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European Central Bank Executive Board Member Decries "Crypto Gamble" and Echoing SEC Chair Gensler, Calls for Regulation of the "New Wild West" of Crypto-Assets

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In a speech given this week at Columbia University by Fabio Panetta, Member of the Executive Board of the European Central Bank (ECB), he decried the entire "crypto gamble," seeing crypto-assets as "bringing about instability and insecurity – the exact opposite of what they promised" and calling for tighter regulation in the EU (and coordination with international partners) to curb the financial and associated risks from crypto-assets.

Panetta's speech (entitled "For a few cryptos more: the Wild West of crypto finance") evoked remarks made by SEC Chair Gary Gensler back in August 2021 that labeled crypto the "Wild West" and requested Congress give the Commission more authority "to write rules for and attach guardrails to crypto trading and lending" that would boost consumer trust and allow the industry to prosper. Panetta's scathing broadside was lobbed against what he sees as the risky, seamier side of crypto – the speculative fervor and greed, the high volatility of crypto markets, the facilitation of criminal financial activity, the lack of adequate disclosures, the largely unregulated or "insufficiently supervised" cryptocurrency miners and service providers, and other un- or under-regulated aspects of the "crypto bubble" that, if left ignored, could pose risks to financial stability (citing the sub-prime mortgage market that triggered the last global financial crisis). While far more strident in tone than President Biden's March 2022 executive order, Panetta's speech similarly articulated a high-level strategy for regulating and fostering innovation in the burgeoning digital assets space and pushed for central banks to move more quickly to develop central bank digital currencies (CBDCs) and "respond to the people's growing demand for digital assets and a digital currency by making sovereign money fit for the digital age" or else sit by as the private sector satisfies this demand.

Taking a wide view, Fabio Panetta's remarks, coupled with the multiple crypto-related regulatory developments ongoing both in the EU and U.S., suggest that some changes are afoot for the crypto industry. While there has been some industry-friendly legislation at the state level in recent years to encourage innovation, at the federal level it seems that the honeymoon period of light touch or no regulation (or largely, regulation by agency enforcement) for the crypto industry is over. Innovation in this space continues at a furious pace at the same time as regulators are slowly gaining experience and expertise about the public policy and investor risks surrounding crypto-assets. Thus, providers should expect more scrutiny and additional compliance hurdles going forward, as multiple regulators have stated that the lasting innovations and societal benefits of cryptocurrencies and DeFi applications can only occur alongside responsible regulation. Panetta stated that pulling off such responsible oversight will not be easy, as there will be "complex trade-offs, balancing the goals of promoting innovation, preserving financial stability and ensuring consumer protection."

Panetta's speech highlighted several areas where he believed crypto-assets were "speculative and high-risk investments" that could eventually become a risk to the financial system, prompting the call for more regulation:

- **Public policy concerns:** Panetta argued that unbacked crypto assets, due to their volatility, cannot perform the basic functions of money and "in the absence of adequate controls," such assets are now largely driven by speculation, FOMO (fear of missing out) and expectations of fast returns. Panetta noted that such crypto-assets are purchased by those who likely do not understand the risks of what they are buying and do so with few, if any, backstops or protections. He went on to comment on the adverse environmental consequences of cryptocurrencies run on proof-of-work blockchains and the use of crypto by criminal enterprises in ransomware and other schemes. Similar to discussions undergoing in Congress surrounding stablecoins, Panetta also argued that stablecoins, which are digital currencies that are backed by fiat currency or tied to other safe assets, "can be low-risk but not riskless" and present their own systemic financial concerns.
- **Regulation of crypto-assets:** Panetta stated that regulation should "balance the risks and benefits so as not to stifle innovation that could stimulate efficiency in payments and broader applications" of blockchain technologies. He outlined four major areas of focus: (1) holding crypto-assets to the same standards as the traditional financial system, especially in the area of AML and sanctions compliance; (2) ensuring fair taxation of crypto-assets, including a suggestion that

> crypto based on proof-of-work be taxed at higher rates; (3) putting in place enhanced reporting and transparency requirements for stablecoins; (4) enacting consumer protection measures to protect unexperienced crypto investors. In his view, the EU needed to act sooner rather than later: "We should make faster progress if we want to ensure that crypto-assets do not trigger a lawless frenzy of risk-taking.".

Panetta's speech referenced several proposals that EU lawmakers are currently working on. Indeed, the EU's branches of government are currently in trilogue discussions on the Markets in crypto-assets regulation or "MiCA," which is a sweeping proposal to enable and regulate digital finance (and which recently made news regarding a rejected provision that would have restricted the use of cryptocurrencies that run on proof-of-work). EU legislators are also completing negotiations on crypto-related AML regulation, as well as debating the proposed Regulation on information accompanying transfers of funds and certain crypto-assets ("FCTR"), which would, among other things, require crypto-asset transfers that include at least one virtual asset service provider to be traced and that suspicious transactions be blocked.

Proposals covering crypto-assets are also percolating in the U.S., as evidenced by: the SEC's push to regulate the next generation of blockchain-based, decentralized finance (DeFi) applications; SEC Chair Gensler's recent statement that the agency will consider whether and how the protections that are afforded to other investors on exchanges with which retail investors interact should apply to crypto platforms; the Treasury Department's Office of Foreign Assets Control (OFAC) release of a sanctions compliance guidance in 2021 for the virtual currency industry; a recent statement by the acting head at the United States Office of the Comptroller of the Currency (OCC), Michael Hsu, contending that standards should be developed surrounding stablecoins, akin to the early days of the internet, to ensure that stablecoins are open and inclusive; Congress's ongoing debate over stablecoin regulation and sweeping regulation of digital assets (e.g., H.R.4741); and President Biden's executive order on digital assets that, among other things, directed the Federal Reserve and others to step up the study of CBDCs.

Thus, as Panetta stated, the growth of crypto-asset markets “reveals society’s growing demand for digital assets and instant payments,” which is pushing providers to create innovative crypto-related products and applications. As a result, global regulators and central banks must now consider a host of new public policy and systemic financial issues.

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