Written Testimony of

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Subcommittee on Digital Assets, Financial Technology, and Artificial Intelligence

For a Hearing on

"American innovation and the Future of Digital Assets: Aligning the U.S. Securities Laws for the Digital Age"

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Chairman Steil, Ranking Member Lynch, and members of the subcommittee, thank you for the opportunity to appear before you today to discuss digital assets and the U.S. securities laws.

My name is Alexandra Thornton. I am senior director of financial regulation at the Center for American Progress, an independent, nonpartisan policy institute that is dedicated to improving the lives of all Americans through bold, progressive ideas, as well as strong leadership and concerted action.

Congress appears determined to pass legislation establishing a light regulatory regime for stablecoins and now for other digital assets—the topic of discussion today. I will comment on what the latter regime should include later in my testimony, but first I would urge this subcommittee and the rest of congress to consider the risks at stake.

First, the digital asset markets have not functioned well so far, with massive asset value swings, billion-dollar losses to investors from hacks, and billions more from frauds. At the same time, these markets have fueled incredible profit margins for trading firms and compensation for their executives, many of whom are seasoned veterans from traditional financial firms, market makers, or high frequency trading firms.

The billion-dollar frauds and hacks and wide profit margins are not simply the growing pains of a nascent industry but rather are from the absence of longstanding market protections.[1]

Of course, some trading firms could have heftier profits if they didn't have to abide by existing leverage restrictions; more digital assets could be sold to retail investors if firms didn't have to abide by FINRA's advertising restrictions.; profits could be faster and possibly higher if firms weren't required to survey the market for the best prices and seek best execution for their customers' orders; and margins for insiders could be bigger if transparency were not required in orders and trades.

But Congress and regulators have been down this path before. The Commodity Futures Modernization Act (CFMA) was enacted in 2000 ostensibly to regulate the previously unregulated over-the-counter (OTC) derivatives market, where financial contracts are traded directly between two parties without a centralized exchange.[2] Congress effectively exempted OTC swaps from both Commodity Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) jurisdiction.[3] Those markets remained opaque, and investors were inadequately informed. In the run-up to the 2008 financial crisis, the swap market expanded by trillions of dollars and ultimately contributed to the crash.[4] Lack of transparency and regulatory oversight resulted in an inefficient market in which end users were prevented from making informed trades and dealers could increase their profits.[5]

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[1] Financial Stability Oversight Council, *Report on Digital Asset Financial Stability Risks and Regulation 2022*, available at https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf.
[2] Michael S. Barr, Howell E. Jackson, and Margaret E. Tahyar, *Financial Regulation Law and Policy, Third Edition* (St.Paul, 2021), at 1259-1262.
[3] Ibid.
[4] Ibid.
[5] Ibid.

Opaque and unregulated bilateral trading under the weak CFMA regime sounds eerily similar to what the crypto industry is seeking in the name of innovation today. The risks posed by inadequate digital asset regulation, such as many of the proposals advanced by the industry,[6] could go far beyond harm to crypto investors and threaten the U.S. financial system.[7]

Second, it is important to acknowledge key risks and uncertainties in the current moment.

President Donald Trump and his Department of Government Efficiency have been crippling the regulators that protect investors and borrowers from scams and manipulation, as well as the stability of our financial system.

The Trump administration has fired staff and tried to stop all work at the Consumer Financial Protection Bureau, an agency whose sole mission is to enforce laws that protect individuals and businesses from fraud and abuses in their borrowing and their financial transactions.[8] The Trump administration's Federal Deposit Insurance Corporation (FDIC), which ensures that bank depositors don't lose their money if the bank collapses, has made substantial job cuts and reportedly will be reorganized.[9] And over 10 percent of staff at the SEC are on their way out the door,[10] imperiling that agency's ability to perform

[6] See, e.g., Letter to Commissioner Hester M. Peirce from Paul Grewal, Coinbase Global, Inc., March 19, 2025, available at https://www.sec.gov/files/ctf-input-grewal-2025-3-19.pdf.

[7] See, Press Release and opening statement, "Warren: Current Stablecoin Bill Risks Americans' Money, our Economy, and our National Security," U.S. Senate Committee on Banking, Housing, and Urban Affairs, March 13, 2025, available at https://www.banking.senate.gov/newsroom/minority/warren-current-stablecoin-bill-risks-americans-money-our-economy-and-our-national-security.

[8] See, CFPB website, "The CFPB," available at https://www.consumerfinance.gov/about-us/the-bureau/ ; and CFPB website, "Small Business Lending," available at https://www.consumerfinance.gov/rules-policy/small-business-lending/.

[9] Maria Aspan, "The FDIC's goal is to prevent another banking crisis. It's now also a Trump target," NPR, February 27, 2025, available at https://www.npr.org/2025/02/27/nx-s1-5307239/fdic-jobs-bank-regulator-trump-doge-elon-musk.

[10] Declan Harty, "SEC set to see hundreds leave through buyout, retirement offers," Politico, March 21, 2025, available at https://www.politico.com/news/2025/03/21/sec-buyouts-retirement-offers-departures-00243673.

its basic functions, including examining compliance of market participants, bringing enforcement actions, and reviewing new product filings or filings for initial public offerings.

The influence of the crypto industry is sweeping across the Trump administration. The SEC has dropped enforcement actions against crypto firms.[11] The CFPB, which likely would have overseen payment systems for digital platforms, has been kneecapped.[12] Trump's Department of Housing and Urban Development has proposed incorporating cryptocurrency and blockchain into routine spending and accounting practices,[13] and President Trump has called for the establishment of a crypto reserve at the Treasury Department.[14]

All of these risks and uncertainties today would counsel a much more cautious approach to adoption of a regulatory regime for an industry plagued by scams, theft, and hacks.

[11] See, e.g., Olga Kharif and Sonali Basak, "Ripple's Garlinghouse Says SEC Dropped Landmark Crypto Case," Yahoo Finance, March 19, 2025, available at https://finance.yahoo.com/news/ripple-garlinghouse-says-sec-dropped-133307516.html; Press Release, "SEC Announces Dismissal of Civil Enforcement Action Against Coinbase," U.S. Securities and Exchange Commission, February 27, 2025, available at https://www.sec.gov/newsroom/press-releases/2025-47; and Ben Schiffrin, "Having Won Almost 100% of Its Cases Against the Crypto Industry, the SEC Baselessly Surrenders," Better Markets, March 12, 2025, available at https://bettermarkets.org/wp-content/uploads/2025/03/Better_Markets_Fact_Sheet_Crypto_Enforcement-3.12.25.pdf. For Commissioner Crenshaw's response, see Statement of Commissioner Caroline A. Crenshaw, "Crypto 2.0: Regulatory Whiplash," U.S. Securities and Exchange Commission, February 27, 2025, available at https://www.sec.gov/newsroom/speeches-statements/crenshaw-remarks-crypto-2-0-regulatory-whiplash-022725?utm_medium=email&utm_source=govdelivery.
[12] See, Stacy Cowley, Jessica Silver-Greenberg, and Kate Congre, "With Attack on Consumer Bureau, Musk Removes Obstacle to His 'X Money' Vision," The New York Times, February 12, 2025, available at https://www.nytimes.com/2025/02/12/business/elon-musk-cfpb-x-money.html; and Lilith Fellowes-Granda and Alexandra Thornton, "The Trump Administration Is Hurting Consumers' Wallets by Kneecapping the CFPB," Center for American Progress, March 20, 2025, available at https://www.americanprogress.org/article/the-trump-administration-is-hurting-consumers-wallets-by-kneecapping-the-cfpb/.
[13] Jesse Coburn, "U.S. Housing Agency Considers Launching Crypto Experiment," ProPublica, March 7, 2025, available at https://www.propublica.org/article/hud-considers-crypto-blockchain-stablecoin-housing-urban-development.
[14] Executive Order, "Establishment of the Strategic Bitcoin Reserve and United States Digital Asset Stockpile," The White House, March 6, 2025, available at https://www.whitehouse.gov/presidential-actions/2025/03/establishment-of-the-strategic-bitcoin-reserve-and-united-states-digital-asset-stockpile/.

Hallmarks of a healthy capital market

With this perspective in mind, below are some hallmarks of healthy capital markets that the United States and other countries have developed over decades—and, in some cases, centuries—of trial and error. I strongly urge the committee to ensure that the new rules for crypto look a lot like the existing rules for U.S. capital markets.

Regulation of asset creators should match the assets' tradeable life

The securities laws and the Commodity Exchange Act generally do not regulate securities or commodities. Rather, they regulate the offering and trading of those financial products. And they regulate the disclosures related to them. Many have argued that digital assets are commodities, but a metric tonne of aluminum in a warehouse that meets specified characteristics does not change over time, like many digital assets can. The initial disclosure of the product at the time a derivative is created on the aluminum should remain accurate for the entirety of its tradeable life. The aluminum holder doesn't vote to suddenly transform the aluminum into nickel, for example. So, the disclosure regime for a physical commodity is tailored to when it is most useful to the investor—at the time of the offering.

For securities, the characteristics and risks of the asset change significantly over the securities' tradeable lifespan. Companies grow, contract, develop new businesses, merge, and have spin-offs. The securities tied to them may change fundamentally. That is why the securities laws require the public issuers of securities to make not just initial disclosures but also ongoing disclosures throughout the tradeable lifetimes of their securities.

Any effective digital asset regulatory regime should tailor the oversight of the asset creator to match its control over the tradeable life of the asset.

Market intermediaries perform different functions, and each function must be effectively regulated

In the capital markets, different players perform different functions, such as broker-dealers, investment advisers, and exchanges. These players each have different incentives and responsibilities. For example, an investment adviser has a fiduciary duty to its customer, the underlying asset owner. Part of that duty is to ensure that their brokers do a good job for their customers. Brokers, in turn, are hired to help buy and sell securities. Regulations impose duties on them to seek best executions for their customers and not take advantage of them. Brokers are not only subject to rules against misleading their customers, but also basic abuses that their customers might not otherwise see, such as capital regulations, prohibitions on front running, anti-money laundering protections, and detailed business continuity plans.

Brokers often turn to other market intermediaries for trading, including registered securities exchanges, alternative trading systems (ATSs), and dedicated markets. Those entities are required to make disclosures about their operations and activities.

Orders and trades in the markets are publicly disseminated via regulated public tapes, informing market participants, the public, and regulators about prices in real time. Transfer agents, clearinghouses, and dozens of other entities and business functions are also clearly prescribed and regulated.

Nearly all these functions exist in the trading of digital assets. An investor may still want an expert to act as an investment adviser, to help make investment decisions. An investor may still want someone to safely and securely hold their assets as a custodian. They will still want to have an expert broker help them trade the digital asset. A broker will still need to find somewhere to source liquidity, such as an exchange or other off-exchange trading center, like market makers. And there will still be a need for tapes that attempt to keep track of orders and executions in digital assets.

All these functions are highly specialized, and each is in natural conflict with the next function. For example, while the broker wants to maximize its trading profit, the investment adviser choosing the broker would naturally want to minimize that.

A key problem right now for the digital asset industry is that, in the absence of effective regulation, top industry players have often merged functions together. Removing intermediaries may remove another layer of potential burdens and cost for the intermediary, but it also eliminates the longstanding checks and balances in profit motives and offsetting conflicts of interest that promote fair competition and protect investors and market integrity. Moreover, a significant amount of crypto trading occurs off the blockchain. Securities rules should apply both off-chain and on-chain.

The importance of these rules was highlighted in the Financial Stability Oversight Council's (FSOC) 2022 report on digital assets. In pointing to the "runs, withdrawal restrictions, failures, and panics" that have occurred in crypto-asset markets at a high frequency, the FSOC said measures that American financial regulators have developed over generations to reduce the frequency of runs are needed in crypto markets. Those measures include "implementing capital and financial reporting, engaging in prudent governance, risk management, and audit and internal control practices," and "subjecting firms to liquidity regulations,…."[15]

Brokers

Someone who helps people buy or sell securities is a broker and subject to basic rules relating to that role. They must register with the Financial Industry Regulatory Authority (FINRA) and are subject to examinations and enforcement actions, including being kicked out of the industry if they commit fraud.

[15] Financial Stability Oversight Council, *Report on Digital Asset Financial Stability Risks and Regulation 2022*, available at https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf, at 46.

Brokers must meet basic operational minimum standards, including having certain job functions and having key personnel pass actual substantive tests on expertise. They must have detailed policies and procedures to cover everything about their business. They must comply with capital rules to ensure that, if they fail, their customers do not lose their assets. They must prepare for hacks and floods and other disasters, including having detailed business continuity plans.

Brokers must also strive to achieve the best execution (usually meaning the best price) when they buy and sell on behalf of their customers.[16] And they cannot trade ahead of their customers (known as "front running").

Brokers are required to provide their customers with detailed reports on their trades, as well as reports on how they handled their customers' orders. They must know their customers and maintain robust anti-money laundering practices. And brokers cannot trick their customers with misleading advertising or make recommendations that are not commensurate with their customers' risk tolerances and resources.

All of these protections are essential for trading digital assets. But none of these rules generally apply to crypto brokers, and they should.

Trading platforms

Securities trading platforms must register as a national securities exchange or qualify for an exemption, such as an Alternative Trading System. They must follow rules designed to prevent them from cheating their customers, discriminating against them, burdening competition, or charging excessive fees. These venues must have strict rules for how they take in orders, disseminate them, and execute them. They

[16] Rule 5310: Best Execution and Interpositioning, FINRA, available at https://www.finra.org/rules-guidance/rulebooks/finra-rules/5310.

are subject to business continuity obligations. They have rules to prevent market free falls, such as the Limit Up, Limit Down Plan.[17] And they are obligated to police their markets for abuses: how they treat their customers' data is regulated; orders and trades are publicly disseminated so market participants and regulators know the best prices and can compete based on transparency, while also identifying abuses and manipulation.

The blockchain is not a substitute for these rules.

Bipartisan recognition for effective broker and trading platform regulation

Under the leadership of Chair Jay Clayton during the first Trump administration, the SEC updated Regulation ATS rules, order routing disclosures required by brokers, and execution disclosures required by exchanges. In addition, Chair Clayton led enhancements for the public market data tapes and the Consolidated Audit Trail. All of these enhancements to the role of brokers and trading venues should be applied to digital asset trading.

Under Chair Gary Gensler, the SEC unanimously voted to lower access fees that exchanges can charge and reduced the minimum trading increments to a half penny for many stocks.[18] These moves, when implemented, will improve the competitiveness and efficiencies of the markets.

Under both heads of the SEC, Republican and Democratic commissioners alike knew these trading issues were essential to healthy capital markets and pushed them forward.

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[17] "What is the Limit Up-Limit Down Rule?" The Securities Institute of America, Inc., December 6, 2018, available at https://securitiesce.com/blog/what-is-the-limit-up-limit-down-rule/?srsltid=AfmBOoqbPqrr_0W3m_Sasvvt2GY7y4V1r3G9G8z_28HRiswOcHl0Dqb4.

[18] Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, U.S. Securities and Exchange Commission, September 18, 2024, available at https://www.sec.gov/files/rules/final/2024/34-101070.pdf.

All of those issues are also essential for digital asset trading. None of them effectively exist now.[19]

<u>Harm to securities law and U.S. capital markets</u>

Finally, returning to risk and uncertainty, Congress must take extreme care to avoid upending U.S. capital markets by rendering long-settled existing definitions unclear or creating a loophole in the existing securities laws. A definition or structure that seems suitable for the crypto market could have adverse ramifications for the longstanding, traditional securities markets upon which the U.S. economy relies.

This could come up in an attempt to create a regulatory regime based on the definition of the asset in question. This was tried but never adequately settled in the last congress in either the Senate or House versions of crypto market structure legislation. Getting it wrong could have devastating consequences for U.S. capital markets.

Another way such harm could arise is with tokenization of securities, whereby a corporate bond or stock has an associated token. If the token is not subject to the securities rules discussed above, this would allow the creation of something that is like a stock but not subject to the rules that apply to stocks. There would be two assets that look economically similar and would trade together, but one would be free of effective regulation. This two-tiered, inextricably linked market structure would be ripe for abuse and risks and could blow up the existing stock and bond markets.

For example, in the securities markets, there are rules to limit leverage customers can take, and rules to limit how much exposure the brokers can take. But those do not exist with digital assets now. So, if a digital asset tied to a traditional security were to be treated differently than the security, an investor or

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[19] Some private market proxies have come into existence but are inferior to what is needed.

broker could effectively avoid those protections. And, while there are rules in the securities markets to limit the fallout, there aren't in the digital asset markets.

Imagine a disaster like Archegos[20] but without any of the regulatory backstops that now make it so rare. Without similar rules in crypto, there would be no need for fraud. Someone could just amass huge positions on margin without reporting them and in hidden transactions that are off the blockchain, creating enormous risks.

Adopting the regulatory approach being advocated by many in the digital asset industry now would be inviting many more Archegos-like disruptions into our markets—without any need for fraud.

Tokenizing of securities may create efficiencies, but that should not create an entirely new regulatory regime that lacks the essential elements of the equivalent securities that were not tokenized. Tokenized securities and their securities analogs should be treated similarly, or else invite an end-run around the traditional securities markets. And in the name of effective regulation of crypto, one of the nation's bedrock competitive advantages would be destroyed—the most robust and reliable capital markets in the world.

Conclusion

The Trump administration is already creating turmoil in the financial markets and weakening key financial regulators. Many items on the digital asset industry's lengthy and ambitious wish lists from Congress and regulators would poorly regulate that industry, while jeopardizing investor and market protections in the existing securities markets by creating loopholes and end-runs around effective

[20] Dennis Kelleher, "Trial of Former Archegos Trader and Historic Stock Manipulator Bill Hwang," Better Markets, May 6, 2024, available at https://bettermarkets.org/newsroom/memo-to-interested-parties-re-trial-of-former-archegos-trader-and-historic-stock-manipulator-bill-hwang/.

regulation of similar products and market actors. This will create even more risk and uncertainty in the financial system and the economy.

Congress has neglected to put in place a sufficiently robust regulatory framework before, and it has ended very poorly.

Thank you again for inviting me to testify today. I look forward to answering your questions.