Alert | Blockchain & Digital Assets

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Digital Assets Sector: What to Watch for in 2022

The digital asset and blockchain sector in 2021 saw exponential growth and adoption fueled by stablecoins, non-fungible tokens (NFTs), decentralized finance (DeFi), and decentralized autonomous organizations (DAOs). Headed into 2022, market participants await regulatory proposals amid increased calls for oversight of this burgeoning industry. This GT Alert discusses six areas that are top-of-mind:

1. **Stemming the Rise of Independent Stablecoins**. Stablecoins are a virtual currency designed to maintain a constant value. In the United States, stablecoins most often are created to have one “coin” equal $1.00. In 2021, the U.S. Congress began to investigate stablecoins and raised concerns regarding their stability. During a hearing of the Senate Banking, Housing, and Urban Affairs Committee, Sen. Elizabeth Warren demanded that regulators “clamp down” on stablecoins and decentralized finance platforms “before it is too late.” 2021 also saw certain stablecoins criticized by a variety of regulators, particularly the Securities and Exchange Commission and the Federal Reserve. Members of the House of Representatives have begun looking to regulate stablecoins with the introduction of the Stablecoin Tethering and Bank Licensing Enforcement (STABLE ACT). The STABLE ACT seeks to ban any stablecoins not issued by a federal bank and would require, among other things, that issuers of stablecoins obtain a banking charter, follow banking regulations, obtain FDIC insurance, and obtain approval from banking agencies six months prior to issuance of the stablecoin. Attempts to regulate stablecoins may accelerate in 2022, with industry closely watching the Fed in anticipation of the potential addition of a digitized version of the U.S. dollar through its own stablecoin, currently referred to as “FedCoin.”

2. **Mainstreaming of NFTs**: 2021 saw the rise of the NFT – a unique, non-interchangeable asset that exists on and is validated over a blockchain – a form of digital ledger – and that can be traded or exchanged for value. NFTs burst into the public consciousness because they allow consumers to purchase bits of internet history such as tweets, digital art, music, and sports video clips, and a growing assortment of other "collectibles." There is an ever-growing list of uses for NFTs. For example, NFTs are used increasingly in areas like online gaming, where users can purchase NFT gaming tokens or use them to allow players to engage in pay-to-earn game play. NFTs may well continue to expand as the market continues to create innovative uses for the technology, such as event tickets, contracts, and certificates of authenticity.

3. **Renewed Interest in DAOs**: Will 2022 be to DAOs what 2021 was to NFTs? DAOs are organizations built on a blockchain that allow owners of the associated token to vote on matters relating to governance of the DAO. DAOs allow token owners to vote directly on the entity's rules and provide increased visibility regarding when and how decisions are made. Some new DAO projects include attempts to buy an NBA team and art investment collectives. In 2021, Wyoming became the first state to recognize DAOs as a new type of LLC, creating a regulatory scheme for registering a DAO LLC requiring, among other things, that such LLCs be domiciled in the state. 2022 could see increased interest in DAOs as entrepreneurs seek to minimize the impact of regulatory intervention.

4. **Categorizing DeFi**: DeFi refers to financial transactions and activities that are conducted without a centralized banking system or intermediaries. DeFi projects and activities rely upon a self-executing computer code or smart contract. DeFi projects have not yet been placed squarely within a regulatory regime. In its October 2021 Guidance, the intergovernmental Financial Action Task Force (FATF) made clear that DeFi applications were not Virtual Asset Providers (VASP) but noted that some owners and creators relating to DeFi arrangements may fall within the organization's definition of VASP. While the SEC noted that DeFi projects have "close analogues within the SEC jurisdiction," it also stated that DeFi projects likely had many regulators, and that DeFi investors generally will not get the same level of compliance and robust disclosure that are the norm in other regulated markets in the United States. U.S. and non-U.S. regulators may impose restrictions on DeFi products and services in 2022.

5. **Countries Attempt to Comply with FATF Regulations and the Travel Rule**. In April 2021, the FATF released new regulations providing a framework for consumer protection laws. Notably, the global taskforce required its members to implement the travel rule, which requires members to share data on virtual-asset transactions over a certain amount. As detailed in GT's July 2021 blog post, member countries have struggled to implement the rule. As the deadline for compliance approaches, countries may push for compliance in 2022. For example, Japan's Virtual Assets and Crypto Assets Exchange Association has announced that it will release self-regulatory rules in April 2022. Other countries may set similar goals as the deadline draws nearer.

6. **Sovereign-Backed Projects Enter the Market**: More governments around the world will experiment with blockchain projects in 2022. In 2021, the Banque de France announced that it had entered the last stage of its first tranche of experiments with a central bank digital currency, which consisted of the issuance of a digital bond on a blockchain. Similarly, the South Korean Ministry of SMEs and Startups announced that it would launch a blockchain-backed investment system that to allow citizens to invest in real estate and other investments. We expect to see sovereign-backed projects within countries as well as in the global market, including sovereign debt raises in the international markets.

7. **Continuing Focus on Government Enforcement and Regulatory Action**. The SEC has warned of increased enforcement and oversight of digital assets and activities. However, the CFTC, DOJ, and IRS also have made it known that the industry has a target on its back, and it's game on.

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