THE FUTURE OF DIGITAL ASSETS: IDENTIFYING THE REGULATORY GAPS IN SPOT MARKET REGULATION

HEARING

BEFORE THE

SUBCOMMITTEE ON COMMODITY MARKETS, DIGITAL ASSETS, AND RURAL DEVELOPMENT

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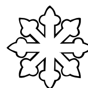

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THE FUTURE OF DIGITAL ASSETS: IDENTIFYING THE REGULATORY GAPS IN SPOT MARKET REGULATION

THURSDAY, APRIL 27, 2023

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMODITY MARKETS, DIGITAL ASSETS,
AND RURAL DEVELOPMENT,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The Subcommittee met, pursuant to call, at 2:00 p.m., in Room 1300 of the Longworth House Office Building, Hon. Dusty Johnson [Chairman of the Subcommittee] presiding.

Members present: Johnson, Rouzer, Bacon, Mann, Rose, Molinaro, Langworthy, Nunn, Thompson (*ex officio*), Caraveo, Davis of North Carolina, Salinas, Budzinski, Jackson of Illinois, and Craig.

Staff present: Paul Balzano, Caleb Crosswhite, Nick Rockwell, Kevin Webb, John Konya, Emily German, Josh Lobert, Ashley Smith, and Dana Sandman.

OPENING STATEMENT OF HON. DUSTY JOHNSON, A REPRESENTATIVE IN CONGRESS FROM SOUTH DAKOTA

The CHAIRMAN. Well, we have an august panel of experts, so we best start on time. I want to thank everybody for coming to this hearing of the Subcommittee on Commodity Markets, Digital Assets, and Rural Development. It has the rather clunky abbreviation of CMDARD. Staff were instructed to find something better, but I guess that is the best that we could do. So be it.

We do have a lot of work to dig into this year, and I am excited to get started. Of course, today's hearing is on digital assets, but it is hardly the only thing that we are collectively going to be working on together. I mean, clearly rural development is going to be really important, particularly in light of that title of the farm bill. We also have the Commodity Futures Trading Commission, which is going to be important, particularly given the fact that we have had both the Chairman and the Ranking Member commit to doing reauthorization of the CFTC this year. And I look forward to working with Ranking Member Caraveo and others on the Committee on that work.

But today, we are tasked with examining digital asset markets and I think, most importantly, understanding what are the gaps in this regulatory framework and how are those gaps harming

innovators and consumers alike. And as I mentioned, we have an august panel to help walk us through that.

I think it would be an unfortunate deficiency if we didn't take a moment to call out the nearly unprecedented level of cooperation and collaboration that we have had with the House Financial Services Committee. This is a town where people very much like to fight over turf and where egos can sometimes get in the way of progress, but that group is convening at this exact same moment a complementary hearing dealing with the same general topic: What are the gaps in the regulatory framework, and how can we work together to address them? And in fact, next month, the collaboration gets even closer insofar as we have a joint hearing to examine these issues together, and those are not typical in this town. And that cooperation is a testament to the importance that both Chairman McHenry and Chairman Thompson, as well as the teams on both sides of the aisle have had to getting things done on digital assets this Congress.

A lot of ink has been spilled on digital assets, a lot of it breathlessly positive, a lot of it angrily negative. I think reasonable people understand that digital assets and the underlying blockchains can bring a tremendous amount of opportunity. They can also be filled with a fair amount of hype. And we know that in this marketplace, as in every marketplace, there are fraudsters and hucksters that seek to make money while, unfortunately, giving the whole industry a bad name. And the hits and misses are well-known to all of us. You have hits like Ethereum, Hedera, Filecoin, and then you have outfits like BananaCoin, KodakCoin, and MoonCoin. So those are the highs and the lows.

The difficult task we are starting today—and we are really not starting it. I know there have been lots of informal conversations over the course of months and even some work done in the last Congress. But the work that we begin anew today is to craft a legislative framework that will allow the next Ethereum or Filecoin to emerge, while at the same time protecting the public from the hype, the scams, and the frauds that we have seen all too much of in the last few years.

This task is bigger than any single person, committee, or agency and in a town that so often prefers food fights to collaboration, it is going to take a pretty substantial collective effort on our part here to make sure that we get it right.

In this effort, there is plenty of work for regulatory agencies. It is not just Congress alone, we will be looking to smart folks in industry, smart folks at the CFTC and the SEC, as well as our state banking regulators, to make sure that we hit the center of the bullseye.

So I am looking forward to today's hearing and the ongoing collaboration with House Financial Services.

[The prepared statement of Mr. Johnson follows:]

PREPARED STATEMENT OF HON. DUSTY JOHNSON, A REPRESENTATIVE IN CONGRESS FROM SOUTH DAKOTA

Good afternoon. I want to welcome everyone to our first hearing of the Subcommittee on Commodity Markets, Digital Assets, and Rural Development.

We have a lot of work to dig into this year and I'm excited to get started. Today's hearing is on digital assets, but in the coming year, we will also focus on rural de-

velopment, oversight of the Commodity Futures Trading Commission, and as the Chairman and Ranking Member committed to last month, legislation to reauthorize the CFTC. I look forward to working with Ranking Member Caraveo and the rest of the Committee on these priorities.

Today, we are tasked with examining digital asset markets and understanding how the gaps in the regulatory framework are harming consumers and innovators alike.

I'm excited to note our unprecedented cooperation with the House Financial Services Committee in this effort. As we meet here today, their Digital Assets, Financial Technology, and Inclusion Subcommittee is convening a complementary hearing, also looking at the gaps in market structure regulation. And next month we will sit together in a joint hearing to continue examining these issues.

This cooperation is a testament to the importance that both Chairman Thompson and Chairman McHenry, as well as Chairman Hill and me, place on getting digital asset legislation done this Congress.

A lot of ink has been spilled on digital assets, their value, their purpose, and their ultimate benefit to society. For my part, I see the potential for valuable tools to be created with digital assets, that will enable Americans to solve some of life's tough problems and build systems to better serve the needs of everyday people. Blockchains and digital assets may not be as revolutionary as some claim, but I don't believe that every digital asset is a scam or a waste of time.

There will be hits and misses with digital assets. For every project like Ethereum, Hedera, and Filecoin, there will be projects like BananaCoin, KodakCoin, and MoonCoin.

The difficult task we are starting today is to craft a legislative framework that will allow the next Filecoin or Ethereum to emerge, while protecting the public from the hype, scams, and frauds, which have been so prevalent to crypto over the past 10 years.

This task is bigger than any single person, committee, or agency. It will take a collective effort here in Congress and among our regulators to craft a legal framework that will protect the public while safeguarding opportunities for innovation.

In this effort, there's plenty of work for our regulatory agencies to do, including the CFTC, the SEC, and our state and Federal banking regulators. But it's up to Congress to divide that work between regulators and ensure our public policy goals are effectively met.

I'm looking forward to today's hearing and our ongoing collaboration with the House Financial Services Committee to craft digital asset market structure legislation.

Thank you.

The CHAIRMAN. And without any further ado, I would turn to Ranking Member Caraveo for her comments.

OPENING STATEMENT OF HON. YADIRA CARAVEO, A REPRESENTATIVE IN CONGRESS FROM COLORADO

Ms. CARAVEO. Well, thank you, Chairman Johnson, for convening today's inaugural Subcommittee hearing on this important topic. It is an honor to serve as Ranking Member of the Commodity Markets, Digital Assets, and Rural Development Subcommittee. I appreciate the opportunity to work with Chairman Johnson as we identify regulatory gaps in the digital assets industry and look for solutions, and in the future opportunities, as our Subcommittee also works to improve the livelihoods of our rural communities.

We have an impressive panel of witnesses before us, and I look forward to hearing from all.

Over the past several years, there has been a tremendous amount of volatility in the digital assets industry. In February last year, the industry had a combined market capitalization of approximately $2 trillion. Today, however, that number is closer to $1 trillion with Bitcoin alone accounting for about $500 billion. We have seen catastrophic failures in this space, including the collapse of

FTX, and dramatic shifts in market capitalization over relatively short periods of time.

Even with the Commodity Futures Trading Commission's limited authorities to regulate digital commodity cash markets, the CFTC has to date brought 70 enforcement actions involving digital asset commodities, and such cases comprised more than 20 percent of all enforcement actions filed in the last fiscal year.

Considering these events, it is vital we closely examine current regulations to ensure investors are appropriately protected and that our agencies have the necessary authorities to oversee this new and evolving industry. Unlike most of the typical commodity market investors under CFTC regulation, a significant number of digital commodity cash market investments are individual retail investors. That means volatility and failures in these digital asset classes disproportionately impact everyday people and families. For sufficient customer protection, we must consider the everyday person's lower risk tolerance and ensure that appropriate disclosures are readily accessible and clearly communicated.

In considering any digital assets legislation, I would be remiss not to emphasize that we must also include the appropriate funding for the CFTC to continue carrying out its mission of promoting the integrity, resilience, and vibrancy of the U.S. derivatives markets through sound regulation. The CFTC is the only Federal financial regulator that relies solely on appropriations from Congress. It is therefore our responsibility to ensure any additional authorities and oversight of a technologically complex and unique industry comes with additional resources. Failure to include the appropriate funding would severely undercut any efforts to reach a comprehensive and cohesive regulatory framework for the digital asset industry that incentivizes innovation and protects customers.

With that, I would like to thank our witnesses for agreeing to testify today. I sincerely appreciate your willingness to be here and the expertise that you all bring to this conversation, and I look forward to a productive exchange.

Thank you, Mr. Chairman, and I yield back my time.

The CHAIRMAN. Thank you much. And if either Chairman Thompson or Ranking Member Scott come and would like to make some opening comments, of course we will provide them that opportunity. Anybody else who would like to make opening remarks, we would just ask that you submit those for the record, and we will make sure that they are included.

[The prepared statement of Mr. Thompson follows:]

PREPARED STATEMENT OF HON. GLENN THOMPSON, A REPRESENTATIVE IN CONGRESS FROM PENNSYLVANIA

Thank you, Mr. Chairman.

I also want to welcome all of the Members of the Subcommittee here today.

There was a great demand to serve on this Subcommittee this Congress, in no small part because of the opportunity to work on digital asset issues.

I am excited about the work of the Subcommittee, and I want to thank you all for your willingness to serve on it.

I think that there is great potential for digital assets to provide significant value for the American public.

Not just in monetary terms, but as tools to solve real world problems, as we'll hear about today.

But, as we'll also hear about today, digital asset developers, users, and institutions need clear, thoughtful rules of the road to create these solutions.

As Chairman Johnson said, we are working hand-in-glove with the House Financial Services Committee to craft legislation that will do just that.

This is perhaps unusual for Congress, but it's the right thing to do to make good public policy.

No one can solve this issue alone. It will take the cooperation of committees and regulators to build a workable framework to oversee digital assets.

Finally, I want to thank our witnesses for coming today to share their expertise with us.

I look forward to your testimony and the discussion that follows. I yield back.

The CHAIRMAN. We have a panel which we will introduce. A number of you are experienced testifiers, so I don't need to tell you this, but you have the time in front of you. Each Member will only be given 5 minutes to hopefully ask questions. Sometimes they make speeches, and I guess that is okay, too. It will remain green until I believe there is 1 minute left on the clock, at which point it will turn yellow. When it hits zero, you will get a red light. And if you are going on and on, you will hear a very light tapping from me. At about 20 seconds it will get more insistent. We do want you to have an opportunity to at least answer the question a bit, understanding that you will follow up afterwards to fill out the evidentiary record. But if a Member with only 6 seconds left has tossed it to you, we will give you 20 seconds to try to address their comments at least a little bit. But we do want to keep it moving. We will have lots of good questions and a lot of good discussion.

So unless there is anything else for the good of the order, I will introduce each of our panelists and then provide them each their time to make their remarks.

Okay. So our first witness today is Mr. Daniel Davis, who is a Partner and the co-Chair of Financial Markets and Regulation at the Katten Muchin Rosenman firm. Previously, he was the General Counsel at the CFTC.

We also have Ms. Purvi Maniar, who is the Deputy General Counsel at FalconX Holdings.

Our third witness is Nilmini Rubin, who is the Head of Global Policy at Hedera.

Our fourth witness is Mr. Timothy Massad. Mr. Massad currently serves as a Research Fellow at the Kennedy School of Government at Harvard and is the Director of the M–RCBG Digital Assets Policy Project. He was, as I suspect many of you know, also a former Chairman of the CFTC.

Our fifth and final witness today is Mr. Joseph A. Hall, who is a Partner at Davis Polk & Wardwell. He was formerly the managing executive for policy at the SEC.

I want to thank all of our witnesses for joining us today.

And with that, Mr. Davis, you are on the clock.

STATEMENT OF DANIEL J. DAVIS, J.D., PARTNER AND CO-CHAIR, FINANCIAL MARKETS AND REGULATION, KATTEN MUCHIN ROSENMAN LLP, WASHINGTON, D.C.

Mr. DAVIS. Thank you, Chairman Johnson, Ranking Member Caraveo, Chairman Thompson, Ranking Member Scott, and Members of the Subcommittee. Thank you for the opportunity to speak with you today. As Chairman Johnson mentioned, my name is Dan Davis. I am co-Chair of the Financial Markets and Regulation

Practice at Katten. From 2017 to 2021, I had the honor of serving as General Counsel at the CFTC. I would like to thank my wife Liz and son Spencer for joining me today and say hello to my daughters Catherine and Abigail, who will be watching this hearing when they return home from school. My views expressed today are in my personal capacity and not on behalf of any person, private-sector, agency, or government agency.

Today's topic is identifying the regulatory gaps in spot market regulation of digital assets. My view can be summarized as this: There is a significant gap in Federal spot market regulation because the large majority of digital assets spot market activity falls outside the regulatory jurisdiction of both the CFTC and the SEC. To explain how I reached this conclusion, I will discuss the jurisdiction of both agencies and how they have exercised their authority regarding the spot market for digital assets.

The major dividing line between CFTC and SEC authority is whether a product is a security or not. If a product is a security or is based on a security, the SEC generally has jurisdiction over that product, so this would include not only securities themselves, but security futures and security-based swaps. The SEC has regulatory jurisdiction, which means it can require registration, require compliance with the securities laws and regulations, and to conduct exams and reviews. It can also bring enforcement actions.

If a product is not a security, then it likely is within some level of CFTC jurisdiction. The CFTC has full regulatory authority over a number of products such as futures, options on futures, and swaps. These all have their counterparts of SEC jurisdiction: futures, security futures, swaps, security-based swaps. The CFTC has regulatory jurisdiction over a couple of other products with a specific retail component, such as certain retail foreign exchange transactions and certain leveraged or margined retail commodity transactions. Over all of these products, the CFTC can require registration, require compliance with all applicable statutes and regulations, including robust customer protection provisions, and conduct exams and reviews.

So what CFTC jurisdiction remains? If there is a spot product that is outside the CFTC regulatory authority for leveraged or margined retail commodity products, the CFTC only has enforcement authority for fraud, manipulation, or false reporting regarding that product. This is a backwards-looking authority to punish bad conduct after it has already occurred. No registration, no exams by the CFTC.

Congress gave the CFTC this authority because the prices in the spot market significantly impact the futures and swaps products. And the CFTC has not hesitated to use its enforcement authority in the digital asset space, bringing over 80 enforcement actions related to digital assets, including 20 percent of its enforcement activity in the past year.

Where does that leave us? If a digital asset activity occurs on the spot market, it is not a security, it is not a leveraged retail commodity product, then there is no CFTC or SEC regulatory authority over that product. There is only CFTC enforcement jurisdiction.

How large is that universe? It is large, and I base that on two key assumptions. First, I looked at the top 15 digital assets by

market capitalization. Now, there are thousands of digital assets, but the top 15 account for about 86 percent of the market. Second, I look to what the Commissions themselves have said about those 15 digital assets, not a Chairman, not a Commissioner, but the Commission itself because only the Commission can speak for itself. Based on my review, and looking at CFTC and SEC enforcement actions, it appears that the CFTC has asserted that seven of the top 15 digital assets are commodities. These seven digital assets are some of the largest, accounting for approximately 76 percent of the digital asset market.

The SEC, as a Commission, has never challenged any of those CFTC determinations, some of which have been around for years. Instead, the SEC, in an enforcement action, has asserted that only one of the top 15 digital assets is a security. And that digital asset currently accounts for about two percent of the market, 76 to 2, 76 percent of commodity, two percent of security, and the rest of the top 15, about eight percent, undetermined. I don't think that should be very surprising because the market division between swaps, regulated by the CFTC, and securities-based swaps, regulated by the SEC, is about 90 percent swaps for the CFTC and ten percent security-based swaps for the SEC.

So I conclude where I began. There is a significant regulatory gap in Federal spot market regulation of digital assets because the large majority of digital asset spot market activity falls outside the regulatory jurisdiction of the CFTC and the SEC. Thank you.

[The prepared statement of Mr. Davis follows:]

PREPARED STATEMENT OF DANIEL J. DAVIS, J.D., PARTNER AND CO-CHAIR, FINANCIAL MARKETS AND REGULATION, KATTEN MUCHIN ROSENMAN LLP, WASHINGTON, D.C.

Chairman Johnson, Ranking Member Caraveo and Members of the Subcommittee:

Thank you for the opportunity to appear before you today and share my views about digital asset regulation, including the Commodity Futures Trading Commission's (CFTC) role in digital asset regulation. I had the honor of serving as the CFTC's General Counsel from 2017–2021 and currently advise clients about CFTC and digital asset regulation in my role as partner with Katten Muchin Rosenman LLP. However, my appearance before you today is in my own personal capacity; I am not representing or speaking on behalf of any other person, private sector agency or governmental agency.

I would like to address a few issues in my testimony today, including the current jurisdiction that the CFTC has over the digital asset market, including the spot market, the CFTC's substantial experience regarding digital assets, and the protections that the Commodity Exchange Act (CEA) and rules currently offer for investors, particularly to retail customers.

CFTC Jurisdiction Regarding Digital Assets

As this Subcommittee is well aware, the CFTC is the primary regulator of the futures, options on futures, and swaps markets. The CFTC also regulates leveraged retail commodity transactions. The CFTC's full "regulatory" authority includes the ability to require registration and examine registered entities that offer these products.

The CFTC also has enforcement jurisdiction (or anti-fraud and anti-manipulation jurisdiction) in the commodities markets at large. Thus, if the CFTC thinks that there is manipulation or fraud in a spot market for a commodity—such as gold or bitcoin—it can institute an enforcement action to enjoin that activity and seek recompense of ill-gotten gains from that activity.

Why is it important for the CFTC to have anti-fraud and anti-manipulation authority over the spot markets? Quite simply, because the spot markets highly influence the derivatives markets. Spot markets and derivatives markets are highly correlated. Furthermore, derivatives market prices are largely determined by prices in

the spot market. If somebody can manipulate the price of the spot market, they generally also can influence the price of derivatives products based upon the underlying asset.[1]

Former CFTC Commissioner Dawn Stump provided an excellent explanation about the rationale and nature of the CFTC's anti-fraud and anti-manipulation authority for the spot market:

> The public should be aware that where cash commodity markets are concerned, this limited authority (anti-fraud/manipulation/false reporting, as opposed to day-to-day regulatory oversight) is bestowed upon the CFTC as a tool to assist in its primary function of regulating derivatives products, such as futures. Futures contracts serve a price discovery function. Well-functioning futures (and other derivatives products) rely upon a sound underlying cash market and may reference cash market indexes in their pricing. Therefore, cash market transactions can potentially be part of a scheme to manipulate prices of derivatives products that are regulated by the CFTC. Congress has recognized these relationships between prices of cash transactions and derivatives products, and thus the CEA provides the CFTC with limited enforcement authorities with respect to cash transactions.[2]

Thus, CFTC enforcement actions in the spot market are not primarily focused on policing the spot market for its own sake. The CFTC emphasizes, instead, its role in regulating the derivatives markets. Chairman Behnam made these points in a Senate Agriculture Committee hearing last month:

> As I discussed in December [2022], the CFTC does not have direct statutory authority to comprehensively regulate cash digital commodity markets. Its jurisdiction is limited to its fraud and manipulation enforcement authority. In the absence of direct regulatory and surveillance authority for digital commodities in an underlying cash market, our enforcement authority is by definition reactionary; we can only act after fraud or manipulation has occurred or been uncovered.[3]

The CFTC nevertheless has actively used its enforcement authority in the digital assets space. It has brought at least 70 enforcement actions involving digital asset commodities. In the last fiscal year, more than 20 percent of the Commission's enforcement actions related to digital asset commodities.[4]

The CFTC has a long history of involvement with digital assets. As early as 2014, the first Bitcoin denominated cash-settled swaps, options and non-deliverable forwards began trading on CFTC-registered swap execution facilities.[5] The next year the CFTC found that Bitcoin and other virtual currencies were commodities.[6] The first cash-settled Bitcoin futures contracts began trading on CFTC-registered Cboe Futures and CME in 2017.[7] During the same year, the CFTC for the first time designated a swap execution facility and derivatives clearing organization to transact in physically deliverable Bitcoin swaps contracts. Also in 2017, the CFTC's LabCFTC released a primer on virtual currencies.[8]

Since 2017, the CFTC has released additional backgrounders on virtual currencies and related derivatives products.[9] And CFTC Staff in 2018 released an advisory re-

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[1] *See, e.g., In re Coinbase, Inc.,* CFTC No. 21–03 at 3–4 (Mar. 19, 2021).

[2] *Concurring Statement of Commissioner Dawn D. Stump Regarding Enforcement Action against Coinbase, Inc.,* (Mar. 19, 2021), *https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement031921*.

[3] Testimony of Chairman Rostin Behnam Before the U.S. Senate Committee on Agriculture, Nutrition, & Forestry, *Oversight of the Commodity Futures Trading Commission,* (Mar. 8, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam32*.

[4] *Id.*

[5] Stan Higgins, *TeraExchange Receives US Approval to Launch First Bitcoin Derivative,* COINDESK (Sept. 12, 2014), *https://www.coindesk.com/tech/2014/09/12/teraexchange-receives-us-approval-to-launch-first-bitcoin-derivative/; In re TeraExchange LLC,* CFTC Docket No. 15–33 at 3 (Sept. 24, 2015) ("On September 11, 2014, Tera filed with [the CFTC Division of Market Oversight] a submission self-certifying the Bitcoin swap for trading on its [swap execution facility]. Tera began offering the Bitcoin swap for trading on September 12, 2014.").

[6] *See In re Coinflip, Inc.,* CFTC No. 15–29 (Sept. 17, 2015).

[7] CFTC, Release No. 7654–17 (Dec. 1, 2017), *https://www.cftc.gov/PressRoom/PressReleases/7654-17*.

[8] LabCFTC, *A Primer on Virtual Currencies* (Oct. 17, 2017), *https://www.cftc.gov/sites/default/files/idc/groups/public/documents/file/labcftc_primercurrencies100417.pdf*.

[9] *See CFTC Backgrounder on Self-Certified Contracts for Bitcoin Products, https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/bitcoin_factsheet120117.pdf; CFTC Backgrounder on Oversight of and Approach to Virtual Currency Futures*

garding their priorities and expectations when reviewing new virtual derivatives products to be listed on CFTC regulated markets.[10]

Today, there are over a dozen actively trading futures and options contracts on digital assets on CFTC-registered markets.[11] These contracts are based on the two most-traded digital assets, Bitcoin and Ether. This long-standing and active oversight of digital asset derivatives has given the CFTC unique insights, expertise, and understanding of the operation of spot digital asset markets. As Dr. Chris Brummer noted to a similar subcommittee last year, "the CFTC gained expertise in overseeing the institutionalization of significant infrastructures intersecting directly with the digital asset commodity spot market, something that the SEC, which has yet to approve a spot Bitcoin or digital asset commodity ETF, has arguably only accomplished in attenuated fashion through multiple Bitcoin Futures ETFs."[12]

Furthermore, the CFTC has clarified the scope of its authority to regulate retail commodity transactions that involve leverage, financing, or margin. A key statutory requirement for CFTC jurisdiction is whether "actual delivery" of retail commodity transactions have occurred within 28 days. The CFTC engaged in extensive rulemaking with the digital asset community and provided thorough guidance about the meaning of "actual delivery" as that phrase applied to digital assets, with multiple examples of acceptable and non-acceptable practices.[13] With Commission-backed guidance on this issue in place after receiving and incorporating extensive public feedback, the Commission has used its enforcement authority to have market participants follow the guidance.[14]

Current Regulatory Gap in the Spot Market at the Federal Level

Neither the CFTC nor any other Federal regulator has plenary regulatory authority over the trading of digital assets that qualify as commodities. If certain transactions involving a digital asset are considered securities, then the SEC would have jurisdiction. To evaluate the amount of the Federal regulatory gap for digital asset transactions, the question then becomes the scope of the SEC's jurisdiction in the digital asset space.

As you are all aware, there is currently a fair amount of discussion about the regulatory oversight of the digital asset market by the CFTC and the SEC, respectively. There have been discussions about which digital assets are under the jurisdiction of the CFTC (as a commodity) and of the SEC (as a security), and recently an apparent dispute regarding the classification of at least one digital asset—Ether—with the CFTC consistently stating that Ether is a commodity and the SEC Chairman last week before the House Financial Services Committee refusing to acknowledge that Ether is or is not a security. This is an important debate, and one that I will not resolve during my testimony today.[15]

Markets (Jan. 4, 2018), *https://www.cftc.gov/sites/default/files/idc/groups/public/%40customerprotection/documents/file/backgrounder_virtualcurrency01.pdf*.

[10] *See* CFTC Staff Advisory No. 18–14 (May 21, 2018), *https://www.cftc.gov/node/214951*.

[11] Products are "self-certified" by a CFTC-registered entity. An entity self-certifying a product must provide to the CFTC "[a] concise explanation and analysis of the product and its compliance with applicable provisions of the [Commodity Exchange] Act, including core principles, and the Commission's regulations thereunder." 17 CFR § 40.2(a)(3)(v). Furthermore, a registered entity must "provide [to CFTC staff] any additional evidence, information or data that demonstrates that the contract meets, initially or on a continuing basis, the requirements of the [Commodity Exchange] Act or the Commission's regulations or policies thereunder." *Id.* § 40.2(b). In certain circumstances, the Commission can stay the trading of the contract. *Id.* § 40.2(c).

[12] Testimony of Chris Brummer before the Subcommittee on Commodity Exchanges, Energy and Credit at 5 (June 23, 2022), *https://agriculture.house.gov/uploadedfiles/brummer_congressional_testimonythe_future_of_digital_asset_regulation.pdf*. Indeed, last year the CFTC voluntarily opened up to public comment consideration of a registered entity's proposed changes to the market structure for certain digital asset derivatives products. *CFTC Seeks Public Comment on FTX Request for Amended DCO Registration Order,* CFTC Release No. 8499–22 (Mar. 10, 2022), *https://www.cftc.gov/PressRoom/PressReleases/8499-22*. The CFTC received 1,500 comments in response. *See https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7254&ctl00_ctl00_cphContentMain_MainContent_gvCommentListChangePage=1_50*. Although the request was ultimately withdrawn, the public comment process provided the CFTC with valuable insight into a host of questions regarding the market structure and operation of digital asset exchanges.

[13] CFTC *Final Interpretive Guidance, Retail Commodity Transactions Involving Certain Digital Assets,* 85 FED. REG. 37734 (June 24, 2020).

[14] *See, e.g., In re Payward Ventures, Inc.,* CFTC No. 21–20 (Sept. 28, 2021).

[15] I do note that both the CFTC and SEC have previously worked together to provide extensive guidance on the lines between their respective jurisdictions. For example, Section 712(d)(1) of the Dodd-Frank Act required the CFTC and SEC jointly to further define the difference between a "swap" (subject to the CFTC's jurisdiction) and a "security-based swap" (subject to the

Continued

What I do want to point out is that, in terms of *market capitalization* and looking at the activities of the Commissions themselves (not the statements of a Chairman or a Commissioner), "commodities" have a much larger share of the spot digital asset market than "securities."[16]

Let's take the top fifteen digital assets by market capitalization. As of April 21, 2023, a popular crypto tracking website estimates that digital assets have a global market capitalization of about $1.17 trillion.[17] The top fifteen digital assets account for approximately $1.01 trillion of market capitalization, or approximately **86 percent** of the market.[18]

As described above, CFTC-registered derivatives products have been trading on the top two digital assets in market capitalization—Bitcoin and Ether—for several years now. Bitcoin (45.3 percent of market cap) and Ether (19.0 percent of market cap) collectively account for approximately 64.3 percent of the total digital asset market capitalization. If Bitcoin and Ether were securities, they should not be trading on CFTC-registered exchanges, and the SEC has never challenged the trading of these products. So, right off the bat, almost ⅔ of the spot digital asset market appear to be outside the SEC's jurisdiction.

One can also evaluate enforcement filings to determine which specific digital assets the CFTC and SEC have formally regarded as a security or a commodity. The numbers point to an even larger share of the spot digital asset market being outside the SEC's jurisdiction.

The CFTC in enforcement filings has alleged that seven of the top fifteen digital assets are commodities (with estimated market capitalization as of April 21, 2023):

- Bitcoin (BTC)[19] (45.3 percent)
- Ether (ETH)[20] (19.0 percent)
- Tether (USDt)[21] (7.0 percent)
- USD Coin (USDC)[22] (2.6 percent)
- Dogecoin (DOGE)[23] (1.0 percent)
- Binance USD (BUSD)[24] (0.6 percent)
- Litecoin (LTC)[25] (0.5 percent)

Collectively, these seven digital assets account for approximately **76 percent** of the total market capitalization of spot digital assets.

The SEC has never asserted in either an enforcement action or a rulemaking that any of the above seven digital assets was or is a security. Of the top fifteen digital assets in terms of market capitalization, the SEC appears to have asserted that only XRP, with a market capitalization of approximately **two percent** of the market, is a security.[26] For the other seven digital assets in the top fifteen—accounting for ap-

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SEC's jurisdiction). Within the space of about 2 years, the CFTC and SEC: (1) issued an advance notice of proposed rulemaking regarding the definitions; (2) published a proposed rulemaking; (3) received and reviewed almost 100 comments to the proposed rules; and (4) issued a final rule filling more than 150 pages in the *Federal Register* giving significant guidance, examples, and applications of the difference between "swaps" and "securities-based swaps." *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping,* 77 FED. REG. 48208, 48209–211 (Aug. 13, 2012). This joint effort has greatly reduced the uncertainty regarding the differences between "swaps" and "securities-based swaps." In addition, both agencies worked together to establish quantitative measures, later modified and adopted by Congress, to clarify the jurisdictional lines between futures and security futures. *See* 7 U.S.C. § 1a(35), 1a(44).

[16] In a recent proposed rule regarding custody requirements for investment advisors, the SEC asserted that "most crypto assets are likely to be funds or crypto asset securities covered by the current [custody] rule." *Safeguarding Advisory Client Assets,* 88 FED. REG. 14672, 14676 (Mar. 9, 2023). The SEC, however, did not specifically identify any particular digital asset as a security.

[17] *See* CoinMarketCap, *https://coinmarketcap.com/* (last visited April 21, 2023).

[18] *Id.*

[19] Complaint at ¶ 2, *CFTC* v. *Binance,* No. 1:23–cv–01887 (N.D. Ill. Mar. 27, 2023).

[20] *Id.*

[21] *Id.* at ¶ 24.

[22] Complaint at ¶ 2, *CFTC* v. *Eisenberg,* No. 1:23–cv–00173 (S.D.N.Y. Jan. 9, 2023).

[23] Complaint at ¶ 1, *CFTC* v. *McAfee,* No. 1:21–cv–01919 (S.D.N.Y. Mar. 5, 2021).

[24] *Supra* note 19 at ¶ 24.

[25] *Id.*

[26] Complaint at ¶ 1, *SEC* v. *Ripple Labs Inc.,* No. 1:20–cv–10832 (S.D.N.Y. Dec. 22, 2020).

proximately 8.5 percent of market capitalization[27]—neither agency has specifically asserted that the digital asset is a security or commodity.[28]

Indeed, the SEC recently brought an enforcement action against digital asset trading platform Bittrex, Inc. (Bittrex) and related parties for, among other things, failure to register as a national securities exchange.[29] The SEC alleges that from 2014 to the present, Bittrex "made available more than 300 crypto assets for trading,"[30] including what appears to be most of the top fifteen digital assets by market capitalization. The SEC, however, did not assert in that complaint that any of the top fifteen digital assets were a security. Instead, the SEC relied primarily upon six digital assets with a total of less than **0.18 percent** of the total spot digital market capitalization to buttress its claim that Bittrex should have registered with the SEC.[31]

Customer Protections Provided in the CFTC Regime

Entities subject to CFTC jurisdiction must provide extensive protections to customers purchasing CFTC-regulated products. And the CFTC and the National Futures Association (NFA)[32] have not hesitated to enforce these customer protections. In addition to the anti-fraud and anti-manipulation authority described above, there are significant rules regarding the segregation and protection of customer funds. CFTC-registered futures commission merchants (FCMs) must provide general written disclosures regarding the risks of futures trading and specific disclosure regarding their own circumstances.[33] FCMs and introducing brokers must have privacy policies and have procedures in place to protect customer information.[34]

The CFTC also has extensive rules to protect retail customers engaging in certain foreign exchange transactions.[35] Entities engaged in retail foreign transactions must register,[36] meet minimum financial requirements,[37] and comply with various recordkeeping and reporting requirements.[38] These entities must also provide appropriate disclosures to retail customers about the risks of engaging in these types of transactions, noting, among other things, that the customer can "rapidly lose all of the funds [they] deposit for such trading and [they] may lose more than [they] deposit."[39]

The NFA has additional rules that protect customers. For example, NFA members and associates must observe high standards of commercial honor and just and equitable principles of trade. This includes dealing fairly with customers and others at all times.[40] NFA members must also comply with express standards in all communications with the public generally and promotional literature specifically.[41]

The NFA additionally requires members to provide specific disclosures regarding their digital asset activities and comply with certain conduct standards regarding their activities involving the digital assets Bitcoin and Ether.[42]

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[27] Those seven are BNB (BNB) (4.3 percent); Cardano (ADA) (1.1 percent); Polygon (MATIC) (0.8 percent); Solana (SOL) (0.7 percent); Polkadot (DOT) (0.6 percent); Shiba Inu (SHIB) (0.5 percent); and Tron (TRX) (0.5 percent).

[28] Over time it would be likely that the digital asset market would trend away from securities and toward commodities. That is because, as a digital asset either becomes more decentralized or becomes used for a consumptive purpose, it is less likely to be considered a security. In addition, if Congress or a court agree that secondary transactions in digital markets do not constitute an "investment contract" under the securities laws, then an even smaller portion of activity in the digital markets would fall within the jurisdiction of the SEC. *See, e.g.,* Motion to Dismiss in *SEC* v. *Wahi, et al.,* Case No. 2:22–cv–01009, Doc. 33 at 13–27 (W.D. Wash. Feb. 6, 2023) (advancing the argument that secondary transactions in digital assets do not fall within the definition of an "investment contract").

[29] Complaint at ¶ 3, *SEC* v. *Bittrex, Inc.,* No. 2:23–cv–00580 (W.D. Wash. Apr. 17, 2023).

[30] *Id.* at ¶ 67.

[31] The six digital assets (and their percentage of market capitalization as of April 21, 2023) are: Algorand (ALGO) (0.1142 percent); Dash (DASH) (0.0472 percent); OMG Network (OMG) (0.0144 percent); Naga (NGC) (0.0007 percent); Monolith (TKN) (0.0002 percent); and I-House Token (IHT) (0.0000001 percent).

[32] The NFA has been designated by the CFTC as a registered futures association.

[33] 17 CFR § 1.55; NFA Rule 2–30.

[34] *See* 17 CFR Parts 160 and 162.

[35] *See generally* 17 CFR Part 5.

[36] *Id.* § 5.3.

[37] *Id.* §§ 5.6–5.7.

[38] *Id.* §§ 5.10–5.11.

[39] *Id.* § 5.5(a)(2)(b).

[40] NFA Rule 2–4.

[41] NFA Rule 2–28.

[42] NFA Rule 2–51; *see also* NFA Interpretive Notice 9073.

Conclusion

There appears to be a significant gap at the Federal level in the regulation of spot digital assets. Assertions of jurisdiction by both the CFTC and SEC in enforcement actions suggest that most of the market capitalization of spot digital assets falls outside SEC jurisdiction.

The CFTC has extensive experience in the digital asset space through both its (1) overseeing of trading of digital asset-based derivatives on CFTC-regulated exchanges and (2) asserting its anti-fraud and anti-manipulation enforcement authorities over the spot markets. The CFTC and NFA also have significant experience in providing protections to customers participating in these markets.

Thank you for the opportunity to appear before the Subcommittee. I look forward to answering any questions you may have.

The CHAIRMAN. And even before the insistent knocking began, very good. You should be proud of your father, our guests. He did a great job.

Ma'am, you are up and on the clock.

STATEMENT OF PURVI R. MANIAR, J.D., DEPUTY GENERAL COUNSEL, FALCONX HOLDINGS LTD., SAN MATEO, CA

Ms. MANIAR. Chairman Johnson, Chairman Thompson, Ranking Member Caraveo, and Members of the Subcommittee, thank you for this opportunity to testify before you today. In my testimony, I will endeavor to provide FalconX's perspective on the current regulatory landscape for digital assets and the benefits of coordinated regulation and responsible innovation in this realm.

FalconX is a prime broker in the digital asset space for the world's leading institutions, and FalconX Bravo is proud to be a CFTC-registered swap dealer. Our mission is to provide secure, efficient, and regulatory-compliant access to these markets for our clients. Our institutional-only business includes regulated, over-the-counter derivatives with digital asset underliers. By employing time-tested OTC market structures and state-of-the-art technology, we enable our customers to hedge risk or gain financial exposure in this space. We are committed to orderly, fair, and liquid markets for all market participants.

We are happy and eager to engage with policymakers and regulators to provide industry insights on this critical issue and recommend potential areas for further legislative clarity.

Digital asset technology is underpinned by the blockchain and paves the way for innovative growth while offering more secure, transparent, and decentralized alternatives to traditional structures. That technology can better facilitate control over the sharing and storing of information. An example of this innovation can be seen in the blockchain networks such as Ethereum, which have multiple significant use-cases and benefits. Ethereum's groundbreaking feature is smart contracts, which have the ability to execute contracts without intermediaries.

It is evident that the existing rules and tools at our disposal are insufficient to address the unique challenges presented by this dynamic technology. I go into more detail regarding the real-world utility and use-cases of such digital asset commodities in my written testimony.

As the digital asset industry has evolved, different U.S. regulators have issued their respective rules and guidance, oftentimes resulting in inconsistent enforcement and an opaque and sometimes conflicting regulatory regime. There is no clear single regu-

lator of digital assets in the U.S., and many regulators have claimed some form of jurisdiction, each with their own authorities and regulatory objectives. While it is not uncommon for an industry to be subject to multiple regulators, a lack of clear oversight and jurisdictional lines creates barriers to entry and confusion for a nascent industry. The absence of regulatory clarity in the U.S. has hindered our global competitiveness in this dynamic but still emerging industry. This moment calls for the United States to take resolute action and to assert leadership in the development of an unambiguous digital asset regulation.

We believe that the majority of digital assets are used and traded like commodities. In part, this is why FalconX decided to actively pursue CFTC registration as the best-suited, available regulatory framework for digital assets in which FalconX makes markets and trades. It should be noted that CFTC-registered swap dealers are subject to very robust regulatory requirements, many of which I have set out in more detail in my written testimony.

While some digital assets may be securities, the securities regulatory structure is ill-suited for most digital assets. SEC-mandated disclosures designed for factors like earnings, cash flow, or material events have no analogy for digital asset commodities and would prevent many of their benefits such as peer-to-peer transactions.

The current U.S. regulatory framework is fragmented. And until this is addressed, it will continue to lead to a loss of economic opportunity and technological advancement for the U.S. We believe that spot markets would benefit from the application of some of the CFTC's business conduct standards, in particular those focused on registration, reporting, and disclosure. At FalconX, we have found that these rules greatly enhance our ability to foster a transparent and orderly market for digital asset derivatives. Tailored to the unique characteristics of a digital assets spot market, we believe they could greatly enhance market integrity and promote market participation, confidence, and protection while facilitating innovation.

We firmly believe that Congress and market regulators should work together to establish a framework for the digital asset ecosystem so that we can ensure that digital asset market participants and markets are safe, transparent, and orderly for all participants. Legislation like the Digital Commodity Exchange Act of 2022 (H.R. 7614, 117th Congress) achieves just this, and we applaud Chairman Thompson, Chairman Johnson, and the rest of this Committee for their leadership in this regard in the last Congress. We look forward to this Committee's efforts to advance legislation and cooperation and coordination with the House Financial Services Committee.

Let me reiterate FalconX's appreciation for this opportunity to testify in front of you this afternoon, and I look forward to answering any questions you have. Thank you.

[The prepared statement of Ms. Maniar follows:]

PREPARED STATEMENT OF PURVI R. MANIAR, J.D., DEPUTY GENERAL COUNSEL, FALCONX HOLDINGS LTD., SAN MATEO, CA

Chairman Johnson, Chairman Thompson, Ranking Member Caraveo, and Members of the Subcommittee, thank you for this opportunity to testify before you today.

In my testimony, I will endeavor to provide FalconX's perspective on the current regulatory landscape for digital assets and the benefits of coordinated regulation and responsible innovation in this realm.

My name is Purvi Maniar, and I currently serve as the Deputy General Counsel of FalconX. In this role, I am responsible for providing legal guidance to FalconX regarding the development of products meeting the needs of our institutional clients in a manner that is compliant with governing regulations.

FalconX provides a platform for institutional clients to hedge risk or gain financial exposure to digital assets, through a variety of products and services. We are committed to orderly, fair markets in this arena for all market participants.

We are happy and eager to engage with policymakers and regulators to provide industry insights on this critical issue and recommend potential areas for further legislative clarity.

I. Background

A. FalconX

FalconX is a prime broker in the digital assets space for the world's leading institutions. FalconX Bravo is a Commodity Futures Trading Commission (CFTC)-registered swap dealer, and it is our mission to provide secure, efficient, and regulatory-compliant access for our clients. Our business includes regulated, over-the-counter (OTC) derivatives with digital asset underliers. Designed specifically for institutional clients, FalconX utilizes a market-risk-neutral approach. By leveraging our extensive expertise in this arena, state-of-the-art technology, and by employing time-tested OTC market structures, FalconX provides institutional-grade products that enable our customers to hedge risk or gain financial exposure within this space.

B. Digital Assets

Digital asset technology is underpinned by the blockchain and paves the way for innovative growth while offering more secure, transparent, and decentralized alternatives to traditional structures. The priority remains user privacy and control over personal information.

Blockchain is a transformative technology. The potential applications of this technology are vast and varied, and the industries that can benefit from their far-reaching power are numerous. By enabling decentralization, efficiency, and programmability, these technologies pave the way for innovation and growth while promoting security and transparency.

Blockchain technology enables individuals to control their data by storing it in a decentralized network of computers rather than a centralized server controlled by a single entity, such as a corporation. This means that users can access and manage their data using their private keys and grant permission for third-party access on a case-by-case basis, rather than granting unrestricted access to a central authority.

An example of this innovation can be seen in blockchain networks such as Ethereum, which have multiple significant uses and benefits. Ethereum's groundbreaking feature is smart contracts that operate on its blockchain. The Ethereum chain's ability to execute contracts automatically without intermediaries offers a more secure, efficient, and transparent alternative to traditional intermediated contract-based processes. By enabling developers to build decentralized applications, Ethereum offers limitless potential for entrepreneurs to create innovative solutions in diverse industries. The flexibility and programmability of the Ethereum blockchain allow for a wide range of possible use cases, and as the technology continues to mature and evolve, we can expect to see new and innovative applications emerge.

The platform's ability to enhance transparency and efficiency could transform sectors such as finance and technology, where a few prominent intermediaries have traditionally played a significant role. As Ethereum's use cases continue to evolve, it is evident that the existing rules and tools at our disposal are insufficient to address the unique challenges presented by this dynamic technology.

II. Current Regulatory Landscape

As the digital asset industry has evolved, different U.S. regulators have issued their own respective rules and regulations, oftentimes resulting in inconsistent enforcement and an opaque and sometimes conflicting regulatory regime.

There is no clear single regulator of digital assets in the United States. A constellation of regulators, including the Commodity Futures Trading Commission (CFTC), Federal Trade Commission (FTC), Securities and Exchange Commission (SEC), Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), along with the Federal Reserve Board, the U.S. Treasury Department, and its Internal Revenue Service (IRS) and Financial Crime Enforcement

Network (FinCEN), along with others have all claimed and asserted some form of jurisdiction.

Each regulator views the industry through its own unique lens and in the context of its own existing authority and enforcement priorities, oftentimes against the backdrop of competing jurisdiction. While multi-pronged regulation is common across industries, given the nascency of this sector, the absence of clear oversight and jurisdictional lines has created confusing outcomes for industry participants and regulators alike.

A common sentiment in policy and media discussions around digital assets is that entities in this arena are trying to skirt regulatory oversight or sufficiently robust risk management and governance practices. The reality is that legitimate digital asset businesses do not want to circumvent regulation; they want clear rules of the road so that they can successfully grow their business. FalconX and other industry leaders have sought to foster policy discussions and serve as a resource to lawmakers on the technology, current market structure, and emerging risks in support of digital asset-specific regulation as the regulatory landscape continues to evolve in the United States.

Globally, major economies, including those of the UK, Japan, China, and the EU, have achieved significant strides toward adopting regulatory frameworks tailored to digital assets. These frameworks not only evidence an increasing appreciation for the potential benefits of these technologies but also enable the industry to expand, resulting in substantial job growth, revenue generation, and tax receipts in these regions.

The absence of regulatory clarity in the U.S. has hindered its global competitiveness in this dynamic but still emerging sector. This moment calls for the United States to take resolute action.

Despite the current challenges, there remains continued interest for the United States to lead by enacting digital asset-specific regulation. We are a leader in global markets and policymaking. Blockchain technology presents an opportunity for our nation to, once again, forge clear, comprehensive, and forward-looking regulations.

We believe now is the right time for the United States to assert leadership in the development of unambiguous digital asset regulation. Clear legislation and accompanying regulation are necessary to keep existing companies from leaving the U.S. or to prevent startups from choosing to launch in other jurisdictions where the rules are clearer, and their businesses are welcomed. We should foster and attract innovation and aim to be leaders in the development of new technologies.

III. Many Digital Assets Are Commodities, Not Securities

Many digital assets are used and traded like commodities. Commodities have independent utility; their value is not typically tied to a revenue stream or annual earnings. Instead, commodities have a specific use (*e.g.,* oil is used to power machinery, Ethereum is used as a building block for smart contract applications). Commodities usually are bought and sold according to certain specifications tied to their use. Their prices typically fluctuate based on their use and macroeconomic factors such as interest rates and inflation, not any disclosed event like quarterly earnings. It is for this reason that the CFTC regulatory architecture is better suited to regulating digital assets.

While some digital assets are undoubtedly securities, the securities regulatory architecture, in contrast, is ill-suited for most digital assets. Securities have no independent utility other than profit participation. As a result, securities regulations focus on robust disclosure of facts affecting that profit movement, such as earnings, cash flow, or material events affecting earnings. However, most securities law-mandated financial disclosures have little applicability to digital assets. Moreover, the requirement under securities laws that spot securities must be traded on a regulated exchange using third-party intermediaries eliminates the benefits of peer-to-peer transactions. The ability to transfer spot assets instantly and safely on a peer-to-peer basis, one of the key benefits of digital assets, does not exist if one is required to place an order with a broker-dealer intermediary on a third-party exchange subject to a multi-day settlement cycle. As a result, few digital asset companies have sought registration or exemption under the securities laws; presumably, it is why few of those applications have been granted, given the difficulties of shoehorning digital assets into the securities law framework.

In part, this is why FalconX decided to actively pursue CFTC registration as the best-suited available regulatory framework for digital assets in which FalconX makes markets and trades.

CFTC registration comes with significant regulation, oversight, and compliance tailored to the derivative products it regulates. The CFTC also has fraud and manipulation authority over the spot markets underlying those derivatives. As a reg-

istered swap dealer, FalconX is subject to business conduct standards that require compliance with policies and procedures designed to ensure our clients are treated fairly and undertake obligations with us in an informed and prudent manner. Those standards require fair dealing, robust disclosure, and confidential handling of client information. CFTC swap dealer registration also obligates FalconX to maintain sufficient regulatory capital, implement margin and market risk policies, and provide complete, robust transaction reporting to the CFTC through a swap data repository. Registration also involves regular regulatory examinations through oversight by an SRO, the National Futures Association, as well as regular reviews and interactions with the CFTC. We undertook this registration voluntarily and at great expense because we believe a properly regulated industry will thrive in the United States and we want to be an active participant in its development.

IV. A Path Forward

The current U.S. regulatory framework is fragmented, and the risks to the U.S. from this lack of a cohesive regulatory approach already have pushed some companies founded in the U.S. to other jurisdictions with greater regulatory clarity. We believe that regulatory uncertainty constitutes a major impediment to U.S. innovation and investment. Until it is addressed, it will continue to lead to a loss of economic opportunity and technological advancement for the U.S.

As discussed above, FalconX has seen great benefits from the application of CFTC rules to its swap dealing business. There are aspects of the CFTC regime that can be applied to spot market trading of digital assets that would provide a regulatory framework to protect customers without stifling innovation.

FalconX believes that there are numerous benefits to applying certain rules from the CFTC's regulatory approach for derivatives markets to digital asset spot markets. The CFTC's rules are clear, tough, and fair. Spot markets would benefit from the application of some of the CFTC business conduct standards, in particular those focused on registration, reporting, and disclosure. At FalconX, we have found that these rules greatly enhance our ability to foster a transparent and orderly market for digital asset derivatives. Tailored to the unique characteristics of digital asset spot markets, they could greatly enhance market integrity, promote investor confidence, ensure investor protection, and facilitate innovation.

V. Conclusion

Many companies in the digital asset space, like FalconX, are voluntarily and eagerly seeking to conduct business in a compliant and transparent manner. We firmly believe that Congress and market regulators should work together to establish a framework for the digital asset ecosystem so that we can both ensure that digital asset markets are safe, transparent, and orderly for all participants.

Legislation like the Digital Commodity Exchange Act achieves just this. We applaud Chairman GT Thompson and the rest of the Committee for their leadership in this regard in the last Congress.

We look forward to this Committee's efforts to progress legislation in cooperation and coordination with the House Financial Services Committee. Chairman Thompson, Chairman Johnson, and Madam Ranking Member, let me reiterate FalconX's appreciation for this opportunity to testify in front of you this afternoon.

I look forward to answering any questions that you might have.

The CHAIRMAN. We are two for two on time. Mrs. Rubin, the pressure mounts. You are up.

STATEMENT OF NILMINI RUBIN, CHIEF OF STAFF AND HEAD OF GLOBAL POLICY, HEDERA HASHGRAPH, LLC, CHEVY CHASE, MD

Mrs. RUBIN. Thank you, Chairman Johnson, Ranking Member Caraveo, Members of the Subcommittee for inviting me to testify. As today is take-your-child-to-work day, my husband has brought two of our three daughters here today.

I am Nilmini Rubin, Head of Global Policy for the Hedera Governing Council, a decentralized multi-stakeholder governing body that establishes policies for the open-source Hedera network.

Hedera is a fast and green distributed ledger or public blockchain. Essentially, Hedera provides a layer of trusted internet infrastructure for applications with real-world impact. What we

call the internet is a set of computers talking to each other through open protocols. These protocols have evolved over time to enable additional features and capabilities that benefit society.

Initially, protocols enabled only read-only text or Web1. Then, they enabled posting content and conducting commerce, or Web2. And now, they enable personal control of data, or Web3. Public blockchains are web-through platforms for other applications and are operated by a network of independent computers, or nodes. Now, these nodes do not fund their operations by showing advertisements or selling subscriptions. Instead, nodes are paid by users directly through fees like water or electricity. Node fees are typically tiny and frequent, with hundreds or thousands of transactions processed per second. It is not possible to use the traditional financial system to send fractions of a penny quickly, efficiently, and globally.

To solve this problem, public blockchains use a digital asset or cryptocurrency to rapidly transfer value between users and node operators. The cryptocurrency serves as a fuel on which the network runs. For example, in March, the Hedera network processed over one billion transactions. Each transaction costs between 1⁄10 and 1⁄100 of a penny and was paid in the Hedera network's cryptocurrency called HBAR.

The key takeaway here is that public blockchains need digital assets to operate. The ability of blockchains to provide trusted and timestamped records enables people to store, track, and monitor data in new and powerful ways. Three examples of products running on the Hedera network include the DOVU marketplace that allows farmers to generate additional income from actions like changing farming techniques and planting additional crops. Their actions are tokenized as carbon credits to fund carbon-reducing projects.

The second one is *atma.io* built by Avery Dennison. It helps brands reduce waste across the supply chain for over 28 billion items, and it has both economic and environmental benefits.

And the third, Everyware. It monitors vaccine cold chain storage across the supply chain and picks up on any irregularities before administering those vaccines to patients, keeping patients safe.

U.S. network and market infrastructure providers need a complete roadmap towards compliance. The current U.S. regulatory environment provides no clear path to compliance for digital assets, leaving blockchains with two choices either stop operating in the U.S. or hope U.S. policy will come through before the enforcement of misaligned regulations.

To protect consumers, enable innovation, and promote competition, we recommend Congress pass legislation creating an activities-based framework to regulate digital assets based on the nature of the transaction. First, Congress should provide a definition of and delineation between *digital commodity* and *digital security* or state when a digital asset is neither. Second, Congress should empower the CFTC to regulate certain digital commodity activities, such as operating a centralized spot marketplace.

To extend U.S. leadership and competitiveness, Congress should establish digital asset policy that supports the use of public blockchains. The rest of the world is recognizing the potential of

blockchains. Other jurisdictions such as Dubai, Europe, Singapore, and the United Kingdom, are creating digital asset regulatory certainty. The United States risks shutting out businesses that rely on digital assets to operate, risks shutting out the ability to regulate the industry, and most importantly, risks removing the American people's access to the efficiency, transparency, and data-storage tools that the rest of the world will be using to their competitive advantage.

Thank you for focusing on policy for the next wave of digital innovation.

[The prepared statement of Mrs. Rubin follows:]

PREPARED STATEMENT OF NILMINI RUBIN, CHIEF OF STAFF AND HEAD OF GLOBAL POLICY, HEDERA HASHGRAPH, LLC, CHEVY CHASE, MD

Thank you, Chairman Johnson, Ranking Member Caraveo, and Members of the Subcommittee on Commodity Markets, Digital Assets, and Rural Development for inviting me to testify today.

I am Nilmini Rubin, Head of Global Policy for the Hedera Governing Council, a decentralized, multi-stakeholder governing body that establishes policies for the open-source Hedera Network. Having spent about twelve years as a House Foreign Affairs Committee and Senate Foreign Relations Committee professional staff member, I am honored to testify before Congress.

The Hedera Governing Council is one of many organizations working on the Hedera network, a public blockchain launched in September of 2019, built on top of the open-source hashgraph technology. The Hedera Network is a fast and green public blockchain whose general purpose applications go well beyond financial services.

I speak today on behalf of only one part of the decentralized Hedera network ecosystem—Hedera Hashgraph, LLC, a U.S. company, whose members consist of twenty-eight leading global companies and universities that comprise the Hedera Governing Council: abrdn, Avery Dennison, Boeing, Chainlink Labs, DBS Bank, Dell Technologies, Dentons, Deutsche Telekom, DLA Piper, EDF (Électricité de France), eftpos, FIS (WorldPay), Google, IBM, the Indian Institute of Technology (IIT), LG Electronics, The London School of Economics (LSE), Magalu, Nomura Holdings, ServiceNow, Shinhan Bank, Standard Bank Group, Swirlds, Tata Communications, Ubisoft, University College London (UCL), Wipro, and Zain Group. My remarks do not necessarily reflect the views of any particular Hedera member.

Why Public Blockchains Need Digital Assets

What we call "the internet" is essentially a decentralized set of computers talking to each other through open protocols on a public network. Each protocol was created by a multi-stakeholder governing body. Those protocols, like TCP/IP, DNS, HTTPS, *etc.,* have never stopped evolving to enable additional features and capabilities that benefit society. Initially, internet protocols just enabled a handful of institutions to share information and send direct messages (the 'read-only' web or "web1"). Protocol innovations enabled people around the world to self-publish and securely message anyone (read and write web or "web2")—unlocking the information revolution. Those web2 protocol innovations enabled the secure sharing of images and videos; secure credit card transactions—unlocking e-commerce; and mobile apps connectivity—unlocking ubiquitous use of the internet anywhere.

Public blockchains are often referred to as "web3" because they deliver the next major protocol innovation. Public blockchains enable unprecedented personal control—the ability to read, write, **and** own your data and assets—without dependency on centralized intermediaries. Unlike in web2, where a user account only exists on a single company's servers, in web3 the entire blockchain network records account ownership. Individuals hold cryptographic keys that enable access to the account. This means that in web3 user accounts are persistent across an unlimited array of services that exist on top of blockchain networks, without requiring users to perpetually create new accounts and passwords.

These web3 protocols, and cryptographically provable individual ownership, allow major innovations including decentralized digital identity. Decentralized identity allows an individual to control what personal information is shared, and with whom it is shared, rather than relying upon an "identity provider" to manage this for them, often under a terms of service agreement the user doesn't fully understand.

So, if I need to prove that I am over 21, I could use my digital ID and choose not to share additional information like my address which helps me protect my safety.

Fundamentally, there are two ways to run a blockchain: (1) private blockchains used for internal operations or with a consortium of partners; and (2) public blockchains that anyone can build applications on.

Public blockchains are operated by a network of independent computers, or "nodes." **Since public blockchain nodes act as the platform on which other applications are built, they cannot fund their operations by showing advertisements or selling subscriptions like web2 intermediaries. Instead, nodes must be compensated by users directly through fees, like water and electricity charges.** The node fees are typically tiny and frequent, with hundreds or thousands of messages or transactions processed per second. **It is not possible to use the existing financial system to send fractions of a penny so quickly, efficiently and globally.**

To solve this problem, public blockchains use a digital asset, or cryptocurrency, to transfer value directly between users and operators. The nodes process these transfers in seconds. As there is no intermediary, they go through an automated consensus-generating process to ensure all computers agree on the amount of cryptocurrency in each network account. **The cryptocurrency serves as the fuel on which the network runs.** For example, during the previous month, the Hedera Network processed over 600 transactions per second—in total over 1.5 billion transactions. Each transaction cost between a tenth ($0.001) and hundredth ($0.0001) of a penny, paid in the network's native cryptocurrency called "hbar."

Public Blockchains Advance the Economy and Humanity

The ability of blockchains to provide immutable, auditable, and order-based records, enables businesses and organizations to store, track and monitor data in new and powerful ways. Products running now on Hedera store, track, and monitor data to reduce waste, fraud, and abuse, and provide economic, social, and environmental benefits, for example:

- **Data storage and provenance—supporting human rights:** Starling Lab, co-founded by Stanford University's School of Engineering and the University of Southern California's Shoah Foundation, built a framework on Hedera and other blockchains to verify, and preserve the authenticity of photos and other evidence.
  - Starling Labs is preserving the USC Shoah Foundation's Holocaust archive and testimonies from tampering, effectively storing, distributing, and verifying the testimonials through sophisticated automated tracking and tracing.[1]
  - Starling Lab and Hala Systems submitted a digital evidence package to the Office of the Prosecutor of the International Criminal Court documenting possible war crimes in Kharkiv, Ukraine. The package was an unbroken chain of digital evidence establishing data provenance, proving it had not been tampered with from the field to the courtroom—a first for any court submission in the world.[2]
- **Value exchange—supporting rural development:** DOVU is a marketplace, built on Hedera, to inexpensively issue tokenized carbon credits in order to fund projects that remove, capture, or sequester carbon from the environment. This presents an opportunity for participating farmers to generate additional income by unlocking carbon sequestered in soil; increase the amount of carbon sequestered, and selling the carbon to buyers looking for offsets. The entire audit trail technology is built on top of Hedera's Guardian open-source framework, and verifies the entire journey for any carbon project from onboarding to retirement, with simple visualizations and documentation.[3]
- **Transparent platforms—supporting the environment:** CYNK, Africa's first verified carbon emissions reduction platform, built a product on Hedera to track and trade emission reduction tokens generated by Tamuwa, Kenya's largest biomass company. CYNK provides an immutable audit trail for all of Tamuwa's

[1] *https://www.jpost.com/diaspora/antisemitism/how-blockchain-can-preserve-holocaust-testimonies-from-manipulation-657308.*

[2] *https://dornsife.usc.edu/cagr-news/news/2022/06/33571-starling-lab-and-hala-systems-file-cryptographic-submission-evidence-war-crimes.*

[3] *https://dovu.earth/en/news/.*

carbon credits, bringing trust and transparency to the emissions reduction platform.[4]

- **Supply chain traceability—supporting waste reduction:** *atma.io,* built by Avery Dennison, utilizes Hedera and helps brands meet net-zero targets and reduce waste across the supply chain. As more than 28 billion items across apparel, retail, food and healthcare move through the supply chain, their movements are recorded as transactions, timestamped and stored on Hedera. This allows *atma.io* to provide a granular view of carbon emissions and enables targeted carbon reductions.[5]
- **Supply chain monitoring—supporting vaccine safety:** Everyware built a product on Hedera to monitor vaccine cold-chain storage and pick up on any irregularities before administering those vaccines to patients. Everyware's sensors monitor the temperature of refrigerators storing the temperature-sensitive vaccines in real-time, and transmit the data to its cloud platform, which is encrypted and then saved on to Hedera's blockchain network.[6]
- **Supply chain tracking—supporting pharmaceutical safety:** AVC Global and Medical Value Chain (MVC), built a product on Hedera and another blockchain to track all pharmaceuticals coming into the Kingdom of Bahrain. Their SmartPass technology cryptographically tracks the entire supply chain to allow users to authenticate pharmaceuticals and avoid dangerous counterfeits.[7]

In addition, establishing strong digital asset policy frameworks and regulation advances American values. Before hosting the Summit for Democracy in March, the U.S. government issued a call to the private sector to address global democratic challenges. Hedera was proud to respond and committed to convening a roundtable on how blockchain technologies can support democracy. Hedera will invite companies, trade associations, advocacy groups, academics and government officials, publicly share a summary of the discussion, and make recommendations for next steps.[8]

Recommendations for Congress

The sale of digital assets to raise money for the creation of a network or application is fundamentally different from the use of digital assets as a fuel to pay for network activity costs or obtain access to other goods or services, and regulations should be tailored to address the unique characteristics of each. Participants in each transaction should be able to have a clear understanding of how the regulations apply and what their obligations are.

Built on the premise that digital asset regulation should protect consumers, enable innovation, and promote competition, ***we recommend passage of legislation to create an activities-based framework that regulates the use of digital assets based on the nature of the transaction:***

- **First, Congress should provide a clear definition of and delineation between "Digital Commodity" and "Digital Security," or when a digital asset is neither.** Currently, it is not clear whether the Commodity Futures Trading Commission (CFTC) or the Securities and Exchange Commission (SEC) is the primary regulator for any given digital asset or transaction.
- **Second, Congress should empower the CFTC to regulate certain Digital Commodity activities, such as operating a centralized spot marketplace.** Network and market infrastructure providers in the U.S. today do not have a complete roadmap toward compliance and appropriate regulatory oversight. For example, if trading platforms must register as a designated contract market (DCM) and intermediaries must register as a futures commission merchant (FCM), how can businesses be brought into the existing regulatory perimeter without friction or harm to purchasers and users? Clarity here will greatly improve consumer safety as adoption of these technologies and their benefits accelerate.

In the same way not all assets are securities, not all digital assets are securities. Not all digital assets are securities because not all digital assets have the

[4] *https://furtherafrica.com/2022/10/05/first-african-emissions-reduction-platform-to-begin-trading/.*
[5] *https://www.labelsandlabeling.com/news/sustainability/atmaio-utilize-hedera-network-co2-emissions.*
[6] *https://www.cnbc.com/2021/01/19/uk-hospitals-use-blockchain-to-track-coronavirus-vaccine-temperature.html.*
[7] *https://www.unlock-bc.com/news/2021-05-25/bahrain-based-medical-value-chain-fully-integrated-with-blockchain-hedera-hashgraph/.*
[8] *https://www.state.gov/private-sector-commitments-to-advance-democracy/.*

same purpose, characteristics, and historical facts and circumstances. **Applying existing securities law to all cryptocurrencies severely limits—if not prohibits—the actual use of public blockchains.** For example, a supply chain application for the manufacturing process of a food item to ensure accurate tracking of expiration dates for consumer safety may require the use of an SEC-registered broker-dealer just to pay a 1¢ transaction fee in cryptocurrency to log a supply chain event.

Legislative clarity for innovative products has been done before. The 2010 Dodd-Frank Wall Street Consumer Protection Act allocated rulemaking authority for swaps to more than one Federal agency. In Title VII of the Dodd-Frank Act, Congress recognized that derivatives contracts differed meaningfully and allocated authority for swaps involving a commodity interest to the CFTC, while at the same time granting rulemaking and oversight of swaps involving an underlying security to the SEC. **Today, swaps market regulation is largely viewed as an example of successful allocation of regulatory authority between two agencies.** The same approach could be taken to digital assets.

Digital asset use is inherently international and it is important that any regulation takes that into account. The CFTC has an established process for permitted substituted compliance with non-U.S. regulatory regimes. Known as Comparability Determinations, the CFTC has the authority to determine that a foreign jurisdiction's regulatory requirements are comparable to the CFTC's requirements under U.S. law.[9]

To regulate fast-developing innovations like digital assets, the CFTC is a more appropriate regulator than the SEC because the CFTC adheres to the concept of "principles-based regulation" while the SEC follows a prescriptive rules based approach.

As former CFTC Chair Heath Tarbert noted, "**It is important to recognize that principles-based regulation is not a euphemism for 'deregulation' or a 'light-touch' approach—far from it. Principles-based regulation is a different way of achieving the same regulatory outcomes as rules-based regulation. But it simply does so in what is, in many cases, a more efficient and flexible manner.**"[10] The current regulatory environment in the U.S. provides no clear path to compliance, leaving two choices: (1) find that path overseas; or (2) continue hoping regulation will catch up before enforcement punishes another innovator for being a square peg they cannot fit into their round hole of prescriptive rules designed for very different activities, decades before these innovative activities were ever considered.

Conclusion

The internet is global but it was invented here in the U.S., allowing American values to underpin fundamental internet protocols. **Congress must define rules in the U.S. to allow public blockchains to thrive so that the next wave of internet value creation continues to echo the U.S.' commitment to markets and democracy.** Other countries and regions, including China, the European Union, Singapore, the United Arab Emirates and the United Kingdom, are swiftly moving forward with their own digital asset regulations. The resulting regulatory certainty may give companies currently based in those locations an advantage over U.S. companies; it may encourage companies to move to some of those locations; and it may present national security risks.

Thank you for your focus on digital assets and setting the rules that will enable American innovators to continue to play a leading role in crafting the future of the internet.

The CHAIRMAN. Very well said.

Mr. Massad, you are up, three for three.

[9] *See Comparability Determination for Substituted Compliance Purposes* at *https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm*.

[10] *See Fintech Regulation Needs More Principles, Not More Rules at https://fortune.com/2019/11/19/bitcoin-blockchain-fintech-regulation-ctfc/*.

STATEMENT OF HON. TIMOTHY G. MASSAD, J.D., RESEARCH FELLOW, MOSSAVAR-RAHMANI CENTER FOR BUSINESS AND GOVERNMENT, KENNEDY SCHOOL OF GOVERNMENT, HARVARD UNIVERSITY; DIRECTOR; M–RCBG DIGITAL ASSETS POLICY PROJECT, WASHINGTON, D.C.

Mr. MASSAD. Chairman Thompson, Chairman Johnson, Ranking Member Caraveo, Members of the Committee and staff, I am honored to be testifying before you today. It is almost a decade since I first testified before this Committee about the lack of a comprehensive regulatory framework for crypto. Four years ago, I wrote a paper on the need to strengthen regulation, which began with the following sentence: "There is a gap in the regulation of crypto assets that Congress needs to fix." That gap still exists today, of course, and it is the absence of a Federal regulator for the spot market and crypto tokens that are not securities, as has been explained. And it is a principal reason why investor protection in the crypto market is extremely weak, and that was made painfully obvious by the failures of several crypto firms last year such as FTX, which resulted in hundreds of thousands of people suffering losses.

Now, there are other gaps. I have noted some of those in my written testimony, but I will focus on this one.

For years now, I have said that either the SEC or the CFTC needs to be given the authority and the resources to regulate that spot market. Today, I want to suggest to you that there is another path forward, an easier path forward, and it addresses the fact that the lack of investor protection is also related to this debate about whether crypto tokens should be considered securities or commodities or something else. Industry participants complained about the lack of regulatory clarity, but trading and lending platforms also claim they are dealing only in tokens that are securities, thereby avoiding direct Federal oversight. SEC Chair Gensler, on the other hand, says most tokens are securities, and the problem is a lack of compliance with existing requirements.

While the SEC has brought enforcement actions on this issue, that path could take a long time to reach sufficient clarity. And while there are legislative proposals to address this issue, by revising regulatory categories, I am concerned those could generate as much confusion as clarity

There is an alternative path forward. It would increase investor protection quickly, without rewriting decades of law or diminishing the existing authority of either the SEC or the CFTC. The investor protection standards we need are largely the same, regardless of whether a token falls in the securities or commodities bucket. Therefore, Congress would pass a law mandating that any trading or lending platform that trades Bitcoin or Ethereum must comply with a core set of principles unless that platform has already registered with the SEC or the CFTC. The principles would include protection of customer assets, prevention of fraud and manipulation, prohibition of conflicts of interest, and others as I have set forth in my written statement. Congress would direct the SEC and the CFTC to develop joint rules implementing these principles or create a self-regulatory organization, SRO, to do so.

This approach has several advantages. First, it is simple. The requirements would apply to any trading or lending platform that trades Bitcoin or Ethereum. That captures almost all of the market, if not the entire market.

Second, it focuses on the core of the problem. Over 90 percent of spot trading volume takes place on centralized intermediaries. This approach would dramatically raise the level of investor protection on those platforms. Simply eliminating wash trading where someone trades with themselves or an affiliate to inflate the price or trading volume of an asset and which has been estimated to represent 50 to 90 percent of the volume on many platforms would be a huge improvement. And of course, the rules can also be customized to apply to decentralized platforms.

Third, it is practical. It is based on the market as it exists today. It would not require a bifurcation of trading into one platform for security tokens and one for commodity tokens. And that is useful because actual trading takes place in pairs of tokens that can often be in different buckets.

In addition, by using an SRO, the industry could be required to pay for the cost of the approach. You would not have to allocate money. The approach would not involve rewriting existing securities or commodities laws, and such proposals might not only fail to bring clarity to crypto, they might unintentionally undermine decades of regulation and jurisprudence. In particular, the law should make clear that the CFTC and SEC would retain their existing authority. The SEC could still contend that any particular token is a security, and if it prevailed, the intermediary would have to stop dealing in that token or move it to a registered platform, but the intermediary would not be shut down. That would assure platforms and their customers that operations will continue on a far more responsible basis.

The approach finally is incremental. While comprehensiveness is desirable, it can take a long time to build consensus. I believe it is better to do something incremental that can protect millions of investors and serve as a foundation which can be improved over time. This is essentially the same thing that former SEC Chair Jay Clayton and I proposed in a *Wall Street Journal* op-ed. And the point is that this is a proposal that can be supported by people, regardless of one's view of the value of crypto, whether you are breathlessly positive or angrily negative I believe you said, Mr. Chairman, and it is a proposal people on both sides of the political aisle can support.

Thank you.

[The prepared statement of Mr. Massad follows:]

PREPARED STATEMENT OF HON. TIMOTHY G. MASSAD, J.D.,* RESEARCH FELLOW, MOSSAVAR-RAHMANI CENTER FOR BUSINESS AND GOVERNMENT, KENNEDY SCHOOL OF GOVERNMENT, HARVARD UNIVERSITY; DIRECTOR; M–RCBG DIGITAL ASSETS POLICY PROJECT, WASHINGTON, D.C.

Chairman Thompson, Ranking Member Scott, Subcommittee Chairman Johnson, Subcommittee Ranking Member Caraveo, Members of the Committee and staff, I

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Continued

am honored to be testifying before you today. It is almost a decade since I first testified before this Committee about the lack of a comprehensive regulatory framework for crypto in the United States. Four years ago, I wrote a *paper* published by the Brookings Institute on the need to strengthen crypto asset regulation. It began with the following sentence: "There is a gap in the regulation of crypto assets that Congress needs to fix."[1] While I am pleased this hearing is being held, it is unfortunate that there are still significant gaps in crypto asset regulation.

The gap I talked about then was the absence of a Federal regulator for the spot market in crypto tokens that are not securities, such as bitcoin. It was during my tenure as Chairman of the Commodity Futures Trading Commission (CFTC) that the agency declared bitcoin and other virtual currencies to be commodities, which gave the agency authority to regulate derivatives based on such commodities, but its authority over the spot market for any commodity is quite limited.[2]

Because of this and other reasons, investor protection is woefully inadequate on crypto trading and lending platforms. These platforms do not observe standards common in our financial markets that ensure protection of customer assets, prohibition of conflicts of interest, prevention of fraud and manipulation, and adequate transparency, among other things. That was made painfully obvious last year by the failures of trading platform FTX, crypto lender Celsius, the Terra/Luna stablecoin and others, resulting in hundreds of thousands of investors sufferinglosses.

There are other gaps in crypto-asset regulation. One is the lack of a Federal regulatory framework for stablecoins. The report of the Financial Stability Oversight Council issued last fall identified additional gaps consisting of the opportunities for regulatory arbitrage and "whether vertically integrated market structures can or should be accommodated under existing laws and regulations."[3] While I agree with these findings and share the concerns in the FSOC report, I will focus on the gap in oversight of the spot market and make some brief comments about the absence of a Federal regulatory framework for stablecoins.

In my 2019 paper, I proposed that either the Securities and Exchange Commission or the Commodity Futures Trading Commission be given authority to regulate the spot market for crypto assets that are not securities. Either agency is capable of doing so ***provided*** it is given sufficient resources. I know first hand the challenges faced by the CFTC because of its limited budget, and the task of regulating the crypto asset (non-security) spot market would require significant resources.

Today, I want to suggest that there is another path forward as well. It addresses the fact that spot market regulation is very challenging because of the question of how to classify digital assets: are they securities or commodities or something else? Should we create a new regulatory category for them? The debate over this issue is a major reason why crypto trading and lending platforms do not observe standards that are common in other financial markets. Industry participants complain about a lack of clarity in the rules for resolving this issue and have called for regulators to create a new set of rules specifically for crypto. But meanwhile trading and lending platforms claim they are only dealing in tokens that are not securities—thereby avoiding direct Federal oversight. Chair Gary Gensler of the Securities and Exchange Commission (SEC) says most tokens are securities and the problem is a lack of compliance with existing legal requirements.[4] There is no need to write new rules just because of a new technology, and doing so might undermine decades of precedents that have contributed to the strength of our capital markets generally.

The SEC has some pending enforcement actions that may bring greater clarity to this question. But that is uncertain and could take time, during which investors

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Trading Commission (2014–2017); Assistant Secretary for Financial Stability of the U.S. Treasury (2010–2014).

[1] Timothy Massad, *It's Time to Strengthen the Regulation of Crypto-Assets,* The Brookings Institute, p. 2 (Mar. 2019), *https://www.brookings.edu/research/its-time-to-strengthen-the-regulation-of-crypto-assets/* (hereinafter "Massad 2019").

[2] The CFTC has authority to bring enforcement actions for fraud and manipulation in the spot market and to regulate certain retail leveraged transactions, but it does not have the authority to prescribe standards under which trading platforms or other intermediaries must operate. For a discussion of the CFTC's authority, see ibid, pp. 32–33 as well as Timothy Massad and Howell Jackson, *How to improve regulation of crypto today—without Congressional action—and make the industry pay for it,* The Brookings Institute, pp. 8–9 (October, 2022), *https://www.brookings.edu/research/how-to-improve-regulation-of-crypto-today-without-congressional-action-and-make-the-industry-pay-for-it/* (hereinafter "Massad-Jackson 2022").

[3] Financial Stability Oversight Council, *Report on Digital Asset Financial Stability Risks and Regulation,* p. 5 (October 2022), *https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf* (hereinafter the "FSOC Report").

[4] See, for example, Chair Gensler's testimony before the U.S. House of Representatives Financial Services Committee on April 18, 2023, at *https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408690*.

will continue to be at risk. Moreover, even if the SEC prevails in particular cases, it may face a game of whack-a-mole, where proponents of other tokens and the trading and lending platforms themselves argue that other tokens are different from the particular facts of an SEC victory, triggering further litigation.

Meanwhile, Members of Congress have proposed legislation that would create new regulatory categories meant to resolve this issue, often in conjunction with giving new authority to the CFTC for the spot market. While admirable in intent, the risk is creating new regulatory categories of assets might generate more confusion than clarity, and lead to disputes over their own meaning that could take years to resolve. They could also have unintended adverse ancillary effects with respect to regulation of capital markets generally.

There is an alternative path forward. It would increase investor protection quickly without rewriting decades of law in one bill. It would not diminish the existing authority of either the SEC or the CFTC.

The idea is to create a baseline of investor protection by recognizing that many of the standards we need are the same regardless of whether a token falls in the securities or commodities bucket. Congress would pass a law mandating that any trading or lending platform that trades bitcoin or ethereum must comply with a set of core principles, unless the platform has already registered with the SEC or CFTC as a securities or derivatives intermediary. The principles would include protection of customer assets, prevention of fraud and manipulation, prohibition of conflicts of interest, adequate disclosure to investors, regular reporting, pre and post trade transparency, risk management and governance standards, among others.

Congress would direct the SEC and the CFTC to develop joint rules implementing these principles (and the principles could also be made applicable pending issuance of such rules). Rules could also be developed by creating a new self-regulatory organization (SRO) jointly supervised by the SEC and the CFTC. SROs have been critical to the regulation of our securities and derivatives markets for decades, and there is precedent for SROs registered with both the SEC and the CFTC.[5] The SRO could also be charged with enforcing the rules.

I believe this approach has several advantages. It is simple. It focuses on the core of the problem. It is practical and feasible. It can be implemented quickly and efficiently. It does not rewrite existing law in ways that may create more confusion than clarity. And it is incremental. Let me explain each of these aspects and then provide some greater detail and background.

First, simplicity: the approach is based on a clear definition of jurisdiction. The requirements would apply to any trading or lending platform that trades bitcoin or ethereum, which are chosen because they represent so much of the market. There would not be confusion as to what entities must comply, though one could add other tokens to the list or include a minimum volume threshold to exclude insignificant activity. It would also be based on principles that are already wellknown in financial market regulation, the desirability of which should command wide support.

Second, it focuses on the core of the problem. Over 90% of spot market trading is estimated to occur through centralized intermediaries.[6] If we can raise the level of investor protection on those intermediaries, that will help prevent the kinds of losses we have seen recently. It may also take some of the speculative air out of the sails of this industry. For example, wash trading—where someone trades with themselves or an affiliate to inflate the price or trading volume of an asset—has been estimated to represent 50% or more of the trading on crypto platforms.[7] If we simply prevented that, it would be a huge improvement. The proposal can also cover decentralized platforms, as the agencies or SRO can be directed to develop appropriate adjustments to rules for those as well.

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[5] See Massad-Jackson 2022, *supra* note 2.

[6] See Coingecko, 2022 Annual Crypto Industry Report which estimated that as of the end of 2022, centralized exchanges had 93% of market share.

[7] See Lin William Cong, *et al., Crypto Wash Trading* (July 2021), *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3530220* (estimating that wash trades account for 70 percent of volume on unregulated cryptocurrency exchanges); see also Jialan, Chen *et al., Do Cryptocurrency Exchanges Fake Trading Volume?* 586 PHYSICA A. 126405 (Jan. 15, 2022); Matthew Hougan, *et al., Economic and Non-Economic Trading In Bitcoin: Exploring the Real Spot Market For The World's First Digital Commodity,* BITWISE ASSET MANAGEMENT (May 24, 2019), *https://www.sec.gov/comments/sr-nysearca-2019-01/srnysearca201901-5574233-185408.pdf* (study demonstrating that "95% of reported trading volume in bitcoin is fake or non-economic in nature"); Javier Paz, *More Than Half of All Bitcoin Trades are Fake,* FORBES (Aug. 26, 2022), *https://www.forbes.com/sites/javierpaz/2022/08/26/more-than-half-of-all-bitcoin-trades-are-fake/?sh=11ea350b6681;* see also Steve Inskeep, *et al., How "wash trading" is perpetuating crypto fraud,* NPR (Sept. 23, 2022), *https://www.npr.org/2022/09/23/1124662811/how-wash-trading-is-perpetuating-crypto-fraud*.

Third, it is practical and feasible. It is practical because it is based on the market as it exists today. The subject platforms would be required to implement the principles regardless of arguments about what is a security and what is a commodity. It would not require a bifurcation of trading into one platform for security tokens and one for commodity tokens. This is particularly useful because crypto trading involves pairs of tokens that might be classified into different buckets. It is feasible because the SEC and the CFTC have the experience to implement the principles and there are precedents for them working together. By forming an SRO, they could draw on the expertise of existing SROs such as the Financial Industry Regulatory Association (FINRA) and the National Futures Association (NFA). Finally, the cost of the SRO's activities could be imposed on the industry through membership fees, consistent with existing practice.

The approach would not involve rewriting existing securities or commodities law. There would be no changes to the definition of security, which might not only fail to bring clarity to crypto; that might unintentionally undermine decades of regulation and jurisprudence as it applies to traditional securities and derivatives markets.

In particular, the law should not diminish the existing authority of either the SEC or the CFTC. It should make clear that the SEC would retain its authority to contend that any particular token is a security. If, for example, it prevailed in any particular case, an intermediary would still have to comply—by ceasing to deal in that token, or only doing so on a registered platform—but it would not be shut down as long as it was complying with these basic standards. This would assure the platforms, and their customers, that operations will continue—on a far more responsible basis—while classification and other issues are resolved.

Finally, the approach is incremental in several ways. It does not seek to regulate all crypto transactions or all players in the crypto world from the get-go or resolve the classification questions. It does not rewrite the law as noted. While comprehensiveness is desirable, it can take a long time to build consensus, and it is much harder to get it right. It is better to do something incremental now that can protect millions of investors and serve as a foundation which can be added to and improved over time.

How Did We Get Here?

Former SEC Chairman Jay Clayton and I have advocated essentially this approach in a *Wall Street Journal* op-ed late last year. We wrote about how "the unique genesis of crypto assets . . . complicated the regulatory challenge."

> Unlike other financial innovations, bitcoin was launched globally and directly to retail consumers, with a claim that it would make traditional intermediaries obsolete. Because financial regulation is implemented on a national basis and largely through intermediaries, this "global retail" path of emergence has challenged regulators as traditional tools are less effective."[8]

It is ironic that an innovation that claimed it would make traditional intermediaries obsolete actually created a whole new category of intermediaries—crypto trading and lending platforms. These new intermediaries are also less accountable than the traditional ones that the creator of bitcoin and many crypto proponents complain about.

Former Chair Clayton and I went on to say that other complicating factors have been the fact that "the use case of many crypto assets is often cloudy"—it is not always clear whether a particular token offers an investment opportunity, access to goods or services, or a bank-like product. In addition, the U.S. has a fragmented financial regulatory system with multiple regulators responsible for different product areas.[9] These factors have all contributed to the lack of a strong investor protection framework.

Achieving Investor Protection Now, While Classification Arguments Continue

A key virtue of this approach is that it will allow us to improve investor protection without having first to resolve questions of which tokens are securities and which are commodities. Crypto trading platforms are all quick to say they do not trade or list any tokens that are securities, but there is significant variation in what they do actually list, which should make us ask why that is the case.

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[8] Jay Clayton and Timothy Massad, "How to Start Regulating the Crypto Markets—Immediately," *The Wall Street Journal,* (Dec. 4, 2022), *https://www.wsj.com/articles/how-regulate-cryptocurrency-markets-11670110885*.

[9] *Id.*

For example, as of a recent date, the four largest U.S. platforms—Binance U.S., Coinbase, Gemini and Kraken, listed approximately 60 tokens in common, such as bitcoin and ethereum.[10] Each platform, however, lists a lot more tokens. The number ranges from over 250 (Coinbase) to about half that amount (Gemini). Collectively, the four platforms list a total of around 400 different tokens, and each one lists many tokens that none of the others list.

If each platform is confident that all the tokens it lists are not securities, why don't they list more tokens in common? Would they say all 400 tokens are not securities and claim their selection is based on other factors?

There are surely other factors that are considered, but it seems unlikely these would account for the degree of difference. For example, Coinbase says it considers other factors such as "customer demand (*i.e.,* trading volume, market cap), traction of token/application (*i.e.,* token holders) and anticipated liquidity."[11] Changpeng (C.Z.) Zhao, the co-founder and chief executive officer of *Binance.com,* once put it more bluntly: "If a coin has a large number of users, then we will list it. That's the overwhelming significant attribute."[12]

While it would seem reasonable for platforms to consider consumer demand, one would expect that criteria to lead to platforms listing the same tokens, not different tokens. And if instead selections reflect the platforms' different judgements about technical or security issues, that would suggest a need for better disclosure about tokens that are listed.

As I noted earlier, there are pending cases that may provide further light on these classification issues, and my approach does not interfere with the exercise of the SEC or CFTC's authority or the proper role of the courts in resolving those questions. Indeed, if the SEC succeeds in establishing that a token is a security, then trading in that token would need to be on an SEC registered exchange. But we do not need to wait for any such case to be resolved.

The Principles

The principles that Congress would articulate would be familiar ones used in our securities and derivatives markets. The list could include the following:

- governance standards (including fitness standards for directors and officers);
- protection of customer assets, including segregation and protection in bankruptcy;
- conflicts of interest (including prohibitions or limitations on the ability of trading platforms to engage in proprietary trading or having financial interests in listed assets);
- having adequate financial resources, including capital and margin;
- recordkeeping and periodic public disclosures;
- execution and settlement of transactions in a competitive, open, efficient and timely manner[;]
- pre- and post-trade transparency requirements;
- prevention of fraud, manipulation and abusive practices (including prevention of wash trading);
- disclosures to customers, including regarding fees, recourse, and dispute resolution;[13]
- risk management practices;

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[10] These numbers are based on a manual comparison of listings noted on their respective websites.

[11] Coinbase Exchange, "Listing Prioritization Process & Standards," (Oct. 2022), *https://assets.ctfassets.net/c5bd0wqjc7v0/1DqPApt37t3uBHAMFUxPyI/4fa9169f9a8d90191d322635e597bfda/Coinbase_Exchange_Listing_Prioritization_Process_and_Standards.pdf*

[12] Helen Partz, "Binance CEO reveals one key factor for token listings," Cointelegraph, (Nov. 30, 2021), *https://cointelegraph.com/news/binance-ceo-reveals-one-key-factor-for-token-listings*.

[13] Howell Jackson and I noted in our SRO paper (see note 2) that some have been critical of FINRA's arbitration proceedings for investor disputes involving securities transactions. *See, e.g.,* Mark Egan, *et al., Arbitration with Uninformed Consumers,* Harvard Business School Finance Working Paper No. 19–046 (May 11, 2021), *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3260442*. Whatever concerns one might have about FINRA arbitration proceedings as currently implemented, the point to recognize is that consumers investing in crypto-asset markets now have no mechanism for supervised dispute resolution. Moreover, the most stringent system of oversight currently under debate for crypto-assets—full compliance with SEC requirements—implicitly contemplates the application of FINRA arbitration requirements. Conceivably a crypto-asset SRO might adopt better arbitration rules, but whatever rules they adopt would most likely be an improvement upon the *status quo.*

- operational resilience, cybersecurity standards and business continuity and disaster recovery policies; and
- know your customer (KYC), anti-money laundering (AML) and combating financial terrorism (CFT) standards.[14]

There could also be a requirement that a platform must make sure there is disclosure regarding a token, whether provided by a person seeking admission of a token to trading or otherwise. This is the approach taken in the new Regulation of the European Parliament and of the Council on Markets in Crypto-assets (MiCA), which provides that a crypto token cannot be listed unless there is a white paper on file that provides basic information.[15] The disclosure requirements need not mirror existing securities law requirements. Georgetown Law Professor Chris Brummer has argued that Regulation S–K, the SEC's primary disclosure regulation, is both "over-inclusive and under-inclusive" with respect to crypto: "it fails in some instances to account for critical aspects of the digital assets ecosystem, and in others imposes obligations with little to no relevance, creating both a lack of clarity and inefficiency in compliance."[16] The approach suggested here allows for development of disclosure requirements without undercutting existing securities law which would continue to apply to any token ultimately deemed a security.

In addition to improving investor protection, requiring intermediaries to observe these principles will serve some broader policy goals. It will strengthen our ability to prevent crypto markets from being used for illicit activity. It will give regulators greater information that can help prevent any potential risks to financial stability. Requiring crypto intermediaries to have stronger resiliency standards and cybersecurity protections—which is critical given how common hacks and outages have been—can also help reduce the risk that such hacks and attacks result in collateral damage to other parts of the financial system.

Implementing the Approach Through a Self-Regulatory Organization

While Congress could direct the SEC and the CFTC to jointly develop and enforce rules implementing the principles, a more efficient approach may be to have the two agencies create and supervise a self-regulatory organization that would do so. Professor Howell Jackson of Harvard Law School and I have written about how such an approach could work in a recent *paper*.

The "self-regulatory" aspect of an SRO does not mean lax standards, as long as the SRO is properly supervised by the SEC and CFTC. On the contrary, our country's SROs have been important components of the regulation of our securities and derivatives markets for decades. They have been central to the development and implementation of strong standards, as well as enforcement of those standards against industry participants.

Although the SEC and CFTC have authority to create an SRO without legislation, and there are precedents for joint SROs,[17] having Congress direct the agencies to do so would make clear the importance of and authority for such an approach. A jointly supervised SRO is also appropriate given the fact that both the SEC and

[14] *See also* Massad and Jackson (2022), *supra,* note 2.

[15] The white paper must contain "(a) information about the offeror or the person seeking admission to trading; (b) information about the issuer, if different from the offeror or person seeking admission to trading; (c) information about the operator of the trading platform in cases where it draws up the crypto-asset white paper; (d) information about the crypto-asset project; (e) information about the offer to the public of the crypto-asset or its admission to trading; (f) information about the crypto-asset; (g) information on the rights and obligations attached to the crypto asset; (h) information on the underlying technology; (i) information on the risks; (j) information on the principal adverse impacts on the climate and other environment-related adverse impacts of the consensus mechanism used to issue the crypto-asset."

These requirements are spelled out in further detail in an appendix. There is also a requirement that the paper not contain any material omission. *See* European Parliament, "Position of the European Parliament adopted at first reading on 20 April 2023 with a view to the adoption of Regulation (EU) 2023/ . . . of the European Parliament and of the Council on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937" (April 24, 2023), Procedure: 2020/0265(COD), available at *https://www.europarl.europa.eu/doceo/document/TA-9-2023-0117_EN.html#title2*.

[16] Georgetown Law Professor Chris Brummer has argued that Regulation S–K, the SEC's primary disclosure regulation, is both "over-inclusive and under-inclusive" with respect to crypto: "it fails in some instances to account for critical aspects of the digital assets ecosystem, and in others imposes obligations with little to no relevance, creating both a lack of clarity and inefficiency in compliance." Chris Brummer, Georgetown Law School, Testimony before the Agriculture Committee of the U.S. House of Representatives, Subcommittee on Commodity Exchanges, Energy, and Credit (June 23, 2002), *https://docs.house.gov/meetings/AG/AG22/20220623/114931/HHRG-117-AG22-Wstate-BrummerC-20220623-U1.pdf*.

[17] *See* Massad-Jackson 2022, at note 2.

CFTC have some jurisdiction over crypto. To the extent there are some differences in existing law with respect to an agency's authority over or relationship to an SRO (such as in the process for approving rules), those could be harmonized or resolved in favor of one approach over another.[18] An SRO could make it easier to conduct supervision and enforcement, because those activities could be conducted by SRO staff rather than joint teams of the two agencies. The Congress could also make clear that the SRO would be financed from industry member dues, as is the practice with existing SROs.

State Law Cannot Fill the Gaps

We cannot rely on state law to address the gaps in crypto regulation. The state law requirements that are imposed today on crypto trading firms are minimal, arising primarily from state money transmitter laws. Those laws have their origins in the telegraph era, and generally impose only minimal requirements pertaining to net worth, security and permissible investments. They do not provide a regulatory framework comparable to that created by the Federal laws and regulations governing the securities and derivatives markets. (They do trigger a requirement to register as a money service business with the Treasury Department and the application of the Bank Secrecy Act, which imposes anti-money laundering and other requirements.) Relying on state law would be analogous to relying on state blue sky laws to regulate the securities market after the crash of 1929, rather than what we actually did—which was to pass the Securities Act, the Securities Exchange Act and the other laws that are the foundation of the strongest capital markets in the world. Moreover, even to the extent that a few states have strengthened their laws or might choose to do so in the future to address the obvious lack of investor protection in the crypto sector, there would still be inconsistency as between different states' requirements. This creates opportunities for regulatory arbitrage that the FSOC report highlighted.[19]

The Path Forward Should Not Depend on Consensus on the Value of Crypto

A recent *Economic Report to the President* issued by the White House takes a very negative view on the value of crypto to date:

> "In addition to the decentralized custody and control of money, it has been argued that crypto assets may provide other benefits, such as improving payment systems, increasing financial inclusion, and creating mechanisms for the distribution of intellectual property and financial value that bypass intermediaries that extract value from both the provider and recipient . . . So far, crypto assets have brought none of these benefits . . . Indeed, crypto assets to date do not appear to offer investments with any fundamental value . . . instead, their innovation has been mostly about creating artificial scarcity in order to support crypto assets' prices—and many of them have no fundamental value."[20]

Those who question the fundamental value of the crypto sector may believe that regulating crypto trading and lending firms will tend to legitimize or encourage more investment in a sector we should prefer to see decline, move offshore or at least not grow. By contrast, there are those who will argue that the United States is failing to create a regulatory framework that encourages the development of technology they believe is transformative and is deserving of a dedicated regulatory regime. They worry that important innovation will move overseas.

I continue to hold the views expressed in my 2019 paper:

> ". . . whether [crypto assets] are the next big thing or modern-day Dutch tulips should not determine whether or how we regulate them. There is nothing so exceptional about crypto assets that justifies giving them a regulatory pass. Nor should they be taxed or regulated out of existence. A traditional principle of financial market regulation in the United States has been to refrain from normative judgements about investments, require transparency and integrity in markets and let investors make their own decisions. We should follow that same principle here."[21]

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[18] For example, under current law, the SEC must approve an SRO's proposed rules; if the CFTC does not object to a proposed rule, it is deemed approved.

[19] *See supra* note 3.

[20] The White House, *Economic Report of the President,* p. 238 (March 2023), *https://www.whitehouse.gov/wp-content/uploads/2023/03/ERP-2023.pdf.*

[21] Massad 2019 *supra* at note 1, p. 6.

This is important also as other jurisdictions work to clarify their crypto regulatory regimes. The possibility that activity moves abroad may not reduce risk to our markets or our citizens; it could simply make it harder for regulators to monitor and regulate that risk.

The approach I am suggesting can find support on both sides of the political aisle. Former SEC Chair Jay Clayton and I advocated essentially this same approach in our *Wall Street Journal* op-ed late last year. We began by noting that "only someone who has been living under a rock could think cryptocurrency markets don't need stronger regulation."[22] We proposed that the SEC and CFTC develop a set of common, basic investor protection requirements and require platforms to adopt them if they haven't already registered with the SEC as a securities intermediary or with the CFTC as a derivatives intermediary. This would strengthen investor protection without either agency relinquishing any authority while classification and other issues are resolved.

In short, this is a proposal that people on both sides of the aisle, and people with different views on the merits of crypto, can support.

Another Critical Gap: The Lack of a Federal Regulatory Framework for Stablecoins

I wish to discuss briefly another critical gap, which is the lack of a Federal regulatory framework for stablecoins, which are used extensively in the crypto spot market. Stablecoin market capitalization has grown quickly in the last few years, and has not declined dramatically despite the fact that the crypto market has generally lost ⅔ of its value since late 2021. The risks posed by stablecoins have been described in detail in two recent government reports—the report of the President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency,[23] and the report of the FSOC previously noted.[24] I will therefore not summarize those risks, nor the inadequacies of present regulation which are also described in those reports. Both those reports call on Congress to pass new legislation to provide specific authority to regulate stablecoins.

I believe we need to bring stablecoin activity within the Federal regulatory perimeter rather than attempt to keep it outside. I believe that is a better way to oversee and manage the risks that stablecoins pose, both to consumers and to the traditional financial system and financial stability generally. Limiting interconnections between crypto and the traditional banking sector generally, which appears to be the current policy of our bank regulators, may slow the growth of certain crypto activities, but it risks pushing the activity overseas, or to less-regulated or non-regulated areas of financial activity. That could ultimately make it harder to oversee and manage the risk. Bringing the activity within the regulatory perimeter is also the best way to realize any positive potential that stablecoins might offer. Although stablecoins are used mostly within the crypto sector today, they might have potential to improve payments in other areas.[25]

Professors Jackson of Harvard Law School and Dan Awrey of Cornell Law School and I wrote a *paper* recently outlining how such a regulatory framework could be created today by our financial regulators (primarily our banking regulators) under existing law without new legislation. However, our bank regulators appear reluctant or unwilling to do so unless given specific authority by Congress.

Therefore, I support legislation that would create a framework for stablecoin regulation based on principles followed primarily in our regulation of banks. As long as stablecoins are used as a payment mechanism, and do not pay interest or a return to their holders, I believe it is best to regulate them as payment instruments. There need to be prudential requirements on the issuer, including that stablecoins be fully backed by reserves in the form of cash or high quality liquid assets as well as capital and liquidity requirements. Operational requirements on the stablecoin issuer are necessary as well, such as KYC and AML requirements, risk management standards, cybersecurity, and restrictions on use of customer data. There should be standards on the issuer's selection and oversight of decentralized blockchains on which stablecoins are transferred. There also need to be standards requiring inter-

[22] *See supra,* at note 8.

[23] President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, *Report on Stablecoins* (Nov. 1, 2021), *https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf* (hereinafter the "PWG Report").

[24] FSOC report, *supra* at note 3.

[25] In the interests of full disclosure, I note that I am a member of PayPal's Advisory Council on Blockchain, Crypto and Digital Currencies. I am testifying in my personal capacity and the views I express are entirely my own.

operability of stablecoins and prevention of concentration of power, as well as limitations on certain commercial affiliations.

The Digital Assets Policy Project at the Harvard Kennedy School, which I direct, held a roundtable on stablecoin regulation last November attended by senior leaders from government, the stablecoin industry, traditional financial institutions, academia and others. Although the event was conducted under Chatham House rules, a summary of the discussion and other materials, including comparisons of different legislative proposals on stablecoins, can be found at the Digital Assets Policy Project *website*.

I would be happy to answer any questions. Thank you.

The CHAIRMAN. Thank you very much, sir.

Mr. Hall, you are recognized for 5 minutes.

STATEMENT OF JOSEPH A. HALL, J.D., PARTNER, DAVIS POLK & WARDWELL LLP, NEW YORK, NY

Mr. HALL. Chairman Johnson, Ranking Member Caraveo, and Members of the Subcommittee, I am Joe Hall, and I am a Partner in the law firm Davis Polk & Wardwell.

The question of where blockchain-based digital assets fit in our regulatory framework frustrates businesses and continues to divide regulators. I believe the lack of certainty has had real costs in terms of consumer confidence in protection, lost economic activity, and unnecessary hurdles to competing with foreign markets. And so when I hear that blockchain technology has not lived up to the hype, I sometimes wonder how we would even know.

At the root of the problem is a simple observation. Many kinds of digital assets are inherently different from the stocks, bonds, options, and futures that our existing regulatory structures were built for. Digital assets may not represent a claim on the revenues or assets of a business or look much like the agricultural products, natural resources, or financial commodities with prices that need to be hedged. Instead, digital assets might be deployed to verify a transaction between two strangers or to facilitate decision-making by a dispersed network of coders or to encourage honest behavior in the fulfillment of an obligation.

Because they combine functionality with easy traceability, one can say that digital assets are in fact different in kind from what preceded them. Now, our system of financial market regulation depends on the ability to distinguish securities from commodities, and so we have to determine whether digital assets are securities under SEC jurisdiction or commodities under CFTC jurisdiction. And as it turns out, it is not so clear. The Supreme Court says that, quote, “When a purchaser is motivated by a desire to use or consume the item purchased, the securities laws do not apply.

And now different Federal and state regulators, including the SEC and the CFTC, have taken conflicting positions on whether some of the most common digital assets are securities. And the SEC suggests market participants should consider a list of 50 or 60 different characteristics, none of which is necessarily determinative on the understanding that when their presence is stronger, then it is more likely that the digital asset is a security. And now that is not a recipe for predictability. It is not easy for businesses to plan and invest when the answer to their most pressing question is, maybe what you want to do is okay, but maybe it is not.

Given this uncertainty, a couple of questions naturally arise. Why not just register with the SEC? And given how well-trod the

path of SEC registration is, are people who take the position that their digital assets are commodities simply behaving as scofflaws? That has not been my experience.

The problem is, today, registering with the SEC is not a practical alternative. First, the obligations that attach to securities make it impractical to use them in everyday transactions, and that is because the securities framework was built for passive investment instruments, and virtually everyone who touches them is subject to extensive regulation by the SEC in ways that, frankly, make sense for debt and equity securities. This framework wasn't built to govern commercial activities like sending a payment. And despite the rise of blockchain technology over the last 10 years, the SEC has taken no apparent action to adapt its rulebook to facilitate activities involving digital assets.

Second, even if the SEC did adapt its rules, market participants would continue to face insurmountable barriers to conducting business across state lines, and that is because each state regulates the sale of securities, each with its own registration process, and digital assets are not exempt. There is no coordination among states on digital assets, and businesses who try to register will find themselves quickly facing a gauntlet of 50 different state securities commissioners.

If there were practical routes to registration, I am confident that many businesses would in fact register. But today, the security-or-not question means that if a digital asset is a security, then we regulate it out of existence or at least out of the United States, but if it isn't, then consumers lack reliable information in the protection of Federal market oversight.

I don't believe it is practical to task the regulators with sorting this out. Our approach to financial regulation relies on competition, and it relies on our Federal financial regulators pushing against the boundaries of their jurisdiction. I believe that competition among the regulators is a feature, not a bug of our system.

So I believe it is time to move past the tired debate over whether digital assets are securities under existing law. Congress should instead step in with a new regulatory approach tailored to this asset class. Concepts drawn from the Federal securities and commodities laws can inform our new paradigm, but regulators will need clear direction from Congress on how these precedents should apply.

I appreciate the Committee's time today and look forward to answering your questions. Thank you.

[The prepared statement of Mr. Hall follows:]

PREPARED STATEMENT OF JOSEPH A. HALL, J.D.,* PARTNER, DAVIS POLK & WARDWELL LLP, NEW YORK, NY

Chairman Johnson, Ranking Member Caraveo, and Members of the Committee:

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*I am a Partner in the law firm of Davis Polk & Wardwell LLP in New York City, where I began my career in 1989. As a member of the firm's capital markets group, I advise public and private companies, asset managers and financial intermediaries on transactional, corporate governance and securities compliance and enforcement matters. In the last decade my practice has focused increasingly on the intersection of federal securities law with cryptoassets and participants in the digital asset industry.

From 2003 to 2005, I served on the staff of the Securities and Exchange Commission, ultimately as managing executive for policy under Chairman William H. Donaldson. From 1988 to 1989 I served as a law clerk for the Hon. Phyllis A. Kravitch of the U.S. Court of Appeals for

Thank you for the privilege to speak before you today.

My name is Joe Hall and I am a Partner in the law firm of Davis Polk & Wardwell, where I have practiced securities law for the last 3 decades. Earlier in my career—a few years before anyone had heard of Satoshi Nakamoto—I served as a senior staff member of the Securities and Exchange Commission.

The question of where blockchain-based digital assets fit into our regulatory framework frustrates and bewilders entrepreneurs, small businesses and large public companies, and continues to divide regulators [1] and experts in financial services regulation.[2] I believe the persistent lack of certainty and workable rules has had real costs in terms of consumer confidence and protection, foregone investment, lost economic activity, and unnecessary hurdles to our ability to compete with foreign markets. And so when I hear that blockchain technology "hasn't lived up to the hype," [3] I sometimes wonder how we would even know.

I would like to focus my remarks on a pair of questions:

- *Is the regulatory environment really uncertain?*
- *Even if it is, why not simply go ahead and register with the SEC—just to be careful?*

Regulatory uncertainty is real

I acknowledge that there are well-informed and thoughtful people who hold the view that claims of regulatory uncertainty are overblown at best,[4] but from my perspective as a practitioner having advised clients on a wide range of digital asset matters, I respectfully disagree.

At the root of the problem lies this simple observation: Many kinds of digital assets are qualitatively different from the stocks, bonds, options and futures that we have experience with and that our existing market regulatory structures were purpose-built for. These new assets may not represent a claim on the revenues or properties of a business, or look much like useful resources with fluctuating prices that producers, manufacturers and consumers need to hedge. Instead, digital assets might be deployed to verify the details of a transaction between two strangers, or to facilitate decisionmaking by a dispersed and ever-changing network of coders, or to encourage honest behavior in the fulfillment of a bargained-for obligation. Because they combine inherent functionality with qualities of an easily tradable and storable instrument, one could say that digital assets are different in kind from what preceded them.[5]

And just as digital assets are different from traditional assets, their trading markets—shaped by economic and business decisions made over time by a growing industry—are structured differently from the markets for traditional stocks, bonds, options and futures. For example, some functions that are split between intermediaries in traditional asset markets are often combined within a single firm in digital asset markets.

the 11th Circuit in Savannah and Atlanta, Ga. I am a graduate of the University of North Carolina at Chapel Hill and Columbia Law School.

Today I am presenting my own views, and not those of my firm or any client of the firm.

[1] *E.g.,* CFTC, *Statement of Commissioner Caroline D. Pham on* ***SEC*** *v.* ***Wahi*** (Jul. 21, 2022), *https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement072122*.

[2] *See generally* Davis Polk & Wardwell, *Client Update: Bipartisan crypto bills could clarify current regulatory confusion—if they tackle Howey* (Aug. 10, 2022), *https://www.davispolk.com/insights/client-update/bipartisan-crypto-bills-could-clarify-current-regulatory-confusion-if-they*.

[3] *E.g., 12 Examples of "Revolutionary" Tech That's Not Living up to the Hype,* FORBES (Aug. 24, 2022), *https://www.forbes.com/sites/forbestechcouncil/2022/08/24/12-examples-of-revolutionary-tech-thats-not-living-up-to-the-hype/?sh=233e56663d22*.

[4] *See, e.g.,* Gary Gensler, *Getting Crypto Firms to Do Their Work Within the Bounds of the Law,* THE HILL (Mar. 9, 2023), *https://thehill.com/opinion/congress-blog/3891970-getting-crypto-firms-to-do-their-work-within-the-bounds-of-the-law/*.

[5] Elsewhere I've argued that because the digital asset class is far from monolithic, a variety of regulatory approaches may be needed to protect consumer interests and foster competition and innovation. *Regulating Crypto: A Guide to the Unfolding Debate,* BLOOMBERG LAW (Dec. 2022), *https://www.davispolk.com/sites/default/files/2022-12/Joe%20Hall%20-%20Bloomberg%20Law%20-%20Regulating_Crypto.pdf*. This in turn suggests the need for a statutory taxonomy based on the describable characteristics of major groupings of digital assets, rather than an approach that builds on generic "investment contract" terminology, as discussed in note 30 below. *E.g.,* Lee A. Schneider, *Introduction: A "Sensible" Token Classification System,* CHAMBERS GLOBAL PRACTICE GUIDES: FINTECH 2022, *https://drive.google.com/file/d/1v4JM8Dk4R8pi1LvZYU4pILNlIXl1jdQ1/view*.

As the Committee knows well, our Federal system of financial market regulation depends on the ability to distinguish securities from commodities.[6] If a particular asset is a security, then trading of the asset in both the spot and derivatives markets is subject to comprehensive oversight by the SEC under the Federal securities laws. On the other hand, if the asset is a commodity, then we do not impose comprehensive Federal regulation over the spot market for that asset,[7] but trading in the derivatives market is subject to comprehensive oversight by the Commodity Futures Trading Commission under the Federal commodities laws.

If a digital asset is a security, it cannot be offered and sold into the public markets without Federal registration, a regulatory review process and a prospectus containing prescribed business, management and financial information. After the security has been sold and begins to trade in the secondary markets, virtually all intermediaries who touch it—exchanges, broker-dealers, clearinghouses, transfer agents, custodians—are themselves subject to pervasive SEC registration and oversight, and the issuer remains subject to ongoing reporting requirements. But if the digital asset is a commodity, none of these advance and ongoing requirements apply.

And so—and not for the first time in the history of Federal financial market oversight[8]—we have to determine whether these new assets are securities under the jurisdiction of the SEC, or commodities under the jurisdiction of the CFTC.

As it turns out, making this call is not so clear-cut.

The point is often made that the Federal securities laws are flexible enough to encompass digital assets, and indeed Justice Thurgood Marshall once observed that "Congress's purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called."[9] But as Justice Powell pointed out a few years earlier in an opinion that Justice Marshall joined, "when a purchaser is motivated by a desire to use or consume the item purchased . . . the securities laws do not apply."[10]

Determining whether a particular digital asset is a commodity and not a security can thus turn on its consumptive uses, and as I noted earlier, many digital assets offer a use case separate and apart from any investment appeal. Because of this, serious arguments can usually be made on both sides of the question of whether any widely traded digital asset is a security, even if some dealings in the asset share hallmarks of a securities transaction.

The SEC has emphasized that the question of whether a particular digital asset is a security is a facts-and-circumstances determination[11]—and that the answer can change over time.[12] When analyzing a digital asset transaction, the SEC suggests market participants should consider a non-exclusive list of 50 or 60 "characteristics," none of which is "necessarily determinative," on the understanding that when their "presence" is "stronger" it is "more likely" that the digital asset, or the transaction in which it is offered and sold, involves a security.

This is not a recipe for predictability and regulatory certainty.

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[6] As a technical matter, securities are also commodities. The Commodity Exchange Act definition of "commodity" is broad and encompasses securities along with substantially "all other goods and articles," but Section 2 of that Act allocates regulatory authority over securities to the SEC. See 7 U.S.C. §§ 1a(9), 2(a)(1)(A) ("nothing contained in this section shall . supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission").

[7] Although the CFTC does not have comprehensive regulatory authority over commodity spot markets, in 2010 Congress granted the CFTC anti-fraud, false reporting, and anti-manipulation enforcement authority over commodity spot markets in interstate commerce, including digital asset spot markets. See Section 6(c)(1) of the Commodity Exchange Act, 7 U.S.C. § 9(1)(A); Cong. Research Svc., *Crypto-Asset Exchanges: Current Practices and Policy Issues* (Jul. 23, 2021), at 2, *https://crsreports.congress.gov/product/pdf/IN/IN11708*.

[8] The CFTC and SEC reached an agreement in 1981 known as the "Shad-Johnson Jurisdictional Accord" to resolve a dispute between the agencies over the regulation of single-stock and stock-index futures; futures on single stocks and "narrow-based" stock indices were thereafter agreed to be regulated as securities, while futures on "broad-based" stock indices were to be regulated as commodity futures. Congress codified the accord into law in 1983. *See* GAO, *Report: CFTC and SEC: Issues Related to the Shad-Johnson Jurisdictional Accord* (2000), at 1, *https://www.gao.gov/products/ggd-00-89*.

[9] *Reves* v. *Ernst & Young,* 494 U.S. 56, 60–61 (1990).

[10] *United Housing Found.*, Inc. v. *Forman,* 421 U.S. 837, 852–853 (1975).

[11] *See* SEC, *Framework for "Investment Contract" Analysis Of Digital Assets* (Apr. 3, 2019), at 2, *https://www.sec.gov/files/dlt-framework.pdf* ("Whether a particular digital asset at the time of its offer or sale satisfies the Howey test depends on the specific facts and circumstances.").

[12] *Id.* at 5 and 8 (discussing considerations for "evaluating whether a digital asset previously sold as a security should be reevaluated at the time of later offers or sales").

The CFTC has determined that both Bitcoin and Ether are commodities.[13] The SEC agrees that Bitcoin, the Ur-digital asset, is not a security, though unfortunately it has never published its analysis and so we don't know how the SEC weighed the dozens of relevant characteristics in arriving at this conclusion.[14] In the past, SEC officials have indicated that Ether was not a security,[15] though today there is some question whether the agency continues to hold this view.[16]

The SEC has never affirmatively stated that any other popularly traded digital asset is not a security, and senior officials have often expressed the view that the "vast majority" of digital assets are in fact securities.[17] Of course, with more than 23,000 digital assets estimated to have been created,[18] but only a handful making up the bulk of the market's value,[19] two propositions can simultaneously be true: (1) the vast majority of digital assets are securities, but (2) the digital assets that people most commonly use, trade and hold are not.

Perhaps an understatement, but it's not easy for businesses to plan and invest when the answer to their most pressing question is: "*Maybe what you want to do is OK, but maybe it's not.*"

SEC registration is not currently practical

Given the uncertainty over whether any particular digital asset is a security, and the risk of severe and costly consequences for the organization that created it, any investor who buys and resells it within a short period of time, and any entity who facilitates trading, custodying or clearing it,[20] a couple of questions naturally arise:

- *Why not just register with the SEC?*
- *Sure, it might take longer and be more expensive, but isn't it just completing some paperwork and paying a fee? After all, people have been registering with the SEC for nearly a century!*

And given how well-trod the path of SEC registration is, are people who take the position that their digital assets are commodities simply scofflaws trying to evade compliance?

That has not been my experience.

Let me pause to acknowledge the obvious: there has been plenty of fraud in the digital asset market. This does not come as a surprise; there are always bad actors in the financial sector, and no asset class in our financial markets is exempt from fraud, manipulation and misrepresentation—indeed, this is one of the primary reasons we have financial services regulation and strong regulators like the CFTC and SEC to begin with. But just as we do not impute the conduct of Bernie Madoff to

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[13] *See, e.g.,* CFTC, *In re Coinflip, Inc.,* No. 15–29 (Sept. 17, 2015), *https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinflipr order09172015.pdf* ("Bitcoin and other virtual currencies are . . . properly defined as commodities."); CFTC, ***In Case You Missed It:*** *Chairman Tarbert Comments on Cryptocurrency Regulation at Yahoo! Finance All Markets Summit,* Press Release Number 8051–19 (Oct. 10, 2019), *https://www.cftc.gov/PressRoom/PressReleases/8051-19* ("It is my view as Chairman of the CFTC that ether is a commodity, and therefore it will be regulated under the CEA.").

[14] *E.g.,* Letter from Brent J. Fields, Assoc. Dir., Div. of Inv. Mgt., SEC, to Jacob E. Comer (Oct. 1, 2019), *https://www.sec.gov/Archives/edgar/data/1776589/999999999719007180/filename1.pdf* ("[W]e disagree with your conclusion that bitcoin is a security. We think that conclusion is incorrect under both the reasoning of *SEC* v. *Howey* and the framework that the staff applies in analyzing digital assets.").

[15] William Hinman, Dir., Div. of Corp. Fin., SEC, *Remarks at the Yahoo Finance All Markets Summit: Digital Asset Transactions: When Howey Met Gary* (Plastic) (Jun. 14, 2018), *https://www.sec.gov/news/speech/speech-hinman-061418* ("And putting aside the fundraising that accompanied the creation of Ether, based on my understanding of the present state of Ether, the Ethereum network and its decentralized structure, current offers and sales of Ether are not securities transactions.").

[16] *See, e.g.,* Paul Kieran and Vicky Ge, *Ether's New "Staking" Model Could Draw SEC Attention,* WALL ST. J. (Sept. 15, 2022), *https://www.wsj.com/articles/ethers-new-staking-model-could-draw-sec-attention-11663266224*.

[17] *See, e.g.,* SEC, Testimony of Chair Gary Gensler Before the United States House of Representatives Committee on Financial Services (Apr. 18, 2023), *https://www.sec.gov/news/testimony/gensler-testimony-house-financial-services-041823*.

[18] *See* CoinMarketCap, *https://coinmarketcap.com* (last visited Apr. 25, 2023).

[19] *Id.* According to CoinMarketCap, on April 25, 2023 the market capitalization of all traded digital assets was in excess of $1 trillion. Bitcoin accounted for approximately 45% of this total, and the ten digital assets with the largest market capitalizations (including Bitcoin) accounted for approximately 85%.

[20] These consequences include SEC fines and sanctions for conduct (including that which is neither fraudulent nor manipulative) in violation of any registration requirement under the Federal securities laws, as well as private causes of action for participation in an unregistered public offering of securities. *See, e.g.,* 15 U.S.C. §§ 77k ,77l 78ff. Willful violations of the Federal securities laws are also subject to criminal penalties. *See, e.g.,* 15 U.S.C. §§ 77x, 78ff(a).

all asset managers, so we should not impute the conduct of Sam Bankman-Fried to all participants in the digital asset industry.

The problem is that simply registering with the SEC in order to avoid the potential risk that the regulator will later say that your digital asset is a security is not, today, a practical alternative. There are two principal reasons.

First, the regulatory obligations that attach to transactions in securities make it impractical to use them for everyday commercial purposes—as a means of payment or transmission of value, or for uses like peer-to-peer lending, file storage or gaming. This is because secondary-market transactions in securities occur within a framework in which intermediaries who trade or facilitate trading in securities,[21] clear transactions in securities, effect transfers of securities or custody securities for third parties, are subject to extensive regulation and supervision by the SEC and self-regulatory organizations under SEC oversight. This framework was not built to govern simple commercial activities like a consumer's sending a payment with a widely available medium of exchange.[22]

But despite our experience with blockchain technology over the past decade, the SEC has taken little apparent action—no rule proposal, no concept release—to adapt its rulebook to facilitate secondary-market activities involving digital assets.[23] Indeed, the SEC has not broached questions as basic as whether a blockchain would itself somehow need to be registered as a securities clearinghouse.[24]

I have a sense as to why the SEC may not have acted, and I certainly do not believe it is because the agency has been ignoring the issues or somehow favors enforcement over rulemaking—this agency never hesitates to use all available tools in its kit.

Instead, it would be extremely difficult—some would say impermissible[25]—for the SEC to architect a regulatory framework for a new industry without express Congressional authority. And, as we know from past efforts to introduce significant market structure changes,[26] the sort of effort that would be required could rapidly become all-consuming for an agency that already has many important priorities on its plate.

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[21] The SEC recently reopened for public comment a proposal to require exchange registration when "the activities of any combination of actors constitute, maintain, or provide, together, a market place or facilities for bringing together buyers and sellers for securities." *See* SEC, *Supplemental Information and Reopening of Comment Period for Amendments to Exchange Act Rule 3b–16 Regarding the Definition of "Exchange,"* Rel. No. 34–97309 (Apr. 14, 2023), at 29, *https://www.sec.gov/rules/proposed/2023/34-97309.pdf*. For a discussion of some of the interpretive questions this could raise in the digital asset marketplace, *see* Statement of Hester M. Peirce, Comm'r, SEC, *Rendering Innovation Kaput: Statement on Amending the Definition of Exchange* (Apr. 14, 2023), *https://www.sec.gov/news/statement/peirce-rendering-inovation-2023-04-12*.

[22] My colleague Zach Zweihorn describes the consequences of this framework for the digital asset markets in testimony today before the Financial Services Committee. *See* Testimony of Zachary J. Zweihorn Before the United States House of Representatives Committee on Financial Services, Subcommittee on Digital Assets, Financial Technology, and Inclusion (Apr. 27, 2023), *https://www.davispolk.com/sites/default/files/2023-04/written-statement-zachary-zweihorn.pdf*.

[23] And far from seeking to avoid regulation, industry participants have repeatedly sought SEC engagement and guidance, including calling on the SEC for rulemaking. *E.g.,* Letter from Paul Grewal, Chief Legal Officer, Coinbase Global Inc., to Vanessa Countryman, Sec'y, SEC, *Petition for Rulemaking-Digital Asset Securities Regulation* (Jul. 21, 2022), *https://www.sec.gov/rules/petitions/2022/petn4-789.pdf*.

[24] Congress has given the SEC broad authority under Section 28 of the Securities Act of 1933, 15 U.S.C. § 77z–3, and Section 36 of the Securities Exchange Act of 1934, 15 U.S.C. § 78m, to tailor the Federal securities laws to transactions in digital asset securities upon a finding that doing so is consistent with the public interest and the protection of investors.

[25] It is easy to predict challenges to such an administrative effort based on the "major questions" doctrine. *See West Virginia* v. *EPA,* 142 S. Ct. 2587, 2609 (2022) (holding that an agency cannot bring about a major policy absent "'clear Congressional authorization' for the authority it claims" (quoting *Utility Air Reg. Grp.* v. *EPA,* 573 U.S. 302, 324 (2014)); *Alabama Ass'n of Realtors* v. *Dep't of Health & Hum. Servs.,* 141 S. Ct. 2485, 2489 (2021) (*per curiam*) (counseling courts against accepting an agency's interpretation if it would result in a sweeping claim of new authority, even if the statutory text is ambiguous or the agency's interpretation is plausible); *Utility Air,* 573 U.S. at 324 (an agency may not "discover" "unheralded power" in a "long extant-statute" that it has never relied on to regulate a business in the manner it seeks in a new, major policy).

[26] For an example, the Committee could revisit the contentious history behind the 2005 adoption of Regulation NMS, which introduced changes to the national market system for equities. *See, e.g.,* Comment Letters of Rep. Peter King, Member of Congress, *et al.* (Jan. 25, 2005), *https://www.sec.gov/rules/proposed/s71004/s71004-727.pdf;* Rep. Paul E. Kanjorski, Member of Congress (Jan. 25, 2005), *https://www.sec.gov/rules/proposed/s71004/s71004-730.pdf;* Reps. Deborah Pryce and Eric Cantor, Members of Congress (Feb. 7, 2005), *https://www.sec.gov/rules/proposed/s71004/s71004-775.pdf*.

Second, even if the SEC did adapt the rulebook to facilitate secondary-market activities involving digital assets, market participants would continue to face near-insurmountable barriers to conducting business across state lines. This is because each state has "blue sky" laws governing the offer and sale of securities, each with its own registration, review and approval process.[27] Unlike the disclosure-based Federal regime, the state process is "merit based," with each regulator exercising broad power to forbid the offer and sale of securities within its state's borders if it concludes that a security is too speculative, too expensive or otherwise not suitable for the public.

The blue sky process varies widely from state to state and can be slow and inscrutable. There is no coordination among the states on an approach to standardize or harmonize the review and approval of digital asset securities, and Congress has already recognized the practical problems that even well-administered blue sky laws pose for businesses who, having successfully negotiated the SEC registration process, nevertheless find themselves hamstrung by the gauntlet of 50 state securities commissions. Indeed, this is why in 1996 Congress preempted blue sky registration requirements for any security listed on the New York Stock Exchange or Nasdaq Stock Market.[28]

And so if there were practical routes and predictable consequences to registration, then I am highly confident that many responsible businesses would eagerly register despite the well-grounded position that their activities are not subject to regulation under Federal securities law. But the net impact of the two consequences I have described means that today, treating a digital asset as a security generally means that it loses all ability to trade and function.

Consumers and businesses need Congress to weigh in

I believe consumers want and deserve better comparative information about digital assets, given their complexity and variety, than they do about traditional agricultural, mineral and industrial commodities. This suggests that our historic approach to the regulation of commodity markets is no more appropriate to the digital asset class than our historic approach to the regulation of securities markets.

But responsible businesses are effectively compelled to rely on the position that their digital assets are commodities and not securities, even though this yields a situation in which consumers and the market as a whole lack consistent information about specific digital assets, and intermediaries in the spot market are not subject to sensible, fairly applied standards for handling customer assets and orders. It is not wrong to wonder whether standards like these, enforced by an energetic regulator like the CFTC or SEC, could have prevented the FTX debacle.

And so I have described a quandary which yields a status quo that is not acceptable. The binary "security-or-not" question means that if a digital asset is a security then it is regulated out of existence, but if it isn't a security then consumers lack both reliable information and the protection of Federal market oversight.[29]

How then to address this quandary?

I do not believe tasking the regulators with sorting it out among themselves is a practical solution. The genius behind our Federal approach to financial services regulation is competition. We want our Federal financial services regulators to push at the boundaries of their jurisdiction; to guard their turf. That is how we make sure things don't fall through the cracks in our massive and endlessly changing economy. A unified financial services regulator may be fine for a less dynamic economy, but not for ours: Competition among regulators is a feature of our system, not a bug. Hoping the regulators can resolve these thorny jurisdictional issues among themselves is therefore not the answer.

It's my belief that we should move past the tired debate over whether digital assets are securities under existing law. Instead, Congress should step in with a new regulatory approach tailored to this asset class, with a clear allocation of authority

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[27] Although it might be possible for the SEC to preempt blue sky laws through rulemaking, this would be unprecedented and controversial. The SEC could use its authority under Section 18(b)(3) of the Securities Act of 1933, 15 U.S.C. § 77r(b)(3), in order to provide that any purchaser of a digital asset security sold in a transaction meeting specified conditions, which could include the availability of SEC-prescribed disclosure, is a "qualified purchaser" of that security, which would result in it being a "covered security" and therefore exempt from blue sky registration requirements (though not from state anti-fraud authority). The SEC would be required to conclude that the qualified-purchaser designation for these digital asset securities was consistent with the public interest and the protection of investors.

[28] National Securities Markets Improvement Act of 1996, Pub. L. No. 104–290, 110 Stat. 3416.

[29] *See* Financial Stability Oversight Council, *Report on Digital Asset Financial Stability Risks and Regulation* (2022), at 112–114, *https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf*.

over both the primary and secondary markets. Although concepts drawn from both Federal commodities and securities law can inform a new regulatory paradigm, the appropriate regulators will need clear direction from Congress on how these precedents should apply.[30] For example, Congress may direct the regulators not to impose structural changes on the market simply because functional activities in the securities or commodities markets have historically been carried out with different organizational forms. Or Congress may direct the regulators not to impose financial statement requirements on a digital asset creator whose digital asset does not represent a debt or equity interest in the creator itself.

All of these decisions can and should be on the table when Congress decides to act.

I appreciate the Committee's time today and look forward to addressing any questions you may have. Thank you.

The CHAIRMAN. Excellent job, panelists. Thank you very much. And for the families of Mrs. Rubin and Mr. Davis who are around it, at the conclusion of the hearing if you would like to get a picture with your parents up here with Ranking Member Caraveo and I or without me, just with her, we can certainly make that happen as a commemorative photo.

I will recognize myself for 5 minutes.

Mr. Davis, I want to start with you. Well, I think every panelist talked about a lack of certainty impairing the marketplace. They talked about it in different ways, but I think they all hit on it. And so in your testimony, you mentioned that the CFTC and the SEC have had some disagreements about classification. And we need look no further than Ether, where we have had the CFTC routinely state that it is a commodity. The SEC agreed for a time, but now we have Chair Gensler, who has hinted around the margins that perhaps the change in their validation status might change their classification as a commodity.

So, Mr. Davis, tell us, those kinds of conflicting statements, what impact do they have on the market and product development?

Mr. DAVIS. Well, as someone who practices in this space, it is very difficult to give advice to clients who come to us, very diligent citizens who very much want to follow the law. They are very interested in technology, they are fascinated with the possibilities that technology creates, and they are not lawyers, and they come to us

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[30] I believe any new legislation should avoid terminology drawn from investment-contract jurisprudence developed under *SEC* v. *W.J. Howey Co.,* 328 U.S. 293 (1946) and succeeding cases. The "Howey test," as it is known, is essential to the SEC's regulatory and enforcement program because it enables the agency to police activities that are squarely within the zone of Federal securities law, regardless of what they are called or how they are structured. This is illustrated by the facts of the Howey case itself, in which Mr. Howey offered his investors passive equity-like returns from a citrus fruit business, albeit not in the form of common stock—and was therefore judged to have sold an "investment contract," which is a security. Of course the oranges, tangerines and grapefruits produced by the business were not themselves securities.

Or were they? The seemingly obvious distinction between a transaction (the investment contract) and a valuable product or object of the transaction (the orange) has proven exceedingly difficult to pin down in the digital asset context, as others have pointed out. *E.g.,* Jai Massari, *Why Cryptoassets Are Not Securities,* HARVARD L. SCH. FORUM ON CORP. GOVERNANCE (Dec. 6, 2022), *https://corpgov.law.harvard.edu/2022/12/06/why-cryptoassets-are-not-securities/*, in which the author discusses Lewis Rinaudo Cohen, Gregory Strong, Freeman Lewin and Sarah Chen, *The Ineluctable Modality of Securities Law: Why Fungible Crypto Assets Are Not Securities* (discussion draft Nov. 10, 2022), *https://dlxlaw.com/wp-content/uploads/2022/11/The-Ineluctable-Modality-of-Securities-Law-DLx-Law-Discussion-Draft-Nov.-10-2022.pdf*.

Part of the difficulty is attributable to encrustations from nearly 80 years of wielding Howey in all manner of factual circumstances, many involving questionable conduct or even outright fraud. As the maxim goes, bad facts make bad law. Writing on a clean slate and steering clear of the term "investment contract" and hoary concepts like "investment of money," "common enterprise," "expectation of profits" and "entrepreneurial or managerial efforts of others," Congress has the opportunity to liberate the digital asset industry once and for all from worn-out and obfuscating analogies to chinchillas, whiskey warehouse receipts, New York City co-ops—and yes, Mr. Howey's oranges.

and they say, "Look, we want to follow the law, we want to do what is right, tell us how to do it." And so when you have those conflicting statements regarding any type of a digital asset, it creates uncertainty.

Now, as I noted in my testimony, I think the case for Bitcoin and Ether being non-securities is strongest, right? The CFTC has been saying with respect to Bitcoin for almost 10 years now that it is a commodity, and with respect to Ether, not nearly as long but for at least 5 years. And the other thing that has happened with Bitcoin and Ether is both of those products had been trading on CFTC-regulated markets for years now.

And so what I like to tell people is, look, Bitcoin and Ether are the clearest cases for something not being a security. And as has been alluded to, those two digital assets accounted for roughly ⅔ of the market capitalization. And so even if you just square away the categorization of simply those two digital assets, you have given clarity to ⅔ of the market.

The CHAIRMAN. Yes, very well said. And, Mr. Hall, I didn't hear it in your verbal testimony, but in your written testimony, you talked about a non-exclusive list of 50 to 60 characteristics that the SEC can rely upon, none of which is necessarily determinative, and they may result in regulatory outcomes which are not *reproducible, predictable,* or *certain.* I think I know what each of those words mean, but I guess I would like a little more meat on the bone, sir. What do they mean in this context, and why is that problematic?

Mr. DAVIS. Sure. Thank you. Look, regulators and the private bar or the regulated need to be able to look at the facts of their asset, they need to be able to look at the facts of their activities, and they need to be able to draw a conclusion about whether their proposed activity is subject to regulation. If so, how is it subject to regulation? So we have to speak a common language, and a common language that needs to have rules that we all understand, that we all understand the consequences of it. If the question is, is this digital asset a security—and that is the basic question that we face in any digital asset activity. If the answer is here is a list of 50 factors that you need to consider and none of them is determinative and so, therefore, no matter how many you tote up in that list, ultimately, you may or may not have a security, you are just asking people to make a judgment call. And if the regulator weighs those factors in one way and the regulated party weighs it in a different way, we will just come up with a different conclusion.

And so I said in my testimony that the SEC's test does not produce or does not lead to reproducible results. I have to be able to look at the facts and come to the same conclusion about whether an asset is a security as the regulator will do. And, it is not helped by the fact that the one digital asset that the SEC seems to be pretty clear is not a security, which is Bitcoin, the SEC has frankly never showed us how they weighed those 50 factors on Bitcoin alone. So we end up stabbing in the dark and not surprisingly coming to conclusions that the regulator may disagree with.

The CHAIRMAN. Very good. It looks like it is time for Congress to get our act together to help with some of these clarities. Thank you very much.

With that, I would—well, before we recognize the Ranking Member, the order is Mr. Thompson will go after Ms. Caraveo and then, Mr. Davis, you are on deck thereafter.

The Ranking Member is recognized.

Ms. CARAVEO. Thank you again, Mr. Chairman, and thank you to the panel for your testimony.

Colorado actually just recently became the first state where residents have the opportunity to pay their taxes in cryptocurrency, so I especially appreciate the opportunity to discuss digital assets because as more and more Americans invest, it is important, as I said earlier, that we recognize these regulatory gaps so that we continue to spur innovation, but also protect customers.

So, Mr. Massad, under your leadership, the CFTC began this conversation regarding virtual currencies and potential CFTC oversight as early as 2014. And the agency determined that virtual currencies can be commodities and began to take enforcement actions. Could you discuss the process through which those initial determinations were made by the Commission and the resources that were necessary to support that work?

Mr. MASSAD. Certainly. Thank you for the question. The definition of *commodity* obviously doesn't contemplate digital assets, but it does refer to language that was included several decades ago that said all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in. Market participants were coming into my office saying we are thinking about doing a Bitcoin swap or a Bitcoin future. What do you think? And we thought about it, and we said, we think that means they are commodities because they were talking about contracts for future delivery. So that is the action we took in a settlement first with an entity called CoinFlip, and then another one with Terra exchange, and that was then built on. But it is important then to keep that concept in mind that it was because market participants were contemplating or engaging in derivatives on those commodities. Now, there are arguments that it should even be interpreted more broadly, but that is where we started.

As far as the resources question, at that time, that was a fairly small part of our activity. But now the market is huge. And neither agency really has the resources it needs to police this market, given what we have seen particularly from the recent failures is evidence of failure to protect customer assets, fraud and manipulation, conflicts of interest, lack of governance, and so forth.

Ms. CARAVEO. You really are leading directly into my second question is what is the potential effect of Congress passing legislation to address those gaps but not providing additional funding or resources?

Mr. MASSAD. Well, I think that would be a real mistake. Now, you are going to have to give the agencies funding if you expect them to really police this market. Now, I have noted that if you create an SRO, that could impose a lot of the burden of the cost on the industry, just the way we do with all our SROs. But clearly, this is a huge market, and it will require additional resources.

Ms. CARAVEO. Great. In the last year, the CFTC has brought a number of major enforcement actions against major players in the digital asset industry, including FTX, and recent actions taken

against Binance. While we are here today discussing regulatory gaps, many of these enforcement actions really seem to be the result of fraud or misrepresentation. For example, in the months following the FTX collapse, many suggestions were made by Commissioners and stakeholders on how to prevent similar future collapses.

So for anyone on the panel, in addition to providing authority to regulate swap digital commodity markets, what other authorities or disclosures should be considered providing for the CFTC? And that is open to anyone.

Mr. MASSAD. Well, again, as I have said, what I would like to see is a way to provide authority and resources to raise the level of investor protection without rewriting the law just yet. We may want to create new definitions. There are lots of them that have been proposed in various proposals of Congress, including the Chairman's and others. And those have a lot to be said for them. But they are all different if you look at them. And the danger is, I think we don't have enough information even about the tokens. We don't have a disclosure regime for the tokens to know whether, in fact, there is an enterprise with people involved who are doing things to enhance the value of that token, which is the basis for whether it is a security. So I don't know how anyone can say that is not a security when you don't even have the information about the token. So again, my proposal is let's elevate investor protection first. Let's get a little more disclosure, and then come back and revisit how we should define this.

Ms. CARAVEO. Thank you. With that, I yield back my time.

The CHAIRMAN. Ladies and gentlemen, the legend of Howard, Pennsylvania, the Chairman of the full Committee, Mr. GT Thompson.

OPENING STATEMENT OF HON. GLENN THOMPSON, A REPRESENTATIVE IN CONGRESS FROM PENNSYLVANIA

Mr. THOMPSON. That was a good walk-on. Couldn't you put some music to that, too? That would be even better. Yes, Howard, Pennsylvania, 600 people, one red light.

Hey, good afternoon, everybody, and thank you to all the witnesses that are here today for lending your expertise to this incredibly important hearing. And thank you to the Chairman and Ranking Member for your leadership and your commitment, your passion in this area. And to all the folks, all of our Members who are serving on this Subcommittee, there was a great demand to serve on this Subcommittee this Congress in no small part because of the opportunity to work on digital asset issues, a critical issue going forward.

And I am excited about the work of the Subcommittee. I want to thank you all for your willingness to serve on this Subcommittee. I think that there is a great potential for digital assets to provide significant value to the American public, Web3.0, not just in monetary terms, but also as tools to solve real-world problems, as have been reflected on that today.

But, digital asset developers, users, institutions need clear, thoughtful rules of the road to create the solutions. As Chairman Johnson said, we are working hand-in-glove with the House Finan-

cial Services Committee to craft legislation that will do just that. This is perhaps unusual for Congress, but it is the right thing to do to make good public policy. No one can solve this issue alone. It will take the cooperation of committees and regulators to build a workable framework to oversee digital assets. And I am so thankful for all the witnesses for sharing their expertise.

I will start my questions with Mrs. Rubin. I would like to further explore with you the practical uses of digital assets and blockchain technology. In your testimony, you talk about how several organizations are using the Hedera network to improve their businesses. Can you elaborate on a project or two who utilize your network to accomplish daily or commercial activities?

Mrs. RUBIN. Thank you, Mr. Chairman, for this question. I included a few use cases in the testimony. One was DOVU, which allows farmers to tokenize the work that they are doing. So let's say they have a regular crop and they plant additional flowers around the edge that has different environmental benefits and carbon benefits. They can tokenize that and sell it as an offset. If they decide to drill instead of tilling, they can tokenize that changed farming technique and make money on it. It is really fascinating. Another one that I thought was fun was *Tune.FM*. And it is kind of like Spotify but on the blockchain, so it will allows artists to get paid immediately. Like, as soon as someone is listening to it, then that tiny amount of money goes to them. They don't have to like wait. They don't have to prove there are a certain number of listeners. It is clearly on the blockchain, this number of people listen to your song and this is how much you get per amount of time that the song was played.

Another that really moved me was with AVC Global and medical value chain. And what it does is it allows—it uses Hedera to authenticate pharmaceuticals so you can track and make sure that that pharmaceutical is legitimate. It turns out that counterfeit pharmaceuticals, it doesn't just cost companies money when they are used. It endangers people's lives because these pharmaceuticals are not real. So these are just amazing use cases that we haven't even begun to explore.

Mr. THOMPSON. Well, thank you for that.

Ms. Maniar, as you know, there has been much debate in the U.S. on whether digital assets are considered commodities or securities. We heard that discussion today. Some Federal regulators have claimed that all digital assets except Bitcoin are securities. If all digital assets were deemed securities tomorrow, how would that affect the customers of FalconX?

Ms. MANIAR. Thank you for your question, Mr. Chairman. It would certainly mean that our customers would be disrupted. They would have an asset that they are holding that they would have no clear avenue to be able to transfer, which really gets at what the heart of the technology is for, which is the ease of transfer and being able to control the terms in which you do it in a disintermediated fashion. It would be extremely disruptive to their businesses.

Mr. THOMPSON. Yes. Well, thank you to each of you for your expertise, your testimony, your oral and your written testimony, is much appreciated.

Mr. Chairman, I yield back.

The CHAIRMAN. We will have Davis, Langworthy, Budzinski. Mr. Davis, you are recognized for 5 minutes.

Mr. DAVIS of North Carolina. Thank you so much, Mr. Chairman, and to our Ranking Member. And thank you to the witnesses who are here. It is always good to see—I think I would concur that the music was absent. We need that.

But to all the witnesses again, thank you for joining us today.

Most people in my district in eastern North Carolina very likely have never heard, I would imagine, of this, CFTC or the SEC. I am just keeping it real today. Most Americans probably haven't either. But more and more Americans have heard of cryptocurrencies and have either purchased them themselves or have raised concerns about how they will affect the traditional economic markets. So my question is, what would you tell people in my district why the CFTC or the SEC matters to them or how these agencies would impact them on a day-to-day basis?

Mr. MASSAD. Thank you for the question, Congressman. It is estimated that about 17 percent of Americans have purchased cryptocurrency. A lot of those—and that is also scaled toward younger generations, and it is scaled somewhat toward lower-income people. And a lot of those people have suffered significant losses. A lot of them bought after prices had gone up quite a bit, and then prices fell dramatically, and we had failures of some big firms. A lot of them lost retirement savings, college savings, other assets very important to them.

Having a regulatory framework is no guarantee against failure, but it can certainly help prevent it. And particularly because the types of things that have come out as to what the failed institutions did in terms of using customer assets improperly, using them through affiliates that had conflicts of interest, failures to prevent fraud and manipulation, I think those are the kinds of things that a good regulatory framework can prevent.

My own view is we shouldn't be basing policy on a judgment about the merits of cryptocurrencies. They are obviously out there, and people are investing. But we do need to set up a framework that gives people some assurance that there is integrity and transparency and protection of customer assets.

Mr. DAVIS of North Carolina. There has been more and more talk about officials and those in the public about a central bank digital currency in the U.S.. Can you speak then on if you have heard from the Federal Government pursuing this policy? And, if so, what would that mean for, again, the average consumer and how they conduct business?

Mr. MASSAD. Well, I think the Federal Reserve is engaged in research on a CBDC, but I think that is years away at best, 5, 10 years away if we decide to have one. It is not clear that we need one. There are a lot of policy issues both ways. Cryptocurrencies are here today, and there are stablecoins, which effectively—the value of those are tied to the dollar, and those could be significant in payments. But again, we lack a regulatory framework for those as well.

So my own view is we need to create the proper regulatory frameworks for the unbacked crypto tokens, as well as a proper

regulatory framework for stablecoins. We need to be pursuing research on CBDCs and how to improve our payment systems, but I see those things as happening on a longer track.

Mr. DAVIS of North Carolina. Yes. Well, I would just end today by saying I have heard so much from residents back home. And at the same time, there appears to be so much of an opportunity here to educate the public, common, everyday people on this whole topic and why we are here. And I can't say enough. When I think about fraud, scams that are taking place, the complexity of this, I can't say enough to our leadership, to our Ranking Member and above to our Chairman for having us here today and also for the Financial Services. I yield back.

The CHAIRMAN. Thank you, Mr. Davis. The lineup is Mr. Langworthy, Ms. Budzinski, and then Mr. Rouzer unless somebody else comes back in.

Mr. Langworthy from New York, you are recognized for 5 minutes.

Mr. LANGWORTHY. Thank you, Mr. Chairman, Ranking Member.

Mrs. Rubin, last week, the European Parliament passed their crypto asset legislative framework known as MiCA (Markets in Crypto-assets). I heard from several crypto companies that, due to the lack of regulatory clarity, that many firms are choosing to domicile their companies in jurisdictions that do have clarity. In addition, a recent study published by the Developer Report reported that the U.S. is continuing to lose its lead in blockchain going from 40 percent of the developers globally to 29 percent. Mrs. Rubin, are you seeing this innovation flight as well? If you are seeing that, how can we reverse that?

Mrs. RUBIN. Thank you, Mr. Langworthy, for that question. Yes, the flight that you are discussing is real, and it is happening. People are fleeing to jurisdictions with regulatory clarity because they want to know that their businesses are operating within the law and that they can operate fully and that they can make investments that will stand. So it is kind of this shocking situation where the United States, which is usually at the forefront of every technology, is now standing back and allowing other jurisdictions to run ahead. And this is not just bad for the businesses themselves, but it is a bad for the American consumers because we won't have access to these transformative technologies.

Hedera was created by U.S. veterans, people who were teaching at the Air Force Academy. Like we launched Hedera here in the United States as a global platform. Our firm desires to make this be a platform from here, but it is very scary and fearful to be working in an environment without regulatory clarity, so the number one thing that you could do is help provide that regulatory clarity.

Mr. LANGWORTHY. Thank you very much.

And, Ms. Maniar, pivoting here to China, we know that adversaries like China and Russia, they are exploring ways to undermine the U.S. dollar and our position as the world leader in finance. As you know, markets have thrived under U.S. leadership as our values of economic freedom, capital formation, and consumer protection. They have shaped the global economy. Many are calling crypto the next wave of financial innovation. So what are the risks

if the U.S. stands idly by while our adversaries take the lead in this area in the future of finance?

Ms. MANIAR. Thank you, Congressman, for your question. I certainly agree. I think it is incredibly important that we remain relevant and a leader in developing what this technology looks like. If the technology is developed offshore and we are going to see U.S. market participants not being interested in engaging in the technology, but they are going to receive what is developed overseas. And the U.S. has always been a leader in technology and financial markets, as you pointed out, and we really look to see that we continue to do that for this asset class as well.

Mr. LANGWORTHY. Okay. Would any of the other panelists wish to weigh in on that question?

Mr. MASSAD. Sure, I think it is very important for the U.S. to be focused on the technology of payments generally. I think we are still a ways away from the dollar really being threatened. The dollar's dominance is related, as you know, to a number of factors, the strength of our economy, the rule of law, the stability of our government. But I think the technology of payments is important. And, it is possible that countries could move away from using the dollar as a payment mechanism, even if they continue to invest in our Treasury securities. So that is why I have supported research not just on CBDCs, but improving payments in other ways, a stablecoin framework, and so forth.

Mr. LANGWORTHY. Thank you very much. And I yield back, Mr. Chairman.

The CHAIRMAN. Thank you very much. We will go Budzinski and then Nunn—I am sorry, Rose, Mr. Rose, and then we will go Ms. Salinas. All right. You are recognized for 5 minutes.

Ms. BUDZINSKI. Thank you, Mr. Chairman, and thank you, Ranking Member. And thank you to the panelists. I really appreciate your expertise and your testimony as it relates to this topic.

I share a lot of the sentiment that Congressman Davis just shared with you as it relates to his district and kind of from the consumer end-user perspective and constituents that might not all be as up to speed on the financial services sector and all the ins and outs of cryptocurrency. And so as I think everyone is looking for new opportunities to take advantage of making a little bit more money, but we want to make sure that consumers are also obviously protected.

Just to kind of piggyback a little bit on what Congressman Davis was asking is could you give some ideas of like maybe some better communication that we might be able to have with consumers around the risks that they are taking on in this new industry but that I think settling some of that risk and getting people more comfortable with it also could have them make more calculated decisions that financially could benefit them. I think communication is really key and something that we haven't really been able to tackle in a good way. So I am just curious what you might think about that.

Mr. MASSAD. Well, sure, I would be happy to address that. I mean, I think one of the challenges is that I think even with people who have gotten into this space investing, they may be aware that the crypto assets themselves have risk because they are volatile.

But what they don't appreciate sometimes is these trading platforms have a lot of risk because they are unregulated. And that is exemplified by, again, the studies that show how much wash trading there are where basically someone is trading with themselves to inflate the price or inflate the volume. And there are holders of Bitcoin, the so-called whales, people who hold a lot of Bitcoin who potentially can easily manipulate that price.

The same is true with protection of customer assets. They don't realize that their customer assets are not protected in the same way that they are if you buy a share of stock or if you deposit money in a bank. There is no insurance scheme, of course, and there is not even what we have for securities where we at least have a regime on brokers or even in commodity futures, we have better protections in bankruptcy. There is no protections in bankruptcy for consumers. I think if we had a stronger regulatory regime, part of that would also be an education campaign so people are aware of these risks.

Ms. BUDZINSKI. That is a great idea. Any other thoughts?

Mr. DAVIS. I am most familiar with the CFTC, but there are robust consumer protection mechanisms under CFTC rules and regulations. And, CFTC does cover a significant retail base. There are retail foreign exchange transactions that are subject to CFTC, and there is also leveraged retail commodity transactions. So if I buy Bitcoin and I want to leverage up and buy five times or six times or seven times Bitcoin, that is a product that is currently regulated by the CFTC.

And so, that agency has already been wrestling with that question about, "Okay, we know we are dealing with retail, we know it is a product that has some differences than other products they may be dealing with. How do we get proper disclosures? What types of requirements do we give to the exchanges or the people who operate in this space so we limit or avoid wash trading?" And I think one of the benefits of a CFTC style of regulation is that the exchange itself obtains responsibilities for implementing core principles and having an effective rulebook that is reviewed by the CFTC and agreed upon by the CFTC that they have to follow and impose and enforce. And that can include those types of provisions, customer disclosures that are common sense that can be understood by the regular retail investor, understanding of the risks that you take. This wash training problem that the former Chairman has talked about, I mean, the CFTC has brought enforcement actions against wash trading in some of the biggest digital assets out there. So I think a lot of the ingredients are there to be able to give your retail investor the type of information and protection and information so they can make an informed choice.

Ms. BUDZINSKI. Thank you. I will ask one really quick question, too. And your testimony has touched on a lot of this, but if we could just kind of go back to a new regulatory framework for digital assets, if you could just topline go through for me really quick what are the guiding principles do you believe should be at the core of any regulation? I know you have talked about this a little bit but if we could review it again one more time.

Mr. MASSAD. Sure, I think they are very similar to the principles we have in our securities and derivatives markets today, the pro-

tection of customer assets, systems to prevent fraud and manipulation, governance measures, including fitness of directors, regular reporting, both publicly pre- and post-trade transparency, as well as reporting to regulators. Risk management, cybersecurity, and that is a big one, because there could be a hack of a platform that has consequential collateral damage to other parts of our financial system. And also just making sure they do a good job on know-your-customer and money laundering because that is important for preventing illicit activity.

Ms. BUDZINSKI. Thank you. Thank you. Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. Let's go to Mr. Rose and then Ms. Salinas.

Mr. ROSE. Thank you, Chairman Johnson and Ranking Member Caraveo, for holding this hearing, and thank you to our witnesses for being with us today and taking time.

Mr. Massad, given the uncertainty created by the regulators, I think it is important that Congress helps clarify the line between digital assets that are commodities and those that are securities. However, it seems there is a third bucket of digital assets like digital collectibles, so-called non-fungible tokens I guess we might say, or digital sports cards that are unique and not like traditional CFTC-regulated commodity products. How would you suggest Congress approach this group of digital assets?

Mr. MASSAD. It is an excellent question, Congressman. I have focused on the fungible tokens, as have many of the pieces of legislation. You are right that there are issues on the non-fungible tokens, too. I would consider those separately. You could consider having the CFPB issue rules on that because they don't create quite the same issues that we have with kind of the securities/commodities world. But I think it is important that we do create a framework, and generally, those are sort of traded on different platforms. They are not the coin bases of the world so much. They are other platforms. So that would be my view, but I agree with you that that is an area that needs examination also.

Mr. ROSE. Thank you. An article published in *Forbes* late last year and written by George Calhoun, who is the quantitative finance program director at the Stevens Institute of Technology, noted that, according to a report by the European Union Institute for Security Studies, the Chinese Government has leveraged the traceability and immutability offered by blockchain technology in the field of policing, has explored the use of blockchain for the dissemination of propaganda, and is already using blockchain to gather evidence against dissidents. As Congress considers clarifying the regulatory scope of the SEC and CFTC's jurisdiction over digital assets, I would like to ask each of you if you feel that Congress should use this opportunity to consider guardrails to ensure that bad actors like the Chinese Communist Party can't utilize digital assets that are developed and/or supported in the United States to assist in repression of their citizens? And I will let any of you that would like to comment.

Mr. DAVIS. I will just say I think everyone recognizes that privacy is something that we all value, that it is important to us. It is part of our culture. And certainly, when I think in terms of CFTC regulation and the way that the CFTC regulates, you think

about core principles, right? So you can imagine a world where one of the core principles an exchange or a regulated entity has to wrestle with and figure out how to implement is how to have proper privacy protections for the way it operates and the way the digital assets that trade under it operate. And so I think it is an important concept, and I think it is one that we are perfectly capable of looking into and figuring out and make sure that we are properly factoring into the way that this industry continues to develop.

Ms. MANIAR. I would say certainly. I would reference back to my earlier point, too, about the fact that this is why it is crucial for the U.S. to be leading on the development of this technology so that we can set the standards for what it should look like.

Mrs. RUBIN. I would agree, yes. We absolutely need to take this opportunity to put up guardrails against repression. And I would add only that the U.S. leadership vacuum gives China an opportunity for influence, and we need to fill it.

Mr. MASSAD. And I would just add that I think that is another reason why it is important for us to be a leader in regulation, not just obviously of cryptocurrencies but of things like stablecoins and looking into a CBDC, not that we should decide to have one. We may not need one. But we need to be at the table as some of these issues are talked about so that we make sure payment systems develop in ways that are consistent with western values, protection of privacy.

Mr. HALL. And I would just add that the lack of a clear regulatory framework at the moment means that we don't have the kind of corporate and institutional investment in this sector that would allow our country and entrepreneurs and brilliant people in our country to be developing and exploring the kinds of use-cases that, frankly, other governments, including repressive governments, are doing right now. So I think we are hamstringing ourselves by not providing clear rules of the road for American businesses to try to solve problems.

Mr. ROSE. Thank you. I see my time has expired. I yield back, Chairman Johnson.

The CHAIRMAN. Ms. Salinas will be recognized for 5 minutes, and next up on deck would be Mr. Rouzer.

Ms. SALINAS. Thank you, Chairman Johnson and Ranking Member Caraveo, for this really important discussion today.

As the country grapples with questions on how to regulate cryptocurrency and what role it plays in our financial markets or otherwise, the states have really had to step up in the interim to try to protect consumers and identify some paths forward. My own State of Oregon was the first state to give control of digital assets to a fiduciary. And currently, Oregon law requires companies that transfer digital currency from one person to another to be licensed as money transmitters. However, Oregon law does not have any requirement on companies that only take cash and turn it into digital currency.

And this is for anyone on the panel who wishes to respond. From your individual perspectives, does licensing money transmitters help protect consumers, and what are the shortfalls in doing so?

Mr. MASSAD. Certainly, the money transmitter laws do help protect consumers, but I think for this sector, for this industry, they

are simply woefully inadequate as a regulatory framework. They basically impose very minimal net worth requirements, very minimal security like posted bond requirements, and some of them have permitted investment requirements. They don't create the kind of framework that we need to regulate this sector and protect the public.

It is kind of like, if you imagine that after the 1929 crash, Roosevelt had said, you know what, I think the states can take care of this, we don't need a securities law. The blue sky laws we had would not have been adequate. So the same is true here. Now, some states have tried to build on that, and that is great. I encourage that kind of activity.

And one of the things that should be done at the state level is to clarify, essentially, property rights and transfers of digital assets, the Uniform Commercial Code issues, and some states are working on that. That is extremely important for states to take up.

Ms. SALINAS. Thank you. Does anyone else wish to respond? All right. I will move on.

So, Mr. Massad, during your tenure as chair of the CFTC, were there instances in which the CFTC worked with the SEC to actually resolve regulatory disagreements, and what were the results in those instances? And would it be helpful to establish a clear process by which Federal agencies regulating digital assets could actually work in tandem?

Mr. MASSAD. Yes, we did. Mary Jo White was the chair then, and we worked very closely together on the implementation of the Dodd-Frank requirements for over-the-counter swaps. And that was critical because both agencies did have responsibilities. And that type of cooperation dates back to the founding of the SEC. The Shad-Johnson accord was one of the main examples. It doesn't come easily sometimes. It does depend sometimes on people's personalities and the time and so forth. But, I think if Congress sets an expectation that they expect the agencies to do that, that it can happen, and clearly it is needed in this space.

Ms. SALINAS. Thank you. Mr. Davis, despite their limited authorities, the CFTC has brought at least 70 enforcement actions involving digital asset commodities, as you note in your testimony. Are there some common themes within those enforcement actions?

Mr. DAVIS. I mean, I remember one person telling me, it doesn't matter the asset class, fraud and schemes to get people separated from their money are always the same right?

Ms. SALINAS. Right.

Mr. DAVIS. And so you have the same types of fraudulent schemes that you get with other asset classes. You have a classic pump-and-dump scheme, right? You tout the benefits of a particular cryptocurrency, you didn't tell people that you own it, you pump up the price, and then you sell out from underneath it. As the former Chairman has referred to, wash sales is active in a host of markets where you are acting on both sides of the ledger to beef up what appears to be the activity in a particular asset, right? And so that the types of activities that are fraudulent aren't unique to digital assets, right, but they are also occurring in the digital asset market. And to the CFTC's credit, during my tenure there, there was an active engagement to learn more about how the digital

asset space operated, how those markets work, how fraudsters were taking the tools that they would use elsewhere and how they were applying it to digital assets. And so I think the CFTC has really done an excellent job through its enforcement actions and other activities that it is doing to really get a better understanding of how these underlying digital asset markets work because it is very important for them with the role that they have with futures and derivatives to understand how those spot markets work.

Ms. SALINAS. Thank you all for your time today. I yield back.

The CHAIRMAN. Mr. Rouzer is recognized for 5 minutes, and he will be followed thereafter by Mr. Jackson.

Mr. ROUZER. Well, thank you, Mr. Chairman. I appreciate our panelists being here today. This is an incredibly important topic.

My experience is Congress either over-prescribes or under-prescribes. It is kind of hard to get it right. So my question to each of you, I will give you an opportunity to share with the Subcommittee, what does over-regulation look like? What are you worried that we are going to do? I always like to know what not to do first, that way it helps get me on the right path, whoever wants to start.

Mr. MASSAD. I am happy to answer that. I am actually worried that you will try too hard to clarify this issue about what is a security, what is a commodity. I respect the intent. I respect the desire to do so. But when you look at the legislation out there, there has been several proposals made. They all do it differently. They all will provoke a lot of questions. I can find problems and loopholes in each one of them. I think any of those things are going to lead to a lot of questions of interpretation, potential litigation. I just don't think we know enough in part it is because we don't have enough disclosure about these tokens, and that is why I am kind of suggesting something incremental. Require the two agencies to set some standards for the platforms that elevate investor protection, that provide a little more disclosure, and then come back and look at how should we really define this permanently. That is the essence of what I am suggesting.

Mr. HALL. I would be concerned about that approach. I understand some of the practical reasons why former Chairman Massad is proposing it, but I would be concerned about an approach where Congress simply acted on Bitcoin and Ether and didn't address the other 23,000 assets that are out there. And I don't think that there is a way for Congress, frankly, to avoid this very difficult question of drawing the line between securities and commodities because the agencies are at loggerheads right now, and the SEC, I believe, is at loggerheads with the industry right now about what these things are. And so from my perspective, as somebody who advises a lot of different clients in the industry, I think we do need Congress to come in and give us some basic line drawing, some basic boxes that we can put these different assets in.

Now, I don't think all digital assets are the same. I think that they are endlessly mutable, but I think that there are some basic categories that we could begin to work with. I have read a lot of the legislation and the drafts that have been out there so far. I am not entirely sure that any of them kind of gets this question just right yet. But I think that hard work does need to be done by Con-

gress. And I, unfortunately, don't have a lot of confidence that if it is left to the regulators to sort out amongst themselves, that we will be in any different situation from the situation that we are in today, which I don't believe is tenable for the industry.

Mr. MASSAD. Can I just clarify? I am not suggesting that we act only on Bitcoin or Ether. What I was suggesting was that Congress pass a law which mandates that any platform trading Bitcoin or Ether be subject to these principles, but that would be for everything that trades. That is just a definitional way of defining which platforms you want. There is no platform out there of any relevance that is not trading Bitcoin or Ether. They are 70 percent of the market, and often, trading is in pairs. So you are going to capture the whole market, and you are going to set standards that then apply to all of the tokens. The fact is 23,000 are not listed. If you take the four largest exchanges, they list a total of about 400. And what is quite interesting, actually, is they don't list the same securities. So if it is so clear to them—or the same tokens, I should say. If it is so clear to them that they are only listing commodities, why are they all different?

Mr. ROUZER. I got 22 seconds real quick.

Mrs. RUBIN. I would briefly add that one thing that Congress could do wrong is to think about regulating the technology. Instead, think about regulating the activity, and that is what we are seeing in other jurisdictions around the world.

Mr. ROUZER. Yes, ma'am?

Ms. MANIAR. I would just add that this is a very entrepreneurial space, so I would like to see principles-based regulation that allows that innovation to continue to grow.

Mr. DAVIS. I would say don't let the perfect be the enemy of the good. Adding better guardrails about the line between securities and commodities will greatly enhance the ability of us to give advice and for businesses to know what to do.

Mr. ROUZER. You all are incredible, 5 seconds left, amazing.

Mr. Chairman, I yield back.

The CHAIRMAN. And there is a lot of good stuff there at the end, really, really good stuff.

All right. We will go Mr. Jackson, and that will be followed by Mr. Nunn. Mr. Jackson, you are recognized for 5 minutes.

Mr. JACKSON of Illinois. Thank you, Mr. Johnson. Thank you for your participation today.

I think to follow up on my colleague's question on defining this as the commodity *versus* the stock, I am very familiar with it. But in simple layman's term for those that are watching us, *stock* is a piece of ownership in the actual corporation, and this *commodity* can be an asset before it has actually been delivered, evolved, or even planted. So in your honest and humble opinion, shall I say, what would you like to see it described as? I do not believe the regulators know your business better than you, and I am concerned that we are behind the ball as to—we can see an implosion. We saw something with a hard asset stock if you will in the SVB that were the assets and the balance sheet and swollen, then contracted from macroeconomic circumstances beyond their control, raising of the interest rates. They couldn't rein it in, and I take it most of you up there are old enough like me to know of long-term capital

and other things. So where is this? Is it a stock as an asset or is it a commodity or an asset to be realized in the future that is in its creation? And that is open to the panel.

Mr. DAVIS. Now, I will go to my testimony. If you look at what the Commissions themselves have said, right, not a Chairman, not a Commissioner, if you look at what the CFTC as a Commission have said and what the SEC as a Commission have said, the CFTC has identified seven of the top traded digital assets as securities, and that is 76 percent of the market. The Securities and Exchange Commission has identified one of the top 15 digital assets as a security, and that is two percent of the market, right? And so you can look at those seven that the CFTC have identified through enforcement actions, and you can see some characteristics about them. They tend to be decentralized, people tend to use them for consumptive purpose and not for an investment purpose, so there are some characteristics there.

And so, I agree that each digital asset is a bit different, but certainly, the actions at the Commission level with the most heavily traded digital assets is at least giving us some additional clarity—there can always be more; there definitely needs to be more—but they have given us some level of clarity about where some of the lines might be between security and commodity.

And the other thing that I would note is that, over time, one would expect that a digital asset becomes more of a commodity than a security because, in theory, with most digital assets the idea it is going to be widely accepted, widely used, widely dispersed, those are much more the characteristics of a commodity than a security.

Mr. HALL. And, Mr. Jackson, I think you have put your finger right on it. An asset that represents a claim on the assets or revenues or properties of a business or a business enterprise, that is a security. And even if it is issued on a blockchain, it should be regulated like a security. And so if I were going to draw lines and create boxes for these things, I would put those in a category by themselves.

But then I would go to the things like Mr. Davis is talking about and say, okay, this particular asset doesn't represent a claim on a business or a promise from a business. This is an asset that I can use to send a payment or an asset that I can use to purchase file storage space or something like that.

I do believe that users need good information about it, and this goes back to one of the questions that came earlier about why should a retail person, why should an ordinary person trading these things, why should they have that information? I think it is different from a commodity. People have an intuitive idea about what an orange is, but they are not necessarily going to have an intuitive idea about what a digital asset is. So I do think we should have standards and information that needs to be provided and back that up with liability for the person providing that information.

And that is where a digital asset is just different from what we customarily think of as a security and what we customarily think of as a commodity. And again, the reason why I think Congress needs to come in and begin to draw these lines and begin to say

how we want these assets to be regulated rather than this tired debate over whether it is a commodity or a security.

Mr. JACKSON of Illinois. And let me ask just one follow-up on that, and please take it, it is an opaque industry, so at what point do you declare this asset, this commodity to be decentralized?

Mr. HALL. Well, I wouldn't have decentralization as being all that important because I think whether the asset is decentralized or not, consumers still need the information about it. And I also think that we still want to have strong market oversight and market regulation. So I personally would not focus on decentralization because I think we need to be able to cover decentralized assets as well.

Mr. MASSAD. The decentralized point also goes to the fact that we don't have enough information about a lot of these tokens. We don't even know sometimes is there a foundation behind it? Are there people with administrative keys? And that is why, again, I am pushing for more information, more disclosure, more consumer protection first, and then come back and define exactly where the lines are drawn because we are talking about thousands and thousands of digital assets.

Mr. JACKSON of Illinois. Thank you. And I yield my time back, Mr. Johnson.

The CHAIRMAN. Very good. Thank you, Mr. Jackson.

We will go to the gentleman from Ohio. Mr. Nunn, you are recognized for 5 minutes. Thereafter, we will go to Mr. Molinaro.

Mr. NUNN. Thank you, Mr. Chairman.

And I want to compliment both the chairs of the digital asset on the Financial Services side, as well as the Agriculture Committee for working so well on this, both bipartisan, bicameral, and we are going to get into—for those folks at home playing the government bingo card on acronyms here, an SEC and a CFTC. Now under the SEC, we are talking about all things that are securities. Under the CFTC, we are talking about all things that would be commodities. In my home State of Iowa, we know commodities very well.

But we do hear from Chair Gensler on the Financial Services Committee that all tokens are securities. And we heard here in the Agriculture Committee not only a month ago from the CFTC's Chairman Behnam who said pretty much the opposite, that all commodities are where they should be.

So if we can, I do think, Mr. Hall, with respect, it is important that we provide some guidance for those who are in this space.

Mr. Massad, you are former CFTC Chairman. Simple question, right? Ethereum, commodity, security?

Mr. MASSAD. I don't have enough information. I think the concern about Ether, Ethereum was in the merge where they changed the system of validating transactions, there seemed to be a foundation, a group of people involved in that. Is that under the Howey Test, a common enterprise from which if I hold Ethereum, I am expecting to receive a return? I don't know. And that is the problem with all these. I don't have enough information.

Mr. NUNN. And I think that there are a lot of Americans who are in the same situation. What is the challenge of having these conflicting messages out there coming from both the CFTC and the SEC?

Mr. MASSAD. Well, it confuses people, obviously. And I think, obviously, we are in a stalemate where we are not improving investor protection because of it.

Mr. NUNN. Right.

Mr. MASSAD. And the risk is, if we try to rewrite it without having enough information, not only could we get it wrong, but there could be unintended consequences in our broader markets. That is why, again, I am not against coming up with a new definition. I am just saying take a little more time.

Mr. NUNN. Well, let me push back on that just a moment.

Mr. MASSAD. Sure.

Mr. NUNN. I think Mrs. Rubin actually had a very good argument here from Hedera, which is an Air Force guy, Air Force creation. Compliments, by the way. Industries do want clarity in the law. And I am going to go to Ms. Maniar on this. We have seen the last few days a couple of other countries and other regions have moved out in this space. The European Union has moved forward with the markets and crypto asset, kind of a space in between the CFTC and SEC called MiCA. The United Kingdom is finalizing its own digital asset regulatory proposal.

What I think was highlighted here is we don't necessarily want to regulate the commodity. We want to provide the framework, right? So could you speak to us from FalconX's perspective where you guys are seeing innovations thrive when there is a structure and where innovation is being stymied because there is no structure?

Ms. MANIAR. Absolutely. Thank you for your question. Certainty in any industry gives the ability for those who want to get involved, who want to build, who want to grow, want to create businesses to do so, right? And having no certainty makes it very hard to do. When you employ people, you can't employ people with the assumption that your company might be here today but may not be here tomorrow. You have an obligation to those employees. That certainty is necessary in the U.S. right now, and we are seeing that the jurisdictions where there is certainty—and I want to make clear, where there is certainty, not lack of regulation—is getting the benefit of those companies being founded there.

Mr. NUNN. You are the first and only—if I have this correct—CFTC-registered cryptocurrency focus where you are a swap dealer, which is a great thing. How is the CFTC as a principle-based regulator in comparison to the SEC in this form of regulation? Do they have it right?

Ms. MANIAR. Yes, we have had a very robust and effective dialogue with the CFTC. It is nuanced. They have been very interested in learning about our space and understanding our business. There is certainly not an easy regulator, and that is okay. That is not what we are looking for. Nobody in the industry is looking for that, right? So they have been very eager to learn about our business, eager to learn about the space, eager to understand how the existing framework that they have is one that we have been able to comply with. And that has made it incredibly easy for us to be able to build in that space because of that certainty.

Mr. NUNN. So let's go back to our bingo card. On the SEC and the CFTC, let's take this away from the unelected bureaucrats and

put it squarely in the court where I have ¾ million bosses back home. What can we be doing in Congress to make this space a better frame for businesses like yours?

Ms. MANIAR. Certainty, taking Congressional action to create some certainty in this space so that we can keep doing this here in the U.S.

Mr. NUNN. I am going to push you one deeper. What does certainty look like to you?

Ms. MANIAR. To me, it looks like a system where there are rules of the road, there is a framework that you know that you can operate in, that you know will be the same tomorrow so that you can invest in this space and build a company in this space.

Mr. NUNN. Nothing worse than D.C. whiplash. I get it. Copy.

Mr. Chairman, thank you very much. I yield back my time.

The CHAIRMAN. As much as it may pain me to say it, I think Mr. Nunn hit it out of the park with his description of the need to close the gap here, well said.

Mr. Molinaro, you are recognized for 5 minutes.

Mr. MOLINARO. Is that now the standard, Mr. Chairman? Are you are going to grade our lines of questioning?

The CHAIRMAN. Yes, sure. Yes. You are either better than Nunn or not quite as good as Nunn.

Mr. MOLINARO. Well, bingo. Mr. Chairman, thank you.

I am excited to be in Congress in this moment in time. And I have said this many times. I represent a rural part of upstate New York. Digital assets provide I think one of the greatest opportunities to harness innovation but also to provide access to capital in places and to people where the traditional banking institutions frankly, I don't want to say fail them but are outside of their reach at times.

And so, interestingly enough, right, this is an entire industry that is seeking to be regulated to a degree. The golden question for us, what are the guiderails that we think are appropriate to both harness but also support the innovation while establishing the basic tenets of regulation to protect people and the industry? And that is the challenge, right? What is the right mix?

Many of my colleagues often speak about American regulation if we were to impose, how would that compare to China or the EU or Great Britain? I often go back to local because, right now, absent Federal action, states are filling the field. And that worries me to a degree. But for better or worse, New York State has been one of the states that has taken sort of initial action to develop a regulatory structure. There are good points and bad points in the state's regulatory structure.

And I think only because, Mr. Hall, you are somewhat a New Yorker—are you a New Yorker? I thought I would start with you. And perhaps just for our benefit, could you just speak to what perhaps are the strengths and weaknesses of a New York system and, if you would like, some of those other tenets that other states have imposed?

Mr. HALL. Sure, and thank you very much. New York has an excellent regulator. DFS is an excellent regulator. They were out well ahead of the Federal Government and well ahead of many other governments in terms of coming up with a bit license back in, now

2016 or 2017, that a lot of our clients have obtained, and I think it works quite well for what it does. I will say that I am aware of businesses that have deliberately avoided serving New York customers because of it.

But look, I think with anything that operates over the internet, honestly, while there is a huge room for the state regulators to play, particularly in anti-fraud enforcement and payment services, money transmission, and things like that, I think when you have a business in the United States that is operating a storefront on the internet, we need Federal legislation. We need legislation that is going to apply consistently across the country and not have a situation where somebody who is a New York resident, maybe using a VPN to get around firewalls so that they can trade with somebody who maybe hasn't obtained that——

Mr. MOLINARO. So I agree with you. The question that I have is can we, should we have a system that has—obviously not—I mean, not obviously, but perhaps not Federal supremacy, but rather sort of the dual banking model that exists now, Fed guiderails, state structure as well or——

Mr. HALL. Yes, I think we should, and I think you have to look at different kinds of digital assets in order to see where that works and where that is actually an improvement. For example, if you are a stablecoin issuer, I think that you ought to be able to elect whether to have a Federal charter or a state charter. I think there is definitely room for state regulation like that.

Mr. MOLINARO. Okay. So one of the challenges in creating the structure for digital assets is that, as we understand, many tokens vary widely in function and underlying value. In New York, there is a trust that offers what essentially is tokenized gold. It is a digital asset that has value. It is pinned to real allocated underlying gold bars in London vault, which was of interest to me, not ETFs or futures. So purchasing the token is equivalent of buying an ounce of physical gold.

To any of you, perhaps could you speak to the tenets that would help in balancing a regulatory structure that is clear and defined but also flexible enough to consider the actual underlying value of tokens? Anyone jump in my last 30 seconds. But I heard the Chairman say he would give you 20 extra.

Mr. DAVIS. So, I mean, CFTC background, the CFTC deals with those types of things, right, where you have an underlying commodity, then you do something on top of it, right? The way you do the something-on-top-of-it impacts from a CFTC perspective under current law how it is regulated, right? I think the same principle applies, right? When you are engaging in that type of asset, you want the same type of protections, and so you need a regime that allows you to define that asset in a way that people can understand and then you know what regulatory regime applies to it.

Mr. MOLINARO. Well, my time——

Ms. MANIAR. If I may just add——

Mr. MOLINARO. I am not sure. Mr. Chairman? Okay. Go ahead.

Ms. MANIAR. Very quickly. This is where the principles *versus* prescriptive method I think really comes in. It allows the principles to apply to the technology without restricting what the technology can do.

Mr. MOLINARO. Thank you. And, Mr. Chairman, I appreciate—not for your benefit, but the leadership of this Subcommittee and the relationship with Financial Services. This is truly an exciting time if this country embraces the innovation. Thanks.

The CHAIRMAN. Thank you.

If the Ranking Member has any closing comments, we will turn to her at this time.

Ms. CARAVEO. Thank you again, Mr. Chairman, and thank you to the panel for really what was a fascinating and enlightening discussion.

I think it has been very clear, there has been a lot of evolution since the start of Bitcoin in 2009. There is volatility in part because of this lack of a Federal regulatory regime, and it has caused harm to customers because we haven't had appropriate regulation and oversight. Since 2014, the CFTC has played a role and should continue to play a role to ensure the safety, soundness, and orderly operation of these markets, but it is clear that Congress needs to enact appropriate legislative solutions.

First, we need to address this regulatory gap that exists in digital commodity spot markets. Second, we need strong customer protections that involve disclosures that are clear and material to the products in which customers are investing. And third, any legislative solution cannot succeed without providing these agencies with the sufficient funding resources that they need.

I think this is a little bit of a simplistic summary, and no doubt there is going to need to be many, complicated decisions as part of a legislative solution that are going to take significant effort and focus and additional conversations, but I think that this is a great start for this Committee, and I appreciate the Majority's convening of the hearing today.

Thank you so much, once again, for your expertise and your valuable insights, and I look forward to future conversations. Thank you, Mr. Chairman, and I yield back.

The CHAIRMAN. Very well said, Ms. Caraveo. I agree about the importance of closing the regulatory gap. You said that very well. The importance of disclosure being a part of that, you are exactly right.

And I just want to thank the panelists. Each of you brought forth some real wisdom today. I agree, we can't let the perfect be the enemy of good. I agree that principles-based regulation will allow innovation to flourish. We certainly don't want to stifle the marketplace as we work to protect consumers.

Mr. Hall, though, I think you really nailed it in your testimony. You mentioned that the lack of certainty, which is in no small part Congress' fault, has had real costs in consumer confidence and protection. It has caused foregone investment, lost economic activity, and it has reduced our ability to compete with foreign markets.

This is why we have to do our work, ladies and gentlemen. It will not be easy. There will be bickering over the contours of what actual legislation will look like. But I think the time is ripe for us to find something that strikes the right balance, and I look forward to doing this in a bipartisan and bi-subcommittee way. And I think we are headed in the right direction.

With that, the record of this hearing will be open for 10 days as Members and our panelists are able to submit additional information. And unless anyone has anything else for the good of the order, this Subcommittee will stand adjourned.

[Whereupon, at 3:45 p.m., the Subcommittee was adjourned.]