.

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Basel Committee approves amendments to its prudential standard to address stablecoin exposures

Key summary points

- ***Headline***: On July 3, 2024, the BCBS finalized targeted amendments to its prudential standard on banks' exposure to digital assets, which set forth standards for stablecoin treatment.
- ***Bankruptcy remoteness***: The final amendments require stablecoin reserve assets to be placed in bankruptcy-remote structures from any party that issues, manages or is involved in the stablecoin operations, or that custodies the reserve assets.
  - There is a limited exception where a bank is only providing custody services to a stablecoin, in which case the cash associated with the reserve does not need to be held bankruptcy remote from the bank's other deposits.
- ***Inclusion of repos in stablecoin reserves***: The final amendments allow cash receivables under reverse repurchase (repo) agreements to be included in stablecoin reserves, subject to certain minimum conditions.
- ***Timeline***: The amendments to the prudential standard have an implementation date of January 1, 2026. However, as BCBS standards are non-binding, it will require individual members to implement in their home jurisdictions.

Considerations

Improved consumer protection

- The Basel Committee's prudential standard's focus on bankruptcy remoteness may improve consumer protection in the event of a stablecoin issuer insolvency.
- Where stablecoin reserves are not placed in a bankruptcy-remote structure (e.g., where ownership of the reserve assets belong to the issuer or are unclear), consumers could face long wait times to redeem their stablecoins and potentially receive less than par value in the event of an insolvency.

Preferential regulatory treatment

- The amended standards set forth the criteria necessary for stablecoins to receive preferential "Group 1b" regulatory treatment (i.e., "cryptoassets with effective stabilisation mechanisms").
- Group 1b digital assets that reference a pool of traditional assets are eligible for the same risk weighting applicable for a direct holding of the referenced pool of traditional assets. Otherwise, a 1250% risk weighting would apply.

Sources: Bank for International Settlements (BIS), "Basel Committee approves disclosure framework and capital standard for banks' cryptoasset exposures and amendments to interest rate risk in the banking book standard, and agrees to consult on third-party risk principles," press release, July 3, 2024; BIS, "Cryptoasset standard amendments," July 17, 2024. See also BIS, "Prudential treatment of cryptoasset exposures," December 2022.

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North Carolina legislature passes law banning CBDCs

Key summary points

- ***Headline***: On September 9, 2024, the General Assembly of North Carolina passed a law prohibiting the state from using a CBDC or participating in potential future testing of CBDCs by the Federal Reserve.
- ***Retail CBDC in scope***: The law focuses only on retail CBDCs, as it defines a CBDC as a digital currency issued by the Federal Reserve or federal agency "that is made directly available to a consumer by such entities." Therefore, wholesale CBDCs (i.e., those issued directly to financial institutions and not made directly available to consumers) appear to be exempt from the law's prohibitions.
- ***Gubernatorial veto overturned***: The law, originally passed in June 2024, was vetoed by Governor Roy Cooper. While the bill originally passed with bipartisan support, the veto override was passed by the state's two legislative chambers nearly along party lines with all Republicans voting in favor of the law and all, but one, Democrats voting against.

Considerations

CBDCs remain politically contentious

- Several other states have passed anti-CBDC legislation, including Florida, Georgia, Alabama, and Indiana.
- As detailed in the July 2024 edition of *Digital Assets Banking and Capital Markets Regulatory Digest*, the US House of Representatives passed a bill that would prohibit the Federal Reserve from issuing a CBDC without congressional authorization.

State prohibitions have thus far focused on retail CBDCs

- While several states have passed anti-CBDC legislation into law, and many more with similar pending bills, the focus of state actions related to CBDCs have largely focused on retail CBDCs that are made available directly to consumers.
- These legislative actions reflect concerns from some policymakers about potential privacy infringement associated with a retail CBDC.
- Therefore, as the path to a retail CBDC appears more challenging, wholesale CBDCs may be the most likely form of a potential Federal Reserve-issued digital currency.

Source: General Assembly of North Carolina, Session 2023, "Session Law 2024-48/House Bill 690," September 9, 2024.

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IMF issues report on cyber resilience of CBDCs

Key summary points

- ***Headline***: On August 27, 2024, the International Monetary Fund (IMF) published a report exploring critical aspects of cybersecurity in the context of CBDCs, detailing the pros and cons of commonly considered design options and suggesting leading practices for developing cyber-resiliency.
- ***Cyber risk and operational risk***: CBDCs could be subject to similar risks of other digital payments; however, they are likely to face greater resiliency risks given they are likely to involve a larger number of intermediaries and third parties, a wider and less cyber risk-aware user base, and may be more attractive to sophisticated cyber attackers, such as nation-states.
- ***Design considerations***: The report highlighted several key design choices surrounding CBDCs that can greatly impact their complexity and resiliency. For example, decisions surrounding distribution models (e.g., direct vs. intermediated), token-based vs. account-based systems, ad centralized vs decentralized ledger technologies, offline functionality and third-party reliance.

Considerations

Wholesale CBDCs may be more resilient than retail CBDCs

- Compared to wholesale CBDCs, a retail CBDC ecosystem is more complex and interconnected, including participants that are outside the central bank's purview with operations highly reliant on telecom networks and national infrastructures.
- Due, in part, to the complexity and resilience advantages, the US CBDC would likely first develop in the form of a wholesale CBDC with direct participants being limited to financial institutions.

CBDC exploration remains widespread globally

- The report noted more than 100 central banks around the globe are exploring CBDCs as a means to modernize their nation's payment systems. These programs can be illustrative in identifying how a US CBDC may develop.
- The report also recommended several leading practices to improve resilience that the US could adopt in the event a CBDC is issued, such as designating CBDCs as critical infrastructure, extending supervisory oversight to third parties engaged with the CBDC's operations, and conducting regular security tests and crisis exercises.

Source: International Monetary Fund (IMF), "Cyber Resilience of the Central Bank Digital Currency Ecosystem," August 27, 2024.

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Basel Committee issues report on distributed ledger risks

Key summary points

- ***Headline***: On August 28, 2024, BCBS released a report that considered the risks faced by banks that transact on permissionless blockchain networks.
- ***Governance risks***: The decentralized governance of permissionless networks challenges banks' ability to establish clear lines of responsibility and conduct third-party due diligence. Additionally, the consensus decision-making process poses challenges in promptly addressing security vulnerabilities, which may increase the risk of loss associated with assets that exist on these blockchains.
- ***Legal and compliance risks***: The pseudonymous nature of blockchain transactions can complicate banks' compliance with know your customer (KYC), anti-money laundering (AML) / combatting the financing of terrorism (CFT), and sanctions regulations.
- ***Potential risk mitigants***: The report discusses different mitigants banks may consider implementing for real-world deployments, including business continuity planning (BCP) and smart contract programmed operational attributes and limitations to certain transactions.

Considerations

Incorporate blockchain risks into business continuity plans

- The BCBS report noted business continuity planning is perhaps the most effective risk management strategy currently available, particularly for traditional financial assets issued on a blockchain settlement layer.
- Financial institutions exploring, or considering, distributed ledger technology should incorporate blockchain-related risks into their BCP strategy, such as off-chain databases for recovery and identification of alternative settlement layers where assets can be ported in the event of disruption.

Monitor legal development and supervisory expectations

- Banks should engage their supervisors early and throughout their blockchain strategy planning and development.
- It's important to monitor changes in laws and regulations globally, particularly for permissionless networks, as changes in public policy may result in sudden changes in validator behavior and network security.
    - For example, jurisdiction bans on mining could reduce the amount of computing power or staked native tokens available to secure the network.

Source: Bank for International Settlements (BIS), "Working Paper 44: Novel risks, mitigants and uncertainties with permissionless distributed ledger technologies," August 28, 2024.

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Endnotes

[1] E.g., Financial Conduct Authority (FCA), PS23/6: Financial promotion rules for cryptoassets, November 15, 2023; European Union, Regulation (EU) 2023/1114 (Markets in Crypto-Assets Regulation [MiCA]), May 31, 2023.

[2] E.g., US House of Representatives, Committee on Financial Services, "McHenry Delivers Remarks at Hearing on the Future of the Digital Asset Ecosystem," press release, June 13, 2023; US Department of Commerce, "Responsible Advancement of U.S. Competitiveness in Digital Assets Report," September 2022.

[3] Securities and Exchange Commission (SEC), "Order Granting Accelerated Approval of Proposed Rule Changes, as Modified by Amendments Thereto, to List and Trade Bitcoin-Based Commodity-Based Trust Shares and Trust Units," January 10, 2024.

[4] SEC, "Order Granting Accelerated Approval of Proposed Rule Changes, as Modified by Amendments Thereto, to List and Trade Shares of Ether-Based Exchange-Traded Products," archived May 23, 2024.

[5] E.g., Federal Deposit Insurance Corporation (FDIC) Office of Inspector General, "FDIC Strategies Related to Crypto-Asset Risks," October 18, 2023; Federal Reserve Board of Governors (FRB), "Policy Statement on Section 9(13) of the Federal Reserve Act," January 27, 2023.

[6] Bank for International Settlements (BIS), Basel Committee on Banking Supervision (BCBS), "Prudential treatment of cryptoasset exposures," December 2022.

[7] FRB, "SR 23-7: Creation of Novel Activities Supervision Program," August 8, 2023; FRB, "SR 22-6 / CA 22-6: Engagement in Crypto-Asset-Related Activities by Federal Reserve-Supervised Banking Organizations," August 16, 2022; FDIC, "Notification and Supervisory Feedback Procedures for FDIC-Supervised Institutions Engaging in Crypto-Related Activities," April 7, 2022; Office of the Comptroller of the Currency (OCC), "Interpretive Letter #1179," November 23, 2021.

[8] 23 NYCRR Part 200 under the New York Financial Services Law; Office of the Governor of California, AB39 signing message, October 13, 2023; California Assembly, Assembly Bill No. 39, October 13, 2023 ("Digital Financial Assets Law").

[9] US Department of the Treasury and Internal Revenue Service (IRS), "Treasury and IRS issue proposed regulations on reporting by brokers for sales or exchanges of digital assets; new steps designed to end confusion, help taxpayers, aid high-income compliance work," press release, August 25, 2023.

[10] US Department of the Treasury, "President's Working Group on Financial Markets releases report and recommendations on stablecoins," press release, November 1, 2021.

[11] Deloitte, "Members of the U.S. Financial Sector to Explore Multi-Asset Settlement Using Shared Ledger Technology," press release, May 8, 2024.

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