Written Submission of Amanda Fischer, Policy Director and COO, Better Markets
Before The U.S. House Committee on Financial Services Committee
"American Innovation and the Future of Digital Assets:
From Blueprint to a Functional Framework"
June 6, 2025, 9am EST

Background

Good morning, Chairman Hill, Ranking Member Waters and Members of the Committee. Thank you for the invitation to testify today. My name is Amanda Fischer, and I am the Policy Director and COO at Better Markets, Inc., a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support financial reforms of Wall Street, and make the financial system work for all Americans again.

Introduction

After the crypto industry and sympathetic policymakers aggressively argued for years that crypto entirely fell outside the remit of the Securities and Exchange Commission (SEC) (notwithstanding the dozens of settled and litigated actions by the SEC dating back to 2013 that indicated otherwise), the Digital Asset Market Clarity Act, or CLARITY Act, proceeds to provide legal immunity for all previously-issued tokens and activities under federal and state securities law, and creates a cascade of prospective offering and conduct exemptions. Perversely, those exemptions apply not based on the characteristics of the asset but based on the recordkeeping technology used to track its purchases and sales.

If you squint, the bill endeavors to replicate the foundational laws born out of the Great Depression – the Securities Act of 1933 and the Securities Exchange Act of 1934 – but it does so in ways that are deliberately fuzzy and loophole-ridden. The bill provides "concepts of a plan" on disclosure, issuer liability, SEC review of issuer statements, broker and dealer regulation, custodial safekeeping, and well-regulated and transparent trading marketplaces. It then airlifts this shoddy regime out of the SEC and airdrops it into the Commodity Futures Trading Commission (CFTC). This regulatory "switcharoo" ignores the fact that the SEC was created with the express purpose of regulating the American public's investments while the CFTC was created for a very different purpose - to regulate a largely non-retail, commercial market for futures and swaps.

This bill would distort capital formation, pushing companies to raise money via investment contracts and on blockchains regardless of how useful that fundraising method and that technology is for their operations. The bill would likewise encourage investors to buy up crypto assets, as they now will have false confidence in a legal framework wrongly touted by policymakers as protective. Compared to the foundational securities laws, the CLARITY Act offers worse disclosures with lower standards of legal liability for issuers, lessens protections for investors when interacting with intermediaries like brokers, and would make buyers of crypto assets more subject to predation and manipulation on exchanges. It also guts the role of our state enforcement agencies.

A False Problem

There is no technological reason why crypto assets cannot comply with existing securities laws. Under existing authority, the SEC has wide latitude to iterate with issuers to develop a disclosure regime bespoke to their offering. For example, the SEC has already registered fractionalized works of art, sculpture and even elite racehorses. Moreover, the trading regime for crypto need not deviate from the Securities Exchange Act of 1934. After all, the vast majority of crypto customers don't trade on blockchains at all, but instead go to centralized exchanges that use internal databases to track customer orders – the same as any existing national securities exchange, transfer agent or clearing agency.

Moreover, crypto projects have in fact raised capital while in compliance with SEC rules. In 2018, one *MarketWatch* analysis found nearly 300 separate crypto projects raised money through exempt offerings via the SEC, mostly using Regulation D (Reg D). In other words, the market was booming for crypto projects to get early-stage, SEC-compliant funding even years ago. However, large crypto trading platforms – which colloquially call themselves "exchanges" – threw caution to the wind in an environment of enforcement forbearance and started listing these exempt offerings and making them available for retail customers to trade. They did this even though the issuers explicitly acknowledged they were offering securities, even filing Form D notices. These trading platforms relied not on the law, but rather on the prevailing sentiment at the time that the SEC would only crack down on fraudster Initial Coin Offerings (ICOs) and not the venues that put crypto securities into the hands of retail investors.

It should also be noted that several crypto/distributed ledger projects currently operate consistent with securities law and were taken effective during Chair Gensler's term - Franklin OnChain USG Money Fund and BlackRock's BUIDL, as two examples, as well as trading platforms like Securitize and tZERO. And Figure Markets recently launched a blockchain-based FAC (YLDS) for use on their alternative trading system (ATS). This is not an exhaustive list but it is meant to be indicative that motivated market participants have, in fact, worked with the SEC constructively.

To the extent that further crypto intermediaries have not registered with the SEC, it is because doing so would require an admission of past misconduct, expose their business to state or private liability even in the face of SEC amnesty, and would likely drastically cut into their profitability (in fact, the CEO of Robinhood said it cost the business 10 times more to run their securities business than their crypto business, mostly likely due to providing consumer protections and paying for Securities Investor Protection Corporation insurance). The reason that the crypto industry is so intent on passing this legislation is not because they can't comply with the securities laws, but because "putting the toothpaste back in the tube" at this point would be too cumbersome and costly.

Political and Administrative Law Context

Disregarding the substantive merits of the proposal, the political and administrative law context in which this bill arrives is worthy of consideration.

First, federal financial regulatory agencies are under siege in the current Administration. Democratic commissioners, dually nominated by the President and confirmed by the Senate, have been fired without cause, with the Supreme Court in a two-page decision declining to place an injunction on the firings. As Justice Kagan pointed out in her dissent in *Trump v. Wilcox*, this may well be a shadow docket decision, with no promise that the court will ever hear oral arguments on the constitutionality of this brazen challenge to the 90-year old *Humphrey's Executor* precedent. Moreover, soon, the CFTC will only have one Commissioner, with no further Commissioner nominations on the horizon. Absent a nomination by the President, the SEC is separately set to have a three-member Republican-only commission by the end of 2025, despite the statutory requirement and long history of being bipartisan. The CFPB is on life support, and their demise is cheered on by leaders in the crypto industry. A pending court decision will determine whether mass firings at the agency can continue. The President has intermittently threatened to fire the Chair of the Federal Reserve Board, and the previous Vice Chair for Supervision and Regulation at the Fed self-demoted in avoidance of being fired.

Second, the President in February signed an Executive Order placing the formerly independent financial regulatory agencies under the control of the White House, requiring review by Office of Information and Regulatory Affairs before rulemakings can be proposed for public comment or adopted. This severely upends the integrity of the rulemaking process.

Third, the CFTC is aggressively and unilaterally expanding its own remit, separate and apart from anything in the CLARITY Act. The agency is moving forward to allow perpetual futures products (or derivatives that never expire) and to permit trading 24 hours a day, seven days a week. This is notwithstanding feedback from the core constituency of the CFTC – farmers, ranchers and traditional derivatives end-users – who have expressed concern that this will import danger into futures markets for which market participants and the CFTC are unprepared. The CFTC also recently withdrew its litigation with KalshiEx LLC, an "event contract" marketplace that allows customers to place bets on the outcome of events like political elections and sporting contests. By unilaterally disarming in the Kalshi case, the CFTC is conceding that the multi-billion dollar gambling industry can now escape longstanding state-level regulation by restructuring their products not as bets but as futures under the jurisdiction of the Commission. Like in the case of perpetual futures and 24/7 trading, the CFTC has no resources, expertise, technology or staff to oversee these expansive new markets. Indeed, they have been operating under continuing resolution-level funding of $365 million for years, and the resources provided in this bill are not commensurate with the surge in responsibility for crypto along with all these unrelated new developments.

Fourth, the administrative law context in the courts has become openly hostile to regulators using permissive authorities granted from Congress to engage in rulemaking. The CLARITY Act includes many instances where Congress punts on providing specific directives to the CFTC or SEC and instead grants the agencies broad authority to write rules (or exceptions to the rules) governing the issuance, custody, brokerage and trading of crypto. In the words of one crypto industry lobbyist, "the big question [on the CLARITY Act] is how much discretion are we comfortable giving to regulators? The CLARITY Act is a meaty bill in 236 pages, but it leaves many issues unresolved, instead authorizing – and frequently requiring – the SEC and CFTC to figure them out in rulemaking." This ambiguity is a risky proposition in the current legal environment, where challengers to agencies' rules increasingly seek out particularly corporate-friendly legal venues. Likewise, there has been a spate of Supreme Court rulings in recent years that narrowly cabin the authorities of agencies to engage in interpretive rulemaking and make it easier for corporate interests to challenge rules. Any legislation should be as prescriptive and robust as possible to ensure a fulsome rulemaking process.

Policymakers would be well-served to keep each of these pieces of context in mind when engaging in any crypto legislative effort.

Cascading Exemptions in the Issuer Disclosure Framework

The CLARITY Act should be viewed as a series of cascading exemptions from registration under securities laws for the issuance and intermediation of crypto assets. In fact, the exemptions are so broad that it is unclear who, if anyone, will avail themselves of the opportunity to issue exempt investment contracts under section 202 of the bill. Below describes the series of exemptions from securities and even commodities law requirements.

Exemption for Decentralized Finance (DeFi)

First, sections 309 and 409 of the CLARITY Act create exemptions from securities and commodities law, respectively, for activities "in relation to the operation of a blockchain system or in relation to a decentralized finance trading protocol." The bill then lists a set of six undefined activities that could encompass large amounts of intermediation in the crypto marketplace. Further, the language is not narrowly tied to *digital commodities activities* that occur in DeFi alone, but instead drafted to encompass any DeFi activity that could at all otherwise fall under the remit of the SEC or CFTC. This should cause policymakers concern. For example, request for quote (RFQ) trading services in the Treasury market have argued that they merely provide "messaging services" that allow buyers and sellers to transact and are therefore not exchanges. Is it the intent of the bill authors to permanently exempt RFQ platforms in Treasuries from SEC regulation? In short, the DeFi exemption from regulation is so broad in the bill it is unclear how much of the crypto market may migrate from centralized platforms to so-called DeFi services in order to escape all oversight.

This DeFi exemption persists even for registered legal entities that engage in the above conduct (i.e., the exemption is not just for open-source code without an owner but for recognized, legal firms incorporated under state law). This provision appears to be modeled upon Wyoming's decentralized autonomous organization (DAO) law, and exempts from regulation activities by the legal entity so long as they are not "centralized" and "hierarchical" and are purely "administrative or ministerial." To be clear, the CFTC previously litigated this in the Ooki DAO case and won the case in the Northern District of California. This provision of the bill would upend that legal precedent and allow market participants the best of all words – the benefits of incorporation without any of the attendant legal liability for their actions.

Digital Commodities Loophole

The next section of this memo discusses the exempt offering framework for investment contracts that happen to trade and settle on a blockchain. But issuers may not even need to avail themselves of that framework under the bill. For example, in many litigated actions with the SEC, defendants claimed that they weren't offering an investment contract at all because various prongs of the *Howey* test had not been met. Coinbase in oral arguments with the SEC in federal court famously argued that the crypto assets listed in the SEC's complaint were not investment contracts but more akin to collectibles, citing Beanie Babies. Though the requirements in the exempt offering framework of the bill are modest, crypto issuers will be able to sidestep the requirements by simply claiming they are digital commodities offered and sold not as part of an investment contract.

Collectibles Loophole

The bill exempts offerings with "value, utility or significance" from being investment contract offerings in the bill. This exception applies even if the token provides voting or economic rights and even if the value of the token can be expected to rise or fall based on the efforts or success of the blockchain. Because nearly every crypto issuer can claim that their offering has "value," this so-called "collectibles" exception will further swallow the rule. This is not withstanding the fact that previous SEC settlements established that, in certain instances, collectibles like NFTs can be securities offerings. Further, courts have established that just because a crypto asset may have a consumptive use (like collectible value) that does not provide the offering blanket immunity from the securities laws.

Airdrop Loophole

The bill also exempts "airdrops" (using the nomenclature "end-user distribution") from being considered securities offerings. Airdrops are transactions in which crypto issuers provide free tokens to users in exchange for bolstering the marketability of the blockchain. While on its face, these transactions would seem to be exempt from the *Howey* test, a facts and circumstances determination ought to be required, and a blanket exemption is ill-advised. For example, in a spate of "free stock cases" in the 1990s the SEC considered whether the distribution of free shares of traditional stock were offerings under the Securities Act. According to one summary, "in each case, prospective recipients of stock were required to sign up on the respective issuer's website and provide personal information including their names, physical addresses and email addresses, in order to receive free shares. Additional free shares were offered in exchange for referrals and, in one case, with the purchase of a service." The SEC's analysis in these cases evaluated whether the "free stock" (or "airdrop" by another name) generated some form of economic benefit for the investment scheme, and in many cases that answer was "yes." In the case of airdrops, they may be employed by crypto issuers to create a market for the tokens, generate promotional benefits for the related blockchain platform, or perhaps creating more interest in a related token sale. All of these indicia might cause the offering to meet the *Howey* test, though the CLARITY Act wholesale exempts these transactions.

Grandfathering Provision Loophole

The bill also provides wide legal amnesty from any reporting requirements for all existing crypto tokens. Specifically, the bill exempts crypto issuers that either last offered tokens before January 1, 2020 or last offered tokens before June 1, 2025, provided that they are no longer engaged in "material ongoing efforts related to the blockchain system." Though that "material ongoing efforts" proviso is undefined, it stands to reason from other parts of the bill – including certification of how a blockchain system becomes "mature" and therefore sufficiently decentralized – that this test should be easy to meet for all extant tokens.

Exempt Offering Framework

For those token projects that cannot or do not take advantage of the myriad exemptions above, the new exempt offering framework proposed in section 202 is another avenue for capital raising that is way outsized and permissive compared to other exempt offering allowances. First, token issuers need only to *intend* for the blockchain system to which the digital commodity relates to be "mature" in four years. Issuers can then raise $75 million per year (adjusted for inflation), for up to 4 years (so $300 million) with no restrictions on general solicitation or accredited investor status of purchasers or any other concentration limits on individual ownership as a function of the person's net worth (though there is a limit on no single purchaser owning more than 10% of total tokens). This exemption dwarfs those available under Regulation A+, Reg D or Regulation Crowdfunding. Issuers need only provide modest disclosures to investors (including an exception to withhold the transaction history if it's not "technically feasible"). There is also no requirement that the token issuers' proceeds be used to actually develop the blockchain or protocol, with funds raised from the public instead able to be used to pay off early investors.

Secondary Market Trading Exemption

For all digital commodities and for all (or nearly all?) investment contracts that even *intend* to become mature, all secondary market trading in the asset is henceforth exempt from SEC oversight and transitions to the CFTC regime.[1] This provision exempting secondary market sales of investment contracts from securities law effectively codifies a single court decision from Judge Torres in the Southern District of New York, notwithstanding the fact that other courts in the same and other districts have uniformly rejected that reasoning.

"Mature" Blockchains

It is worth unpacking how an asset is meant to escape SEC oversight and migrate to the CFTC. To wit, the bill provides that when taken together with its related digital commodity, a blockchain that "is not controlled by any person or group of persons under common control" can apply to be deemed mature pending some modest proof-of-concept with operations and functionality, and therefore free from SEC oversight. Assets that trade on mature blockchains are able to transition to the CFTC trading regime. Notably, there is a glaring loophole related to the already permissive "unilateral control" proviso, with there being an exception to allow for unilateral control for the purposes of "regular maintenance" and "cyber security." Given that all major coding changes could framed as "regular maintenance," this exception seems significant.

Generally speaking, the maturity threshold is incredibly low, and notably, the SEC will not have resources to hire staff to make these determinations. Reading source code, in particular, is not the natural skill set of current employees at the Commission. And even if the SEC did reject maturity determinations for being insufficient, the punishment for failing to achieve maturity is some disclosure obligations and permissive authority vested in the SEC to stop future capital raising efforts. Further, while the discussion draft allowed any digital commodity issuer, related person, or affiliated person to certify to the SEC that the blockchain was now mature, the CLARITY Act now also allows a "decentralized governance system of the blockchain system" to do so. It is unclear how a decentralized group of persons would hire counsel and submit to the SEC such a certification.

There is also a per-entity 20% limit of ownership of the native token of the blockchain for it to be deemed "mature." That is also a permissive standard. Even if one wanted to enforce this standard, it will be difficult to do so because the beneficial owners of the tokens could have wallet addresses that are pseudonymous. For example, it is common in crypto for scammers to engage in "Sybil attacks" in airdops, where they create duplicate wallet addresses to claim multiple dumps of the same token. The bill has some language directing regulators to write

[1] Previous iterations of the bill restricted this secondary market trading exemption to investment contracts that did not give the purchaser an ownership interest or other interest in the revenues, profits, or assets of the issuer (meaning, offering an investment contract whose only expectation of profit was capital appreciation was the only type of exempt investment contract). It is unclear what the bill authors intend for this version of the bill based on the drafting of various definitions and exemptions.

rules to require reporting around the ownership of tokens by related and affiliated persons, but that information may be kept confidential by the SEC and it is unclear if they will require Know Your Customer-level information or merely wallet addresses.

Oddly, even after a blockchain is "mature" (and presumably free from the individual control of a single entity?) there are ongoing reporting requirements for unnamed persons engaged in material ongoing efforts. If the blockchain is mature, why would there continue to be entrepreneurs responsible for its development? Who is responsible for reporting ongoing information to the SEC? These questions reflect the inherent tensions embodied in this legislation.

The bill also does not contemplate the idea of blockchains or their digital commodities morphing back into being securities, even though crypto industry leaders themselves have admitted that that is a possible outcome.[2] This rigidity to re-regulate crypto as a security is all the more noticeable given that regulators have flexibility to find other ways to deem blockchains to be mature in response to evolving circumstances.

A Shoddy Trading Framework

Now that this memo has discussed the offering framework for digital commodities and how they migrate onto trading platforms, it is worth discussing the weak investor protections available to crypto customers in the secondary market.

CFTC Spot Authority on Exchanges

The CLARITY Act provides the CFTC with "exclusive jurisdiction with respect to any account, agreement, contract or transaction involving a contract of sale of a digital commodity" and authorizes the Commission to register digital commodity exchanges. There are exceptions to the CFTC's exclusive authority for custodial and depository activities of banks (but oddly, not credit unions) and an exception for initial offerings of investment contracts, which is the purview of the SEC (but maintains exclusive CFTC jurisdiction over the secondary sale of investment contracts). It is unclear how this CFTC exclusive jurisdiction provision is meant to interact with other places in the bill that attempt to preserve certain SEC examination and enforcement authorities when digital commodities are traded by SEC registrants.

The CFTC's digital commodity exchange regime differs substantially from the securities regime governing trading venues. First, exchanges can provisionally apply to be eligible with the CFTC, with existing registrants basically waived through and new registrants given a set of very preliminary disclosures to provide to the CFTC. This "ask forgiveness, not permission" approach

[2] Coinbase Chief Legal Officer Paul Grewal in response to a question from Rep. Richie Torres in the House Financial Services Committee Digital Asset Subcommittee on March 9, 2023 noted, "Speaking generally, Congressman Torres, I agree that assets can change character over time, and to be completely fair, I suppose it is equally true that an asset that began as a commodity might evolve into security in some form as well."

is non-existent in the retail-focused traditional securities market. Even after that provisional period, when the CFTC is then set to permanently register an entity, the rigor and process undergirding that application review is only briefly outlined in the bill. Instead, digital commodity exchanges need only represent to the CFTC that they comply with a set of "core principles" and the exchanges themselves "shall have reasonable discretion in establishing the manner in which the digital commodity exchange complies." This deviates from the SEC's exchange registration provisions, which require a rigorous, affirmative approval process by the SEC.

Digital commodity exchanges are permitted to trade essentially any asset where the underlying blockchain has been deemed "mature" according to the permissive SEC process described above, or any asset where the crypto company has submitted the basic exempt offering disclosures to the SEC with the intention to mature. Again, this is extremely light-touch compared to national securities exchanges, which can only list products approved by the SEC. Further, the CLARITY Act deletes previous language in the discussion draft that required digital commodity exchanges to "permit trading only in a digital commodity that is not readily susceptible to manipulation." This is a requirement in the existing swaps regime which should also apply in the crypto market.

Likewise, digital commodity exchanges are not required to file rules and subject them to notice and comment, as in the case currently with national securities exchanges. This SEC exchange rule process requires regulatory and public engagement on issues such as changes to fees, allowable trading practices and listing standards, ensuring transparency and allowing for public comment before the SEC makes an approval or disapproval decision.

The CFTC has permissive authority to write rules to ensure fair market access to crypto exchanges. This differs substantially from the national securities exchange model, in which broker-dealers are members of the exchange and are generally entitled to fair access to the marketplace. In this CFTC regime, digital commodity exchanges would have much more latitude to discriminate against platform users across factors such as prices, fees or access based on subjective criteria. While a previous iteration of the bill required exchanges to "establish governance arrangements that are transparent to fulfill public interest requirements," the new text deletes the public interest requirement and instead says governance arrangements must be transparent and "designed to permit consideration of the views of market participants."

The provisions providing for digital commodity exchange registration also allow for several concerning conflicts of interest. First, there is no express prohibition on crypto exchanges having venture capital affiliates that make investments in crypto issuers that may want to list on the platform. Though there is vague language on mitigating conflicts of interest, again, exchanges are left with wide discretion on how to implement those core principles. Given that Coinbase operates a venture capital arm that invested in token projects like Do Kwon's TerraForm Labs, it is important to expressly prohibit this.

Additionally, the bill has a fairly large allowance for crypto exchanges to trade for their own account on their own exchange, with the bill providing for such trading in instances where it is needed for "risk management" or "operational needs." This loophole is concerning, given instances such as those related to FTX and Binance where the SEC alleged preferential access and manipulative trading schemes by exchange-affiliated "market-makers." Even in the case of Coinbase, a senior executive testified to Congress in 2021 that "Coinbase is an agency only platform. We do not engage in proprietary trading on our platform. All prices established on our platform are due to market makers. So, we offer a platform for customers to come together, to offer bids and asks on a variety of currencies that we offer on our platform. So, the market price is determined by the market participants." That same executive, when pressed later in the hearing on this topic, admitted that "every month we make an investment of crypto and add to our balance sheet…we do increase the investment on a monthly basis on pre-established investment protocols. We do buy those on our Exchange." At a minimum, digital commodity exchanges should be required to provide granular detail to the public on if and how they trade on their own exchange to avoid uncertainty.

Finally, while the bill requires digital commodity exchanges to devise certain general "system safeguards," there is no express requirement for any cybersecurity compliance requirements. In contrast, the SEC's regime for national securities exchanges mandates compliance with Reg SCI, which mandates that the exchange establish written policies and procedures, conduct annual reviews, and maintain records related to compliance with the regulation. They also need to establish systems and maintain them with adequate capacity, integrity, resiliency, availability, and security. Given the prevalence of hacks in the crypto market, including a recent cyber incident against Coinbase in which customer assets up to $400 million have been put at risk by cyber criminals, this lack of cybersecurity resiliency requirements is troubling.

Trading Under SEC Brokers and Alternative Trading Systems (ATS)

The CLARITY Act permits SEC brokers and ATSs (and entities dually registered with the CFTC) to engage in transactions in digital commodities. SEC registrants can begin trading in digital commodities simply upon notification to the SEC (in contrast to the traditional securities market where brokers must submit Form BD to the SEC and a Continuing Membership Application with FINRA). The SEC is afforded one sentence of legislative authority to write rules governing brokers, dealers, national securities exchanges and ATSs, providing the Commission with the ability to "issue rules" according to what is "necessary or appropriate in the public interest or for the protection of investors." The SEC examination and enforcement authority over solely or dually registered ATSs and broker-dealers is likewise murky under the bill, with various provisions at time appearing to contradict one another.

Oddly, ATSs registered only with the SEC can only trade up to 25% of the total volume of digital commodities or $50 billion in any quarter over the last two calendar years. It is unclear what the ATS is supposed to do if or when the cap is hit. For example, should they automatically suspend all trading? How would that work with customers that may be mid-execution in a transaction? Likewise, brokers are permitted to engage in digital commodities provided that, in the two most recently completed fiscal years, its sales, commissions or other activities in digital commodities that do not exceed the lesser of 10% of gross revenues or $100 million. These volume and dollar caps are odd, and it is unclear whether the total volume of digital commodities traded is based on domestic activity, domestic and international activity, only ATS activity, or ATS and digital commodity exchange activity, etc.

The bill also stipulates that a digital commodity ATS that is part of a national securities exchange will not be considered a facility of an exchange. This is important because currently, facilities of exchanges are subject to the same regulation and rule filings as the exchange itself – important protections to ensure that the ATS activity does not import risk or conflicts to the national securities exchange.

Finally, the bill clarifies that Securities Investor Protection Corporation (SIPC) insurance does not apply to digital commodities or stablecoins, which may cause investor confusion when held or traded alongside traditional securities. The typical investor, when dealing with an SEC-registrant, should not be expected to know which of their investments is covered by insurance protection for the broker's failure and which is not. Stablecoins may be even more confusing, as up to $250,000 in cash is covered under SIPC but dollar substitutes in the form of stablecoins are not.

Custody and Safeguarding Customer Assets

Both in the provisional registration sections (which relate to digital commodity exchanges, brokers and dealers) and in the sections outlining CFTC regulation of those entities, it is unclear if a crypto intermediary needs to maintain an actual crypto asset for every crypto asset put into custody by the customer. For example, if I buy one Bitcoin for the price of $100,000, does the exchange need to keep on-hand one Bitcoin or $100,000? What happens if the price of Bitcoin surges and investors all run to withdraw their Bitcoin? Likewise, the bill allows intermediaries to invest customer assets into a range of "safe" investments but also includes a provision allowing the CFTC to expand permitted investment to any other assets they deem approved. The CFTC is also given authority to waive the requirement that digital commodity exchanges keep customer assets in a qualified digital commodity custodian, notwithstanding that a wide range of entities are already conditionally eligible to meet that qualification in the bill under existing licenses (i.e., all state-chartered trust companies, regardless of the robustness of the state regime).

As noted further below, this bill allows exchanges to permit customers to waive asset segregation requirements to engage in staking or other "blockchain-related" activities. Again, this type of rehypothecation subjects both customers and the platforms to substantial risk, regardless of customer consent.

Crypto Lending and Staking

The exclusive jurisdiction of the CFTC likewise could well apply to crypto lending arrangements, whereby crypto exchanges today offer products where customers can deposit crypto assets and be promised a return if they keep those assets locked at the exchange. Many [crypto lenders](

including BlockFi, Voyager, Celsius and Nexo went bankrupt or ceased operations in the United States during the Crypto Winter of 2022. Both the SEC and state securities regulators took action against these arrangements which multiple cases resolved that it was unregistered securities market activity.

Likewise, the bill would expressly allow crypto exchanges to provide crypto staking products under the exclusive jurisdiction of the CFTC. Staking involves exchanges pooling crypto assets of customers, locking them up for some period of time, during which the exchange performs certain expert services for maintenance of those assets, and sometimes guaranteeing revenue smoothing on the staking returns (in one case, promised returns were as high as 21%). Staking can bear a striking resemblance to any traditional pooling/yield securities arrangement. In addition to the settled action, the SEC litigated that staking was an unregistered securities offering in two separate actions in which the Commission prevailed in early court decisions by judges that considered the issue.

Gutting the Gold Standard of Investor Protection

The CLARITY Act represents a severe diminution of the protections owed to investors dealing with brokers in the digital commodity marketplace versus the securities marketplace. The bill requires vague business conduct requirements mostly focused on disclosing risks, requiring businesses to deal in a fair and balanced manner, and establishing standards around testimonials and marketing. This falls far short of the requirements applicable to SEC-registered brokers, which must abide by Regulation Best Interest, which requires broker-dealers to act in the best interest of their retail customers at the time they make a recommendation, without putting their own financial or other interests ahead of the customer's interests. The bill also does not contain rules related to best execution, which require brokers to execute customer orders under the most favorable conditions available to them. Other rules not present in the digital commodity broker regime include those related to customer notifications of cyber breaches, limits on sharing customers' data, and explicit rights in arbitration.

Further, the bill does not even contemplate the concept of a digital commodity investment adviser, meaning no investor will be able to find an investment professional to offer them advice on crypto purchases that will owe them a fiduciary duty.

Sundry Other Problems

Funding Resources

In the CLARITY Act the SEC is not granted authority to apply Section 31 fees, which cover the cost of the SEC's operations, to crypto market participants. This is notwithstanding the fact that SEC-registered entities may engage in crypto trading. The consequent lack of funding authority will burden-shift the cost of resources to oversee the crypto market from crypto firms to firms engaged in traditional securities markets.

For the CFTC, the ability to collect fees to pay for all the activities required under the bill expires in four years. It is unclear who or how the regime is supposed to sustain itself in a future Administration. And again, given the unrelated ways in which the CFTC is expanding its remit, this sunsetted fee authority cannot possibly pay for all the staff and technology required by the bill.

Bank Engagement in Crypto

The bill would prevent federal banking agencies and the SEC from requiring digital commodity market participants from recognizing a liability on their balance sheet related to crypto or to hold capital against that liability. This seeks to codify the repeal of Staff Accounting Bulletin 121. Given the uncertainty of bankruptcy law's application to crypto (including as recently in the Prime Trust bankruptcy case in which crypto market participants wrote amicus briefs due to legal uncertainty), this provision feels like an unwise limitation on banking agencies on preventing the risks of the crypto market from metastasizing into the wider banking system.

The bill also allows banks to engage in any number of digital commodity activities or even acquire equity in crypto companies by amending Bank Holding Company Act section 4(k).

Public Interest

Throughout the CLARITY Act, mentions of the "public interest" as a standard whereby regulators or market participants should evaluate actions has been stricken from the text versus the discussion draft version of the bill.

Wide Discretion

The CFTC in the bill can waive a host of integral requirements for intermediaries. Not all of those exemptions need to be done by rule, and they overwhelmingly require very few findings and universally require no findings that it is solely in the interest of investors or an orderly and efficient market. Put in the hands of a captured regulator (or an agency without a bipartisan quorum), this wide authority presents significant risks.

Implementation Timelines

Throughout the bill, implementation times are unrealistic given the amount of work required of regulators, the mandated interagency coordination and the lack of resources afforded to agencies. The CFTC will take significant time to hire requisite staff even if the budget resources are available.

Whistleblower Protections

The CLARITY Act applies the CFTC's whistleblower program to activities covered under the Act but does not appear to apply the SEC's whistleblower program notwithstanding the fact that investment contract offerings fall within the remit of the SEC and that SEC-registered intermediaries can broker, deal in and make available to trade crypto assets.

"Innovation"

The bill oddly adds "innovation" to the mission of the SEC, even though innovation should already be encompassed by the other categories in the tripartite mission. For example, innovation should be in service to capital formation or investor protection or orderly and efficient markets, not an end onto itself. This provision could also provide a new basis upon which market participants can challenge SEC rules in court.

Crypto Cheerleading

The findings and Sense of Congress in the bill make unsubstantiated claims about crypto fueling the next generation of American growth. The Congress and regulators should not put their fingers on the scale of different modes of recordkeeping for capital formation.

Finhub

The bill oddly codifies the Finhub office at the SEC even though Chair Atkins just disbanded it.