Written Statement of Timothy G. Massad*

before the

U.S. House of Representatives Financial Services Committee

"American Innovation and the Future of Digital Assets: From Blueprint to a Functional Framework"

June 4, 2025

Chairman Hill and Ranking Member Waters, members of the committee and staff, thank you for inviting me to testify today.

Introduction

The goals of promoting innovation and providing clarity with respect to digital asset technology are ones that everyone can support. But there is no consensus on the blueprint for getting there. If the Digital Asset Market CLARITY Act of 2025 (the "Clarity Act") is the committee's blueprint, we should step back and consider what we are trying to build.

The Clarity Act seems to start with the technology and ask, what do we need to do to make it easier for people to invest in this technology? But the strength of our securities and derivatives laws lies in the fact that we have traditionally focused on regulatory goals, and provided regulators with the flexibility to respond to changing conditions, including evolutions in technology, in order to achieve those goals.

If we ask, what is it that *Congress* needs to do to make sure the goals of our securities and derivatives laws are met as technology evolves, that leads to a different approach. The principal objective of market structure *legislation* –as opposed to *regulation* by the market regulators--should be to provide regulatory oversight of the spot market for digital asset tokens that are not securities. That structural gap in our regulatory framework has led to the high degree of fraud, manipulation and lack of investor protection, as well as rampant speculation, that has characterized the digital asset sector to date.

I have spoken about this gap since shortly after I became chairman of the Commodity Futures Trading Commission (CFTC) in 2014 and we declared bitcoin to be a commodity.[1] But efforts

---

* Research Fellow and Director, Digital Assets Policy Project, Mossavar-Rahmani Center for Business and Government at the Kennedy School of Govcrment at Harvard University; Chairman of the Commodity Futures Trading Commission (2014-2017); Assistant Secretary for Financial Stability of the U.S. Treasury (2010-2014). The views I express are my own and do not represent the views of the Kennedy School of Government at Harvard University.

[1] *See* 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"); and my testimony before the Subcommittee on Digital Assets, Financial Technology and Inclusion

to address this gap have been bogged down by an ongoing debate about how to classify digital asset tokens: are they securities, commodities or something else? Some would say we cannot provide for oversight of the market in digital asset tokens that are not securities unless we rewrite the definition of security and related standards. But having Congress rewrite the securities laws to "clarify" this boundary will do more harm than good.

Therefore, the first challenge in filling that gap is how to define the scope of jurisdiction, or how to define the digital asset tokens that are not securities and should not be regulated as securities. This committee's prior attempt—the Financial Innovation and Technology Act for the 21st Century—proposed an incredibly complicated tri-partite test. It was unworkable and fortunately has been discarded. In its place, the Clarity Act proposes a slightly different approach but one built on a similar concept: when is a digital asset sufficiently "decentralized" so that it should not be considered a security? This approach is embodied in complex definitions that would be difficult to apply and measure in the real world. (Ironically, the Act offers an escape from some of its own tortured definitions by providing that a "blockchain system" need not actually *be decentralized* in order to be exempt from certain regulatory requirements. Instead, it is sufficient for the issuer to have the *intent that it be decentralized.*)

Thus, the Clarity Act takes us down a rabbit hole, one likely to generate more confusion than clarity. That is not to say decentralization is irrelevant; it can be an important factor in disclosure and other regulatory requirements, and I suggested the same when first writing about the need to strengthen crypto regulation in 2019.[2] But as used in the Clarity Act, it is an unstable foundation on which to build a regulatory framework.

The path forward should recognize that the regulatory gap arises in large part because we have a fragmented regulatory system. Indeed, the industry has exploited this fragmentation, by arguing that tokens are not securities and therefore not subject to regulation since neither agency had that spot market authority. The solution should therefore involve bringing the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) closer together, and giving them the authority, to address the gap.

Two years ago, Jay Clayton, the former SEC chair appointed by President Trump, and I argued that the critical way forward was to have Congress require the SEC and CFTC to work together to develop joint standards, either through a self-regulatory organization (SRO) or otherwise, that would apply to any intermediary that trades bitcoin or Ether—the two tokens whose status as non-securities is generally agreed upon. In this way, regulators would capture all relevant platforms "without first debating classification of each token or Congress pursuing tortured rewriting of existing definitions of securities and commodities." The rules would apply to all tokens traded on such platforms, with the proviso that the SEC would retain jurisdiction over tokens that were securities. We warned that rewriting existing law "might fail to bring clarity

---

of the U.S. House of Representatives Financial Services Committee and the Subcommittee on Commodity Markets, Digital Assets and Rural Development of the U.S. House of Representatives Committee on Agriculture, "The Future of Digital Assets: Measuring the Regulatory Gaps in the Digital Asset Market," May 10, 2023, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408754 ("2023 Testimony").

[2] *Ibid*, Massad 2019 at 49ff.

and inadvertently undermine decades of regulation and jurisprudence as they apply to traditional securities and commodities markets." [3]

I have proposed bringing the SEC and CFTC closer together through an SRO in more detail in other writings and describe it further below.[4] The SRO envisioned here would not mean the industry is governing itself. Consistent with U.S. practice since the 1930s, this SRO would be closely supervised and overseen by regulators—in this case, by the SEC and the CFTC jointly.

There may be other ways to bring the SEC and CFTC closer together to fill the regulatory gap and make sure regulations are technologically neutral, such as appointing common commissioners, or mandating that there be shared staff. The fact that this committee and the House Agriculture Committee have worked together on these issues is a good example of the cooperation that is needed.

Some members of the committee might say legislation must respond to the fact that previous regulators were not willing to consider whether rules needed to be revised in light of the technology. But if so, I would suggest they are fighting the last war. Some may feel that delegating authority to the SEC and the CFTC, even with general principles mandated by Congress, does not bring enough certainty: how do we know that the rules won't be changed? Yet it is this type of administrative process that many on this committee, as well as many in the crypto industry, have been wanting the SEC and CFTC to undertake with respect to digital assets for many years. While success will depend on the mandate and direction from Congress, and the execution by the agencies, it is far better than writing into law complicated standards that are likely to be exploited and that cannot be easily fixed.

Others worry whether creating an SRO under the control of the SEC and CFTC will lead to vigorous investor protection in light of the current environment. The SEC, the CFTC and the Department of Justice have ended or paused nearly every crypto-related enforcement action, and disbanded teams with crypto expertise. The DOJ has publicly stated that it will not prosecute someone in the crypto sector for regulatory violations unless the defendant both knew of the regulatory requirement and violated it willfully. Considered together with the Clarity Act, it seems you need not comply with regulatory requirements as long as you either have the right intent or remain ignorant of what those requirements are.

In addition, the President of the United States and members of his family have launched several business ventures to personally profit from crypto, including issuing meme coins and a stablecoin. Traditional ethical standards have been ignored. He is selling the very tokens that his Administration will regulate. It increasingly seems as if this Administration's primary goal is not to promote innovation but to promote the President's own personal enrichment.

---

[3]*See* Clayton, Jay and Timothy Massad. "A Path Forward for Regulating Crypto Markets." *Wall Street Journal*, 7 July 2023 , and also "How to Start Regulating the Crypto Markets—Immediately." *Wall Street Journal*, 4 December 2022.

[4] *See* Massad, Timothy G. and Howell E. Jackson. "How to Improve Regulation of Crypto Today—Without Congressional Action—and Make the Industry Pay For It." *Hutchins Center Working Paper*, no. 79, October 2022 ("Massad-Jackson 2022"). I also proposed the SRO concept in my testimony in May 2023. *See n. 1*.

I have spoken to many people involved in crypto who abhor the President's activities. They recognize it hurts the industry. Unfortunately, they do not speak out because they fear it will adversely affect their business interests and they doubt speaking out will make any difference. They know that the President's activity can only be addressed by Congress, but they doubt that Congress will do anything. So the question is, if not you, then who? And if not now, then when?

My testimony proceeds as follows. I first discuss two principles that should inform market structure legislation: it must do no harm to our existing markets, and it should be kept simple. I then discuss why I believe the Clarity Act violates both these principles and why an alternative approach such as an SRO is better. I then turn to the risks of illicit activity, a subject that unfortunately gets very little attention in the Clarity Act, as well as some general comments on decentralized finance. Finally, I conclude with a discussion of how the current environment affects the consideration of market structure legislation.

The Importance of Doing No Harm and Keeping Things Simple

There have been several suggestions for the principles that should inform market structure legislation, including by the chairs of this Committee and the House Agriculture Committee.[5] I suggest two simple ones: do no harm and keep it simple.

Do no harm means making sure that any digital asset market structure legislation does not undermine our existing capital markets. The U.S.'s $120 trillion equity and debt markets, together with our derivatives markets, are the foundation of the U.S. economy and the envy of the world. They directly impact the health and well-being of our citizens and our businesses. Their depth, liquidity and diversity has been the source of great innovation over the years—and probably more useful innovation since the launching of bitcoin fifteen years ago than has come from digital asset technology. Their strength and integrity rests on a legal regulatory framework that has been gradually and thoughtfully created over almost 100 years.

For all the talk about the innovative potential of digital asset technology, it is vital to maintain perspective about its relative role in our economy and the fact that it is a *technology*, not an asset class.

Here is one point of comparison: the collective market capitalization of the "Magnificent Seven" companies—Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla—is $16 trillion today. At the time bitcoin was launched in early 2009, two of these companies were not even public, and the other five had a collective market capitalization of just over $300 billion. Their collective growth (of over 5,000%) and the incredible innovation they have brought over that period is due in part to the strength of our capital markets.

---

[5] *See* French Hill and Glenn GT Thompson, "A Blueprint for Digital Assets in America," Coindesk, April 4, 2025. https://www.coindesk.com/opinion/2025/04/04/a-blueprint-for-digital-assets-in-america.
Chairs Hill and Thompson proposed the following principles: promote innovation; provide clarity for the classification of assets; codify a framework for the issuance of new digital assets; establish the regulation of spot market exchanges and intermediaries; establish best practices for the protection of customer assets; and protect innovative decentralized projects and activities and an individual's right to self-custody their digital assets.

Legislation that rewrites the definition of a security or revises the Howey test[6] to promote this technology can easily undermine the markets. It could create fractures in the legal underpinnings of our markets that lead to evasion and regulatory arbitrage as market participants seek to take advantage of new standards to avoid compliance obligations.

This might include attempts to use digital wrappers around instruments that would otherwise be classified as securities, or distributing assets through an autonomous protocol that qualifies as "decentralized" and therefore exempt from regulation. The ingenuity of market participants will come up with endless ways to test, evade and exploit any legislative rewrite of core provisions of the securities laws. This could undermine disclosure requirements, position reporting requirements, control standards, rules to prevent fraud and manipulation and other standards.

I point out examples of how the Clarity Act could give rise to this below.

The desire to rewrite the definition of a security or revise the Howey test has also been motivated in large part not by the *absence* of legal clarity as to what constitutes a security, but rather by a *dislike* of recent judicial decisions as to that standard. The fact is the SEC has won most of its cases as to what constitutes a security, particularly in the context of primary offerings. A submission for a recent SEC roundtable documented in detail how the Howey test has been consistently applied in digital asset cases. [7]

There is another argument for clarity, however, that is sound. If it is not clear *how* one complies with the law in the case of digital technology—as opposed to simply being unwilling to do so—regulators can and should address that complaint. Whether the rules pertain to registration of intermediaries, custody, clearing and settlement, recording and transfer of securities or other areas, regulations should be technologically neutral. They should work for securities held in digital asset form.

Consistent with the keep it simple principle, that task should be left to the regulatory process and should not be the focus of legislation at this time. The SEC and the CFTC are now led by chairs who wish to address those issues and they can be expected to do so, ideally through public rule-making or other processes open to public input. Congress should step in only if regulators determine that they lack the authority to do so.

The keep it simple principle calls for choosing a path forward that is most likely to achieve the primary goals most efficiently, with least risk of inadvertent harm. That means writing legislation that is not overly complicated, that establishes general principles, and that leaves to an administrative process the development of more detailed rules or guidance. Unfortunately, the Clarity Act, as with its predecessor, FIT 21, does not do this.

---

[6] SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

[7] Lee Reiners, Prepared Statement for SEC's Crypto Task Force March 21, 2025 Roundtable titled "How We Got Here and How We Get Out – Defining Security Status" and Responses to "Security Status" Questions in SEC Commissioner Hester Peirce's February 21, 2025 Statement Titled "There Must Be Some Way Out of Here." https://www.sec.gov/files/ctf-input-reiners-2025-3-18.pdf

The CLARITY Act

The CLARITY Act is an extremely complicated bill, and I do not claim to have fully understood all its provisions in the short time since its publication. I would guess that most members of Congress will not have the time to fully understand its provisions and implications. That concern alone should lead us to question whether this is the right "blueprint."

There should be no doubt that many, many lawyers will spend huge amounts of time developing ways to exploit this legislation and engage in regulatory arbitrage strategies on behalf of their clients, in order to find ways to take advantage of lesser compliance burdens. (I was a corporate lawyer for 25 years with one of the top firms in the world and am very familiar with how complex legislation can be very susceptible to regulatory arbitrage.)

With over 200 pages of detailed, complicated provisions, the implications of which are difficult to assess, I fear the Clarity Act is likely to have two principal effects: first, it will guarantee its own obsolescence, because the technology will evolve and the particulars of provisions will become outdated or not relevant. Second, and of far greater danger, it will encourage people to make investment or transaction decisions because something is a digital asset, or a digital commodity, or can be certified as a mature blockchain system, or can be traded on a decentralized finance trading protocol, and would therefore be subject to materially different regulation. In short, it will generate massive exploitation of its provisions and regulatory arbitrage.

I wish to highlight a few examples of the reasons why I say this.

Excessive Reliance on the Concept of Decentralization. The Act relies excessively on the concept of decentralization. It is used to rewrite and provide exemptions from important provisions of the securities laws. But the concept of decentralization is unstable ground on which to build a regulatory framework: it is difficult to define and measure, it can change over time, and it is not necessarily even the right metric by which to judge innovation.

Even those who might be expected to support legislation that is built on this concept have expressed their skepticism or even opposition. Consider the recent article by Joseph Hall, a partner at the law firm of Davis Polk and Wardwell and one of the top lawyers advising crypto companies. He testified, along with me and others, at a hearing of the Agriculture Committee two years ago. He recently wrote that it isn't clear that decentralization is the best framework to use for market structure legislation. "The difficulty in saying whether decentralization occurs counsels against using it as the dividing line" between securities and commodities. In addition, whether an asset is decentralized can change over time, and a test built on decentralization excludes business models which are centralized, which is not a good way to advance development of digital assets. The subtitle of his article is that "policymakers are asking the wrong questions."[8]

---

[8] Joseph A. Hall, "Rethinking Crypto Regulation Means Throwing Out Old Questions," Bloomberg Law, April 18, 2025, at https://www.davispolk.com/sites/default/files/2025-04/Rethinking%20Crypto%20Regulation%20Means%20Throwing%20Out%20Old%20Questions.pdf

The Chopping Block, a podcast hosted by three veteran crypto proponents who are widely followed in the industry and are quite knowledgeable about how crypto markets actually work, put it well in the title of a recent episode: "Decentralization Used to Mean Something. Now It Is Just a Vibe."[9]

As I noted earlier, the concept of decentralization may be one factor to consider in fine-tuning disclosure or other requirements for digital assets.[10] But it is very dependent on facts and circumstances, and it pertains to how a token is stored or maintained, not what it represents. For these and other reasons, it should not be the basis for a legislative definition of when a digital asset is or is not a security.

<u>The Act Will Not Fill the Regulatory Gap.</u> The Clarity Act is also unlikely to fill the gap in regulation that exists today—that is, the absence of spot market regulation of digital assets that are not securities. That gap has been the principal cause of investor abuses, as it has allowed crypto intermediaries—especially large, centralized ones on which most trading takes place—to operate largely as they please and without following the investor protection standards common in other financial markets. The problem is that although the Act provides for regulation of the spot market in "digital commodities," the Act's definition arguably would refer to just a handful of tokens. Indeed, that was the view of a few crypto industry experts to whom I put the question. Yet, the main centralized exchanges such as Coinbase, Kraken and Gemini list anywhere from 70 to 400 tokens.

What, then, about the rest? Nothing in the Act would appear to regulate the offer, sale or trading of those other tokens. There appears to be no prohibition on a centralized entity trading those other tokens, though it might have to be a sister platform to one on which "digital commodities" are traded. As a result, investors or users would remain with no protection unless those tokens are deemed securities.

Moreover, the tokens listed on centralized exchanges are just a fraction of the total tokens created each year. The crypto web site CoinGecko estimates that 600,000 new tokens were created in January of 2025 alone.[11] Those that aren't listed on centralized exchanges may then be traded on decentralized exchanges.

With respect to these other tokens, whether traded on centralized as well as decentralized platforms, many are meme coins, which the SEC has stated are not securities. There has been a dramatic increase in recent years in the issuance of meme coins and investor abuses pertaining to them—most notably pump and dump schemes. Other tokens may be the equivalent of reward points, or tokens used in video games, or other types of "utility" tokens. It may well be that many of these tokens should not be viewed as financial instruments and should not be subject to

---

[9] "Decentralization Used to Mean Something. Now It Is Just a Vibe," The Chopping Block/Unchained podcast, May 29, 2025. The episode focuses on how the $223 million Sui hack illustrates how the term decentralization is "being quietly redefined." In their May 10, 2025 episode, the hosts discuss the Clarity Act and one says "I didn't totally understand what the boundaries of [the mature blockchain system definition] are. And I think it's intended to be a little bit vague. But it's not really clear what it means for a team or a small group of people to have control over this thing."
[10] See *n. 2*.
[11] https://www.coingecko.com/research/publications/bobbys-crypto-aggregate-2025-02

regulation by either the SEC or the CFTC. But we need a process for deciding how to classify them and should decide what type of standards should apply--including whether the activity more closely resembles gambling and should be regulated as such.

Other Examples of How the Clarity Act May Undermine Existing Securities Laws. The Act could also undermine existing securities laws in other ways. I will offer a few examples, which require some detailed explanations of how the provisions work.

The definition and use of the term "**mature blockchain system**" is one example of how the Clarity Act's excessive reliance on the concept of decentralization would subvert traditional securities laws and fail to create adequate investor protection. This term is a building block for offerings of "digital commodities", the new asset category that the Act would distinguish from securities. The term "mature blockchain system" is defined to be a system "that is not controlled by any person *or group of persons under common control*" (ital. added). But the concept of a "group" and the concept of "under common control" are separate and distinct attributes in the securities laws, either of which can constitute a form of control: a group can exist by virtue of a contract or unwritten understanding among multiple persons, while "under common control" is a measure of affiliate status. By combining the two, "control" is far less likely to be deemed to exist, thus making it easier to qualify as a mature blockchain system and to get the benefit of a lesser regulatory burden. Compounding that problem, the certification of a blockchain system as being mature uses a 20% threshold for control—as long as there is no person (or "group of persons under common control") above that threshold, there is no control. But control is often deemed to exist at a much lower level, depending on the facts and circumstances. The certification also requires that an issuer not have "unique permission or privilege" to alter the system except in certain respects. That standard is one that an issuer seeking to maintain effective control could easily get around, by providing token holders with a limited supermajority veto right, for example.

All these elements make it easier for someone to maintain effective control of a blockchain system but still meet the test of being considered "mature." A further weakness of the Act is that one need not actually *satisfy* the "mature" standard to be entitled to the new exemption from the Securities Act for a capital raising transaction. One need only have the *intent* to create a "mature blockchain system."

Another problematic area is **the definition of "digital commodity" and the revision of the term "investment contract."** The Act revises the term "investment contract"—a core component of the definition of "security" in the securities laws—so as to exclude an "investment contract asset," which is defined as a digital commodity. This creates the basis for exempting offers and sales of digital commodities from the securities laws, both offerings by the issuer (subject to meeting certain minimal requirements) and secondary offerings. Although the definition of "digital commodity" excludes certain securities, the relationship of these two definitions and the way they relate to certain exemptions is likely to lead to confusion and attempts to evade requirements.

This, together with the "mature blockchain system" standard, illustrates the dangers of writing complex definitions based on decentralization. Even SEC Commissioner Hester Peirce has warned against the dangers exemptions of this sort can create. In recent comments about the general idea of exempting sales of investment contract assets from the securities laws, her words are equally applicable to the Clarity Act provisions:

> [T]reating all secondary sales of crypto assets as being free of the investment contract runs the risk of facilitating bad behavior: the dumping of crypto assets bought as part of an investment contract on retail investors while the crypto asset lacks function and its associated network or application remains centralized (and thus subject to information asymmetry concerns). If the initial holders are out of the picture because they have sold their crypto assets, the investment contract is unenforceable, and the issuer can dump its crypto assets too and walk away—wealthy and unaccountable—for completing the project. Companies looking at capital raising options might even be tempted to use such crypto asset sales instead of other capital-raising methods: promise to build a network or functional product, do a crypto asset presale to venture capitalists, stop developing the network or product once they have sold out to retail, and plow the proceeds of the initial crypto asset sale into building their actual business.[12]

Her remarks are ample reason why we should not create such an exemption legislatively. Even if it makes sense for the SEC to develop customized disclosure or other rules for such transactions, matters that are very facts-and-circumstances dependent such as these should be left to an administrative process.

A final example I will cite of how the Clarity Act could create confusion and potentially undermine existing law is in the **definition of and exemptions for "decentralized finance trading protocols."** A decentralized finance trading protocol means a blockchain system through which participants can "execute a financial transaction," subject only to minimal conditions such as "without reliance on any other person to maintain control of the *digital assets* [ital. added] of the user". The Act provides that activities related to decentralized finance trading protocols are largely exempt from the Securities Exchange Act. The scope of activities is broad, and includes "providing a user-interface that enables a user to . . .interact with a blockchain system." That could be a business which exercises discretion over routing of transactions, or which could be the source of asymmetrical information—both reasons we should consider it an attachment point for regulation. But none appears to be provided in the Act. Moreover, given the breadth of the phrase "execute a financial transaction" and the definition of "digital asset"—which includes any representation of value on a blockchain system—all sorts of activities could conceivably take place on such platforms and be exempt from the law, including transactions in securities.

These are just a handful of examples. The Act's detailed provisions over the course of its almost 200 pages create other ways in which it may generate confusion and undermine our securities laws. Even where there is a valid argument for customizing rules for assets in digital form, Congress should focus on higher level principles and leave the work of writing detailed rules or guidance to an administrative process.

---

[12] Commissioner Hester Peirce, "New Paradigm: Remarks at SEC Speaks," May 19, 2025, at https://www.sec.gov/newsroom/speeches-statements/peirce-remarks-sec-speaks-051925-new-paradigm-remarks-sec-speaks

The SRO and Other Alternative Approaches

Congress should not try to write detailed rules and should instead direct the SEC and CFTC to work together to (i) address the gap in investor protection that exists with respect to the spot market in non-security digital assets and (ii) make sure existing rules are technologically neutral. This could be done with a joint SRO or otherwise.

A primary reason why the security versus commodity debate has been so vexing is because of our fragmented regulatory structure. It has been easier for countries with a single regulator with broad authority to respond to the rise of digital asset technology because it did not trigger a jurisdictional question between different agencies. Any solution needs to bring the agencies closer together.[13]

The Congress can provide the SEC and CFTC with the necessary authority by using a simple way of addressing what has otherwise seemed like a difficult problem: how does one define "non-security digital asset tokens" in order to create regulatory oversight of that market, without rewriting securities laws in ways that undermine traditional protections? The market structure law can mandate that these joint rules would apply to any trading platform or other intermediary transacting in bitcoin or Ether. (Other assets as to which there is a consensus that they are not securities could also be included in the legislation but is likely not necessary.) This is likely to ensure that any significant intermediary is covered. The rules would then apply to all digital asset tokens in which any such intermediary transacts, subject to certain carve outs. These carve outs could go both ways: any digital asset token that is deemed a security would not be included and would remain subject to the securities laws. In addition, tokens that are not securities and do not have sufficient financial characteristics to warrant financial market regulation could be excluded, though this could be coupled with some other arrangement to provide reasonable investor or user protection.

While the SEC and CFTC could create an SRO on their own, it is preferable for Congress to direct them to do so. Congress should spell out its jurisdiction, structure, governance and responsibilities. To this end, if an SRO path is chosen, the market structure law would, among other things:

---

[13] There have been many proposals over the years calling for a merger of the two agencies or at least better coordination between them because of gaps in oversight, lack of coordination, inefficiencies or other problems arising from having two market regulators. *See, for example,* Report of the President Task Force on Market Mechanisms (under Treasury Secretary Nicholas Brady in 1988) recommending greater coordination; the U.S. Treasury, Blueprint for a Modernized Financial Regulatory Structure (under Treasury Secretary Henry Paulson in 2008) recommending a merger; The Group of Thirty Report: Financial Reform: A Framework for Financial Stability, (chaired by former Federal Reserve Board chairman Paul Volcker in 2009), recommending a merger; the U.S. Government Accountability Office, Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System (2009), recommending merger or better coordination; the Financial Crisis Inquiry Commission Report of 2011 (highlighting problems caused by having two regulators); and the U.S. Treasury, A Financial System That Creates Economic Opportunities: Capital Markets, (under Treasury Secretary Steve Mnuchin in 2017), calling for greater harmonization. This is a good time to take a simple step to institutionalize greater cooperation.

— set forth the basic structure and governance of the SRO, drawing on the precedents that exist in both the Securities Exchange Act and the Commodity Exchange Act, except that this would be jointly and closely governed by the SEC and CFTC. The board of governors would be diverse, and include not only representatives of digital asset market participants, but also traditional financial institutions, public interest organizations, and others. The SEC and CFTC would approve the SRO's rules and its budget (though funding can be imposed on the industry consistent with our traditional SRO practice). The Treasury Department could also be given some authority if deemed necessary to arbitrate any differences between the two agencies in the governance. While a new SRO would be mandated, the SEC and the CFTC can draw on the expertise and staffing of existing SROs such as the Financial Industry Regulatory Association (FINRA) and the National Futures Association (NFA) in forming the entity.

— mandate that any trading or lending platform that trades or otherwise deals in bitcoin or Ether would be subject to the rules of the SRO, as would any broker or dealer or certain other intermediaries, unless the platform or intermediary is registered with the SEC or CFTC as a securities or derivatives intermediary. (There could be de minimus exceptions for small actors.)

— mandate the core principles that would serve as the basis for SRO rules, which would be similar to the principles used in our securities and derivatives markets; and

— mandate that those rules would apply to all digital asset tokens traded or used on or by any such platform or intermediary that transacts in bitcoin or Ether, subject to certain limitations that pertain to the "boundaries" of the market regulated by the SRO.

Policing the Boundaries

There are two critical boundary questions in filling the gap in regulation. The first is whether a digital asset token is a security, but that is precisely why any solution must bring the SEC and CFTC together. With an SRO, the SEC could have the equivalent of a right of first refusal to determine that a digital asset token is a security and therefore must be traded on an SEC-registered platform or by an SEC-registered intermediary. An intermediary would not face the threat of being shut down, however, for having listed any such token.

While the SEC would rely on the Howey test and the other jurisprudence in this area, the mere fact that there would now be a regulatory framework for those non-security tokens should make the determinations easier. Although it is not expressly articulated as a fifth prong of the Howey test, Supreme Court cases have made clear that the existence of an alternative regulatory scheme can be an important factor in concluding that a financial instrument is not a security. For example, in Marine Bank v. Weaver, the Supreme court held that neither a federally insured certificate of deposit nor a related agreement constituted a security in part because the CD was subject to a robust, alternative regulatory regime, and therefore it lacked the risk typically associated with a security.[14] Similarly, in International Brotherhood of Teamsters v. Daniels, the

[14] Marine Bank v. Weaver, 455 U.S. 551 (1982)

court overturned a lower court ruling that held that participation in a non-contributory, compulsory pension plan was an investment contract and subject to the protections of the securities laws. The court said that the argument that securities regulation should apply was undercut by the fact that such plans are subject to extensive regulation under the Employee Retirement Income Security Act of 1974.[15] The existence of an alternative regulatory scheme reduces the importance, from an investor protection standpoint, of concluding that something is a security.

The second boundary concerns digital asset tokens that are not securities *and* that are not financial in nature. That is, they should not be regarded as commodities, nor as instruments that are necessarily subject to financial market regulation. The agencies, or the SRO with the agencies' approval, could develop guidance by which to distinguish these tokens and the consequences of being in this third bucket. These determinations could also be formalized into a process involving the Treasury Department.

Ensuring Robust Oversight

If an SRO is used, it is vital that it not be captured by the industry. That is why an SRO must be tightly governed and supervised by the agencies. They would appoint its board, approve its budget and rules and have other measures of control. One could also incorporate lessons learned from the experience of the SEC's oversight of the Public Company Accounting Oversight Board (PCAOB), and its approval of budget and rules.

The Core Principles for Regulation

Congress would set forth the core principles for the rules that the agencies themselves, or an SRO, would develop. The principles would be familiar ones used in our securities and derivatives markets. They would also be similar to principles in the Clarity Act for the regulation of digital commodity exchanges and would include:

- 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, clearing and settlement of transactions in a competitive, open, efficient and timely manner;
- pre- and post-trade transparency requirements including as to price, volume, and other trading data;
- prevention of fraud, manipulation and abusive practices (including prevention of wash trading, price distortion and disruption to delivery and settlement processes);
- listing standards and disclosure requirements for tokens;

[15] Teamsters v. Daniel, 439 U.S. 551 (1979)

- disclosures to customers, including regarding fees, recourse, trading procedures, and dispute resolution;
- impartial access;
- risk management practices;
- operational resilience, cybersecurity standards and business continuity and disaster recovery policies;
- reporting to and sharing of information with regulators and other agencies including the Treasury and the Federal Reserve Board; and
- know your customer (KYC), anti-money laundering (AML) and combating financial terrorism (CFT) standards. [16]

These principles are further discussed in the paper I wrote with Professor Howell Jackson.

The approach outlined here is a pathway to achieving investor protection quickly and comprehensively. Most spot market trading occurs through centralized intermediaries. This approach would dramatically improve investor protection on those platforms by covering all tokens traded. 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% or more of the trading on crypto platforms[17]—would be a huge improvement. I believe this approach would also take some of the speculative air out of the sector's sails generally and help encourage investment and developer activity toward more useful applications of the technology.

Illicit Finance Risks and DeFi Protocols

I wish to highlight two other subjects that are critical in any market structure legislation:

<u>*Illicit Finance*</u>
It is surprising to me how little is said about the risks of illicit finance in the Clarity Act. When proposals have been recently made in connection with the stablecoin legislation to expand the authority of the Treasury Department to address illicit finance, particularly in decentralized finance activities, some proponents of the legislation responded that those subjects should be addressed in the market structure legislation. But that is not evident in the current draft.

---

[16] See *also* Massad and Jackson (2022), *supra,* note 5.
[17] *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.

The legislation should give the Treasury Department and market regulators ample authority with respect to preventing the use of digital assets for illicit finance or evasion of sanctions. This should not be limited to requiring intermediaries to comply with the Bank Secrecy Act because digital assets can be transferred without the involvement of an intermediary on decentralized blockchains. The authority needs to be broad and flexible for that reason. In 2023, the Treasury Department proposed several ways in which its authority should be expanded, which could be included in this legislation. Among other things, it should include authority to address the role of mixers, tumblers and other devices used to disguise identity. That can be coupled with a recognition that rules must strike a balance between preventing illicit finance and respecting individuals' privacy. The authority needs to be broad and flexible also because we do not know exactly how the sector and technology will evolve.

DeFi Protocols

I noted earlier concerns about the specific term "decentralized finance trading protocol" in the Clarity Act. It is worth noting some general reasons why we should not exempt from regulation protocols or processes on the basis that they are "decentralized," regardless of the particulars of the definition. DeFi protocols that engage in providing financial market services or transactions should meet, or have outcomes consistent with, the requirements we impose through regulation on similar "trad fi" services and transactions, even if the manner of meeting those requirements might vary.

The subject of "DeFi" is often discussed as if it were monolithic, when in fact the terms "decentralization" and "DeFi" are used to describe all sorts of protocols, processes and services taking place in the crypto universe that vary tremendously with respect to the degree to which they are automated, decentralized or distributed, and with respect to the degree to which firms or human actors exercise control or discretion. DeFi protocols and services may have various types of what have been called "centralization vectors"—that is, ways in which there is some degree of control or discretion, including administrative keys that permit modification of code or restricting access.[18] That is, they are not fully decentralized. It is also the case that there may be an automated protocol but a related "front-end" service provided by a firm or person in which discretion and control are being exercised. Therefore, the term "decentralization" is of little value.

Proponents of making wholesale exceptions for "DeFi" also seem to ignore the fact that the "trad fi" world has experienced waves of automation before. We developed regulatory responses to automation and can do so again, even if this is a somewhat different type of automation. Our securities and derivatives markets have gone from manual floor trading to highly automated processes in just a few decades. Our rules have generally kept pace with an increasing diversity of trading platforms, faster speed, and less human involvement.

As an example, internalizers in the securities markets could be thought of as having certain similarities to the automated market makers of the digital asset world: they are large broker-dealers who fill orders from their own inventory rather than routing them to public exchanges.

[18] Shuler, Katrin, et al. "On DeFi and On-Chain CeFi: How (Not) to Regulate Decentralized Finance." *Journal of Financial Regulation*, vol. 10, no. 2, 2024.

Internalizers have been made subject to order routing, best execution and payment for order flow requirements. Under Regulation SCI, an internalizer that operates a system critical to market infrastructure can be designated an SCI Entity which is then required to maintain robust cybersecurity, disaster recovery and reporting systems. While internalizers are centralized entities that provide a clear point of attachment for regulations, the regulatory response to them is an example of how we have responded to automation in the past and can do so again.

While automation and ability for users to control assets may reduce certain types of risks that are often the targets of regulation, they may introduce others, and we must ensure that the regulatory goals of consumer and investor protection, market integrity and transparency, financial stability or prevention of financial crime are achieved, even if in a different manner. A simple example is to imagine a "decentralized" or automated platform for the trading of Treasury securities that becomes a dominant, and indeed systemically important, platform given the importance of the Treasury securities market. Even if such a platform truly was automated and not subject to the control of a human operator, and even if participants engaged in self-custody, we would still want to make sure various regulatory goals were achieved.

The extent of DeFi activity in the crypto world is still relatively small. (Although estimates and methods of calculation vary, Messari data finds that only 5% of crypto trading takes place on decentralized exchanges whereas 95% is on centralized exchanges.[19]) We need to develop more precise analysis of the various ways in which protocols might be decentralized and autonomous, as well as the control vectors that might still be present, and develop agreed-upon language for describing the extent or type of "decentralization". The market structure legislation should call for appropriate studies and recommendations by regulators and Treasury; it should not be granting broad exemptions or exceptions at this time.

The President's Crypto Business Ventures

As we consider legislation to regulate the crypto markets, we cannot ignore the actions by President Trump to personally profit from crypto. These actions deserve opprobrium in any context, but all the more so at a time when regulation of digital asset technology is such a prominent public issue.

The Trump meme coins were issued two days before inauguration and five days before the issuance of the Executive Order on Strengthening American Leadership in Digital Asset Technology.[20] It is hard to imagine an action that could have been more contrary to the spirit and opening words of that order, which is to "promote United States leadership in digital assets" and "responsible growth and use of digital assets."[21] The meme coins have been described as a "classic meme-coin pump and dump scheme."[22] They appear to serve no purpose other than the

---

[19] Messari April 25, 2025, add cite. https://messari.io/exchanges
[20] United States, Executive Office of the President [Donald J. Trump]. Executive Order 14178: Strengthening American Leadership in Digital Financial Technology. 23 January 2025. *Federal Register*, vol. 90, no. 20, pp. 8647-8650 ("Executive Order 14178").
[21] Executive Order 14178.
[22] Khalili, Joel. "The Trump Memecoin's 'Money-Grab' Economics." *Wired*, 20 January 2025 (citing interview with Jacob Silverman).

personal enrichment of the president. In the words of Vitalik Buterin, they are vehicles for "unlimited political bribery," because those seeking to curry favor with the Administration—whether they be individuals, companies or countries—may purchase the coins, knowing the President will profit from their actions, while they can still deny that seeking government favoritism was their purpose. Instead, they can claim they were merely speculating on a digital asset.[23] The reports concerning the dinner that the President held for the top 220 holders indicate he spent little time there and had little of substance to say. That seems to underscore that his crypto agenda is making a profit.

The Trump Organization's acquisition of World Liberty Financial and its issuance of a stablecoin is equally inappropriate and shocking, particularly as Congress works to pass stablecoin legislation. The various other business ventures that have been discussed in the press—such as a transaction with Binance or the acquisition of bitcoin mining capacity—further suggest that the priority of the Administration is not promoting crypto innovation but promoting the President's personal enrichment.

This activity creates a cloud over the crypto industry, and over the enterprise of developing market structure legislation. Only Congress can address this and I strongly encourage Congress to do so.

Conclusion

Thank you for the opportunity to testify. I would be happy to take your questions.

[23] Turner Wright, "Vitalik Buterin takes aim at "unlimited political bribery" using tokens," Cointelegraph, January 23, 2025, at https://cointelegraph.com/news/vitalik-buterin-unlimited-political-bribery-tokens