HOUSE COMMITTEE ON FINANCIAL SERVICES
– *RANKING MEMBER MAXINE WATERS* –
HOUSE COMMITTEE ON AGRICULTURE
– *RANKING MEMBER DAVID SCOTT* –
OPPOSE H.R. 4763
THE "NOT FIT FOR PURPOSE ACT"

Bill Summary: When this bill passed the House Financial Services Committee and the House Agriculture Committee in July 2023, it was purported to change securities laws in order to create a lighter-touch regulatory regime for crypto. While this was problematic, significant and troubling changes have been made to this bill since markup. Due to these changes, this bill would now severely upend 90 years of securities laws and investor protections for both crypto ***and*** traditional securities, ultimately causing severe instability and uncertainty in our capital markets. As drafted, this bill would shockingly allow a substantial portion of crypto *and* some traditional securities to escape nearly all laws and regulations and operate without any primary regulator overseeing them. This massive loophole would allow fraud to proliferate and result in devastating losses for not just crypto consumers, but also for non-crypto investors who are trying to save for retirement, college, or other life goals. By undermining investor confidence in our capital markets, this bill would also hurt companies, large and small, making it more costly for them to raise capital.

Background: Securities and Exchange Commission (SEC) Chair Gary Gensler, and his two predecessors, including the Trump-appointed Jay Clayton, have repeatedly and unambiguously stated that most of digital assets are in fact securities.[1] Unfortunately, nearly all digital assets firms have not registered with the SEC or otherwise complied with our securities laws, making billions of dollars unlawfully issuing, or facilitating the buying and selling of crypto securities. In response, the Biden Administration's SEC has been diligent in utilizing the resources at its disposal to crack down on this mass noncompliance.[2] To the extent that the Biden Administration's SEC's enforcement actions have been challenged in court, the SEC has prevailed again and again with stunning consistency, with few exceptions. The Biden Administration's SEC has also proposed and adopted rules or guidance specifically for digital assets, but the crypto industry continues to insist that there is a lack of regulatory clarity.[3] Rather than comply with the law, crypto firms are lobbying Congress to legalize their illegal activities.

Key Concerns:

1. ***This bill would result in mass deregulation of the securities market, not just for crypto.***

    a. The definition of "digital assets" and the revised bill's addition in Title II regarding "investment contract assets" would functionally deregulate most crypto and some traditional securities by removing them from the purview of the SEC and our nation's securities laws. While the bill offers one pathway providing for a light-touch regulatory framework (defined as "digital commodities" to be implemented and enforced by the Commodity Futures Trading Commission, or CFTC), the bill provides a second pathway for "investment contract assets" with no alternate regulator, **meaning that virtually NO laws or regulations would govern them**. This effectively creates a

[1] *Most Cryptocurrencies Are Securities, Says SEC Chair*, Investopedia (Sept. 8, 2022).
[2] *Gensler defends SEC's crypto crackdown in marathon House hearing*, CNBC (Apr. 18, 2023).
[3] On April 3, 2019, the SEC released "Framework for "Investment Contract" Analysis of Digital Assets," which offered a detailed analysis and guidance to help issuers of digital assets to assess whether their issuance would likely be deemed a security. This analysis has been updated on March 8, 2023. On Feb 15, 2023, the "SEC Proposes Enhanced Safeguarding Rule for Registered Investment Advisers (including crypto assets)," the proposal remains open to comments but crypto companies largely oppose the change; On April 14, 2023, the SEC reopens the comment period of proposed rule to amend the definition of "exchange" to now include DeFi platforms; On April 11, 2022, the SEC staff issues "Staff Accounting Bulletin 121," which provides clarity to entities that safeguard crypto assets.

regulatory void for "investment contract assets," making it fairly easy and attractive for crypto companies and other companies to take advantage of this regulatory "no man's land."

b. Under the bill, digital assets not issued as an "investment contract asset" would largely fall within the purview of the CFTC rather than the SEC. Though the bill provides the CFTC with some additional tools to police the crypto market, the CFTC's regulatory regime is largely designed for sophisticated institutional investors and traders, and therefore does not have the same type of protections that consumers and ordinary investors are familiar with under the SEC. Crypto that falls under the CFTC's purview would not have specific key SEC requirements under existing securities laws that prevent conflicts of interest and promote transparency.

2. ***By allowing for a mass deregulation of our securities market, this bill would nullify all protections afforded by the securities laws for crypto investors and consumers, including:***

a. ***A private right of action***. Under existing securities laws, shareholders can sue a publicly traded company if it makes materially misleading statements or omissions on their disclosures. These rights would not be available for investors under this framework.

b. ***Enforcement by states.*** This bill would pre-empt all state authorities with regard to digital assets. Just last year, Alabama, California, Illinois, Kentucky, Maryland, New Jersey, South Carolina, Vermont, Washington, and Wisconsin brought a case against Coinbase for violating states' securities laws. State regulators are on the frontlines against fraud; the bill would disarm them.

c. ***Enforcement by the SEC***. The SEC has been at the forefront of cracking down on noncompliant crypto companies. In fact, the SEC has brought and won over 170 crypto related enforcement cases. The bill would bar the SEC from enforcing its laws against a large swath of the market, defanging the very agency that's most capable of protecting investors against crypto fraud and market manipulation.

d. ***Fiduciary duty***. Those who sell, market, or offer personalized investment recommendations about "digital commodities" and "investment contract assets" under the bill would no longer be subject to SEC laws that require those entities to act in the best interest of the investor and put their client's interests first. This would allow "digital commodities brokers," or anyone who peddles "investment contract assets," to engage in conflicted financial transactions that would put their profit and junk fees above the interest of everyday investors who want to build wealth.

e. ***Disclosures for investors***. Neither "digital commodities" issuers nor issuers of "investment contract assets" would need to make fulsome, detailed, reliable, or audited disclosures that would help investors, or those working on behalf of investors, to make informed decisions. Lack of these disclosures would also mean no other stakeholders could gain insight into the environmental, social, governance, labor, or national security impact of issuers' actions.

f. ***Protections against conflicts of interest.*** This bill bakes in the deeply conflicted business relationships today's crypto exchanges enjoy. It allows "digital assets brokers" (i.e., exchanges or platforms) to also become "digital assets clearing agencies." It allows "digital assets brokers" to promote tokens that they may be early investors in. In other words, it allows Coinbase to list, market, and sell the tokens that their own venture capital arm, Coinbase Ventures, has a financial interest in. None of these conflicts of interest are permissible under existing law.

3. ***This bill would severely undermine the functioning of our capital markets.*** Deregulated capital markets would inevitably lead to fraud, manipulation, information asymmetry, misallocation of capital, financial instability, bubbles, regulatory arbitrage, and ultimately a shattering of investor confidence. We have seen examples of this in the recent past, including before the Great Recession, when the effects of massive

deregulation of the swaps markets and other "innovations" in the derivatives markets led to catastrophic and long-lasting losses to everyday Americans. With this bill, we risk sowing the seeds of the next crisis, which in turn would make it more difficult and more expensive for businesses of all sizes to raise capital, stifle economic activity and increase the costs of a broad range of goods and services for consumers.

Stakeholder Opposition: The following consumer, investor, community, good government, and civic organizations opposed this bill at the time of HFSC markup in July 2023: American Association for Justice, American Economic Liberties Project, Americans for Financial Reform, Better Markets, Center for American Progress, Center for Responsible Lending, Consumer Action, Consumer Federation of America, Consumer Reports, Demand Progress, Institute for Agriculture and Trade Policy, National Consumer Law Center (on behalf of its low-income clients), National Community Reinvestment Coalition, North American Securities Administrators Association; Open Markets Institute, Public Citizen, Revolving Door Project, Rise Economy (formerly California Reinvestment Coalition), Strong Economy for All Coalition, Texas Appleseed, 20/20 Vision, and Woodstock Institute.