

MEMORANDUM

To: Republican Members, Committee on Financial Services

From: Republican Financial Services Staff

Date: June 8, 2023

Re: House Financial Services Committee Hearing Entitled: “The Future of Digital Assets: Providing Clarity for the Digital Asset Ecosystem”

On Tuesday, June 13, at 2:00 p.m. (ET) in 2128 Rayburn House Office Building, the House Financial Services Committee will hold a hearing, entitled: “The Future of Digital Assets: Providing Clarity for the Digital Asset Ecosystem.” Testifying at the hearing will be:

- **Mr. Jeremy Allaire**, Co-founder, Chairman, and CEO, Circle
- **Mr. Coy Garrison**, Partner, Steptoe & Johnson LLP and former Counsel to Commissioner Hester M. Peirce
- **Dr. Emin Gün Sirer**, Founder and CEO, Ava Labs
- **Mr. Thomas Sexton, III**, President and CEO, National Futures Association
- **Mr. Aaron Kaplan**, Founder and Co-CEO, Prometheum, Inc.

Digital Asset Market Structure

Under the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act), the SEC has full authority over the offer, sale, and the trading of securities, including investment contracts, and the derivatives trading of securities.¹ Under the federal securities laws, every offer and sale of securities must be either registered with the SEC or conducted under an exemption.

The Commodity Exchange Act (CEA) and the CFTC regulations promulgated thereunder provide a comprehensive regulatory regime for the trading of commodity derivatives (e.g., buying or selling futures contracts on corn, cattle, or oil). Under the CEA, the CFTC also has “after-the-fact” enforcement jurisdiction over fraud and manipulation in the “spot” or cash commodity markets (e.g., buying or selling bushels of corn, heads of cattle, or barrels of oil). The CFTC has no statutory authority to impose registration and regulatory requirements on participants in the cash or spot commodity markets. Currently, there is no comprehensive federal regulatory regime for the spot trading of commodities.

Determining whether a digital asset is offered as part of an investment contract (i.e., meeting the definition of a security) or falling under the definition of commodity in the CEA has proven

¹ U.S. Securities and Exchange Commission: The Laws That Govern the Securities Industry, <https://www.sec.gov/about/about-securities-laws>.

difficult in the United States. Until there is a consistent, clear framework in place, market participants, consumers, and investors will continue to seek regulatory clarity given the requirements that stem from the classification of a particular digital asset.

The central question of whether the SEC has jurisdiction over a digital asset is whether it falls within the definition of a security. The Securities Act of 1933 (the “Securities Act”) requires every offer or sale of securities to be registered with the SEC or meet a condition for exemption from registration.² The Securities Act defines a security to include an “investment contract,” which was in turn defined by the Supreme Court in *SEC v. W.J. Howey Co.*³ Under *Howey* and the case law that followed, an arrangement qualifies an investment contract if it is: 1) an investment of money; 2) in a common enterprise; 3) with the expectation of profits; 4) derived from the efforts of others. The test is not a “balancing test,” rather, all four factors must be present for the arrangement to constitute an investment contract.⁴ Several characteristics of digital assets may cause it not to meet the *Howey* test.

Generally, the SEC and CFTC have attempted to resolve the legal question of whether a digital asset is a security or a commodity through enforcement actions. However, the agencies have not always agreed on which digital assets are considered securities and which digital assets are considered commodities. For example, last month, the CFTC brought an enforcement action against the trading platform Binance, asserting Binance’s BUSD stablecoin, bitcoin, ether, and litecoin are commodities.⁵ However, Chair Gensler has stated that he considers all digital assets other than bitcoin to be securities.⁶ Last week, in the charges brought against Binance and Founder Changpeng Zhao, the SEC alleged that certain digital assets offered and sold as “securities” included Solana’s SOL, Cardano’s ADA, Polygon’s MATIC, Filecoin’s FIL, Cosmos’ ATOM, Sandbox’s SAND, Decentraland’s MANA, Algorand’s ALGO, Axie Infinity’s AXS and Coti’s COTI tokens as well as Binance’s BUSD.⁷ These inconsistent positions demonstrate the necessity and urgency of congressional action.⁸

² Paul Vigna, *SEC Clears Blockstack to Hold First Regulated Token Offering*, Wall Street Journal (Jul. 10, 2019), <https://www.wsj.com/articles/sec-clears-blockstack-to-hold-first-regulated-token-offering-11562794848>; Guillermo Jimenez, *SEC Greenlights a Second Crypto Offering: YouNow’s Props Tokens*, Yahoo Finance (Jul. 19, 2019), <https://finance.yahoo.com/news/sec-greenlights-second-crypto-offering-223301606.html>.

³ See *SEC v. Howey Co.*, 328 U.S. 293 (1946).

⁴ *Id.*

⁵ See CFTC, *Commodity Futures Trading Commission, v. Changpeng Zhao, Binance Holdings Limited, Binance Holdings (IE) Limited, Binance (Services) Holdings Limited, and Samuel Lim* (March 27, 2023), <https://www.cftc.gov/PressRoom/PressReleases/8680-23>.

⁶ Ankush Khardori, *Can Gary Gensler Survive Crypto Winter? D.C.’s top financial cop on Bankman-Fried blowback.*, New York Magazine (Feb. 23, 2023), <https://nymag.com/intelligencer/2023/02/gary-gensler-on-meeting-with-sbf-and-his-crypto-crackdown.html>.

⁷ SEC Press Release: SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao (Jun. 4, 2023), available at <https://www.sec.gov/news/press-release/2023-101>.

⁸ There are also contradictions in the positions of state and federal regulators. For example, the New York State Attorney General is asserting in court that Ether is a security, while the CFTC states that Ether is a commodity. See *People of the State of New York against MEK Global Limited and Pheonixfin PTE LTD* (Mar. 9, 2023), https://ag.ny.gov/sites/default/files/2023.03.09_memorandum_of_law_people_v_mek_global_limited_and_pheonixfin_pte_ltd_dba_kucoin.pdf.

Stablecoins

Stablecoins are a class of digital assets designed to offer price stability by being pegged to another asset's value. The most popular stablecoins are currently pegged to the U.S. dollar. Stablecoins, as the name implies, are intended to be less volatile than other digital assets and sufficiently stable to enable them to be used in a similar manner to currency.

There are different types of stablecoins that are identifiable based on their underlying collateral structures. They include fiat-collateralized stablecoins, crypto-collateralized stablecoins, commodity-collateralized stablecoins, and non-collateralized stablecoins.⁹ Fiat-collateralized coins are pegged to a fiat currency, and crypto-collateralized stablecoins are backed by other digital assets. Commodity-backed stablecoins are collateralized using physical assets like metals, oil, or real estate. Non-collateralized stablecoins, or algorithmic stablecoins, use a working, autonomous mechanism to maintain a stable price.¹⁰

Today, there are more than two hundred different types of stablecoins, collectively worth more than \$130 billion. The most popular stablecoin is Tether (USDT) with a \$82.5 billion market capitalization, followed by USD Coin (USDC) with a \$30.1 billion market capitalization, and Binance Coin (BUSD) with a \$5.7 billion market capitalization.

Each state has a different regulatory framework for stablecoins. Generally, states have concluded that stablecoin issuers are engaged in money transmission activities and require issuers to obtain a license submitting to periodic examinations and take certain actions to safeguard consumers.¹¹ Most state money transmitter statutes were not drafted to address digital asset businesses. The state regulatory framework imposes significant costs on market participants, who must work with each state regulator to satisfy each state's regulatory requirements.¹²

Stablecoins and activities involving stablecoins may fall under the jurisdiction of several regulators depending on the composition of stablecoin reserve assets and the range of activities in which a user engages.¹³ Aspects of certain stablecoin related activities may also implicate additional state and federal regulators, including the Board of Governors of the Federal Reserve System, the OCC, the FDIC, and the Financial Crimes Enforcement Network.

Legislative Proposals

H.R. ____ (Chairman McHenry and Chairman Thompson) – The discussion draft clarifies the SEC's jurisdiction over digital assets offered as part of an investment contract and provides the

⁹ See Cryptopedia Staff, *The Global Stablecoin Ecosystem*, *Cryptopedia* (Mar. 8, 2022), <https://www.gemini.com/cryptopedia/what-are-stablecoins-list-global-ecosystem>.

¹⁰ *Id.*

¹¹ American Bar Association, *50-state survey of virtual currency regulation* (Oct. 8, 2020), https://www.americanbar.org/content/dam/aba/administrative/business_law/buslaw/committees/CL620000pub/digital_assets.pdf.

¹² *Id.*

¹³ American Bar Association, *Digital and Digitized Assets: Federal and State Jurisdictional Issues* (Dec. 2020), https://www.americanbar.org/content/dam/aba/administrative/business_law/buslaw/committees/CL620000pub/digital_assets.pdf.

CFTC with jurisdiction over the digital commodity spot market. Finally, the Act imposes robust customer protections on all entities required to be registered with the SEC and CFTC.

H.R. _____, To provide for the regulation of payment stablecoins, and for other purposes (Chairman McHenry) – The discussion draft defines payment stablecoins and requires such stablecoins to be issued by an issuer who has been approved by their primary federal regulator or state regulator. The bill subjects payment stablecoins to standards for reserves, redemption, disclosure, and risk management. The bill also provides clarity for insured depository institutions seeking to provide digital asset-related services.