

Statement by
Todd Phillips, Director of Financial Regulation and Corporate Governance
Center for American Progress
Before the United States Senate Committee on Agriculture, Nutrition, and Forestry
“Legislative Hearing to Review S.4760, the Digital Commodities Consumer Protection Act”
September 15, 2022

Chairwoman Stabenow, Ranking Member Boozman, and members of the Committee, thank you for the opportunity to discuss the Digital Commodities Consumer Protection Act of 2022 (S. 4760). I am Todd Phillips, Director of Financial Regulation and Corporate Governance at the Center for American Progress. I am pleased to support this bipartisan bill, which would provide much needed regulatory oversight of the crypto commodity markets while ensuring other regulators may continue to police other parts of the crypto markets.

Risks, Harms, and the Existing Regulatory Regime

Retail Investors Face Elevated Risks from Crypto

In recent years, crypto assets have grown significantly in usage and prominence in the economy and culture.¹ An NBC News poll in March found that 21 percent of Americans have used or invested in crypto.² The significant expansion in crypto usage in the last few years can likely be explained not only by the innovativeness of the underlying technology, but also a general “hype” and narrative promoted by advocates that crypto is revolutionizing the financial system. Many advocates have made significant claims about how crypto and the blockchain—often labeled as “Web3”—could have a transformative impact on the financial system and the economy.³ These claims rely on the fact that the blockchain allows for decentralized, peer-to-peer transactions that obviate the need for traditional intermediaries—and thus can provide, in theory, an open, egalitarian outlet for individuals to earn money and trade assets outside of the traditional financial system.⁴ Further, many buyers of crypto no doubt purchased tokens with the expectation that their value will only continue to increase—an expectation reinforced by a frequent claim made by advocates that the price of Bitcoin will inevitably grow to \$100,000 or more.⁵

¹ “Total Cryptocurrency Market Cap,” CoinMarketCap, available at <https://coinmarketcap.com/charts/> (last accessed July 2022); Will Gottsegen, “Ads of the ‘Crypto-Bowl,’” CoinDesk, February 8, 2022, available at <https://www.coindesk.com/layer2/2022/02/08/ads-of-the-crypto-bowl/>.

² Thomas Franck, “One in five adults has invested in, traded or used cryptocurrency, NBC News poll shows,” CNBC, March 31, 2022, available at <https://www.cnbc.com/2022/03/31/cryptocurrency-news-21percent-of-adults-have-traded-or-used-crypto-nbc-poll-shows.html>.

³ Rebecca King, “Web3: The hype and how it can transform the internet,” World Economic Forum, February 1, 2022, available at <https://www.weforum.org/agenda/2022/02/web3-transform-the-internet/>.

⁴ David Yaffe-Bellamy, “Crypto Crash Widens a Divide: ‘Those With Money Will End Up Being Fine,’” *The New York Times*, June 29, 2022, available at <https://www.nytimes.com/2022/06/29/technology/crypto-crash-divide.html>.

⁵ Shivdeep Dhaliwal, “Bitcoin At \$100,000 Before The Year Is Out, Says Novogratz,” Yahoo! Finance, February 9, 2021, available at <https://finance.yahoo.com/news/bitcoin-100-000-says-novogratz-053354426.html>.

However, because the longstanding federal financial regulatory laws designed to protect investors are not being enforced, practices such as market manipulation, so-called “rug pulls,” fraud, and outright theft plague crypto markets.⁶ According to one estimate, \$2.9 billion of crypto was stolen in the first four months of 2022 alone,⁷ and a major crypto exchange was recently sued by a retirement savings firm alleging that the exchange failed to protect customers from an attack that led to the theft of \$36 million in crypto assets (the case is ongoing).⁸ These types of problems pose a significant risk to retail investors, who in some cases invest their life savings into crypto assets. So long as existing laws are not effectively applied to crypto markets and gaps exist in existing financial regulatory laws, customers and investors will not benefit from the many protections that these laws guarantee for traditional financial services products ranging from stocks and bonds to bank deposits.

Investors have also been drawn into a variety of crypto projects by implausible and sometimes fantastical promises. Recently failed crypto projects accumulated investors with promises of stability plus high returns (in the case of Celsius, promising returns as high as 19 percent).⁹ These businesses were essentially engaging in fractional-reserve banking when they lent depositors’ crypto to speculators on margin. When crypto prices sharply declined in recent months, these firms suddenly found that their counterparties were unable to meet margin calls. The situation was made worse as the depositors lost confidence and began demanding withdrawals *en masse* which, given the nature of fractional-reserve banking, the lenders could not meet in full. Consequently, these firms have been forced to file for bankruptcy.¹⁰

Similarly, the recent collapse of the stablecoin TerraUSD and demonstrates the significant risks to investors in algorithmic stablecoins. Stablecoin issuers have economic features that resemble banks even though they are not regulated as such. Issuers, in theory, hold reserve assets that allow investors to redeem tokens on demand for \$1 each in cash (very similar to how a traditional bank deposit account works). However, issuers may (and the issuer of TerraUSD did) rehypothecate the assets for their own benefit. Terra, accordingly, did not have sufficient assets

⁶ Deloitte, “Market Manipulation in Digital Assets,” March 2021, available at <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Financial-Services/gx-design-market-manipulation-in-digital-assets-whitepaper-v2-1.pdf>; CoinMarketCap, “Rug Pull,” available at <https://coinmarketcap.com/alexandria/glossary/rug-pull> (last accessed July 2022); Adam Morgan McCarthy, “Founder of now-defunct BitConnect has been indicted for a \$2.4 billion crypto Ponzi scheme,” Markets Insider, February 28, 2022, available at <https://markets.businessinsider.com/news/currencies/bitcoin-bitconnect-fraud-ponzi-scheme-indictment-jury-sec-crypto-blockchain-2022-2>.

⁷ Sead Fadilpašić, “The crypto theft problem is getting worse and worse,” TechRadar, April 25, 2022, available at <https://www.techradar.com/news/the-crypto-theft-problem-is-getting-worse-and-worse>.

⁸ Jon Fingas, “Winklevoss twins' crypto exchange faces lawsuit over \$36 million theft,” Yahoo! News, June 7, 2022, available at <https://www.yahoo.com/news/winklevoss-twins-gemini-crypto-theft-lawsuit-200542527.html>.

⁹ Manya Saini and Noel Randewich, “Crypto lender Celsius says it is exploring options,” Reuters, June 30, 2022, available at <https://www.reuters.com/markets/us/crypto-lender-celsius-says-it-is-exploring-options-2022-06-30/>.

¹⁰ Rob Davies, “Celsius Network: crypto firm reveals \$1.2bn deficit in bankruptcy filing,” *The Guardian*, July 15, 2022, available at <https://www.theguardian.com/technology/2022/jul/15/celsius-network-crypto-firm-deficit-bankruptcy-funds>; Ryan Browne, “Crypto brokerage Voyager Digital files for Chapter 11 bankruptcy protection,” CNBC, July 6, 2022, available at <https://www.cnbc.com/2022/07/06/crypto-firm-voyager-digital-files-for-chapter-11-bankruptcy-protection.html>.

on reserve, which prompted a run by investors demanding redemptions that caused the token to “lose its peg” and collapse in value.¹¹

Crypto’s Consequences for Climate Change

In addition to imposing significant risks on retail investors, there is evidence that activities involving crypto assets—particularly, the process of solving a repetitive mathematical function to record new transactions known as mining, hashing, or validating—are extremely energy intensive, and therefore have a large carbon footprint. By some estimates, Bitcoin alone is responsible for 0.40% of the world’s electricity consumption, has a carbon footprint equal to that of Denmark or New Zealand, and in a single transaction uses more energy than 100,000 Visa transactions.¹² By another estimate, the carbon footprint of a single mined Bitcoin is 221 metric tons of carbon dioxide, while the carbon footprint of mining gold valued at the equivalent of one Bitcoin is only 8 tons of carbon dioxide.¹³ As the Office of Science and Technology Policy noted, “[t]he explosive growth of the digital asset ecosystem may contribute to greater energy use and negatively impact the climate.”¹⁴

Crypto’s Heretofore Negligible Effects on Financial Inclusion

One particularly noteworthy element of the crypto industry’s advocacy has been claims by industry leaders that the growth of crypto assets will bolster financial inclusion by providing low-income individuals easier and cheaper access to financial services than those offered by the traditional financial services industry.¹⁵ Financial inclusion is defined as access to financial products and services, such as payments, savings, and credit, that are “delivered in a responsible and sustainable way,” and is typically measured by the percentage of a community’s population that has access to a bank account.¹⁶ Individuals who lack access to any financial services are considered “unbanked,” accounting for about 6 percent of the U.S. population and disproportionately consisting of people of color.¹⁷

The fundamental purpose of financial inclusion is to improve the overall economic well-being of low-income individuals. Expanding access to financial services should help reduce poverty and

¹¹ Alexander Osipovich and Caitlin Ostroff, “Crash of TerraUSD Shakes Crypto. ‘There Was a Run on the Bank.’” *The Wall Street Journal*, May 12, 2022, available at <https://www.wsj.com/articles/crash-of-terrausd-shakes-crypto-there-was-a-run-on-the-bank-11652371839>.

¹² Alice Feng, “Is Cryptomining Harming the Environment?” Princeton Student Climate Initiative, February 27, 2021, available at <https://psci.princeton.edu/tips/2021/2/27/is-cryptomining-harming-the-environment>.

¹³ Digiconomist, “Bitcoin Energy Consumption Index,” available at <https://digiconomist.net/bitcoin-energy-consumption> (last accessed September 2022).

¹⁴ Federal Register, “Request for Information on the Energy and Climate Implications of Digital Assets” (Washington, DC: 2022), available at <https://www.federalregister.gov/documents/2022/03/25/2022-06284/request-for-information-on-the-energy-and-climate-implications-of-digital-assets>.

¹⁵ “Cryptocurrencies can enable financial inclusion. Will you participate?”, World Economic Forum, June 9, 2021, available at <https://www.weforum.org/agenda/2021/06/cryptocurrencies-financial-inclusion-help-shape-it/>; Chamber of Digital Commerce, “Blockchain and Financial Inclusion” (Washington, DC: 2017) available at <https://digitalchamber.org/assets/blockchain-and-financial-inclusion.pdf>.

¹⁶ The World Bank, “Financial Inclusion”, available at <https://www.worldbank.org/en/topic/financialinclusion/overview> (last accessed August 30 2022).

¹⁷ See Board of Governors of the Federal Reserve System, “Report on the Economic Well-Being of U.S. Households in 2019 - May 2020” (Washington, DC: 2020), Available at <https://www.federalreserve.gov/publications/2020-economic-well-being-of-us-households-in-2019-banking-and-credit.htm>.

improve the overall economic well-being of the unbanked by enabling individuals to build savings, make financial transactions at lower costs, and better prepare for future financial risks.¹⁸ The primary obstacle for financial inclusion is cost: Bank account fees, particularly overdraft fees, can be prohibitive for low-income individuals.¹⁹ Moreover, the cumbersome nature of the U.S. payments system, in which transactions usually take a couple of days to clear and checks can take as many as six days to clear, is a significant obstacle for individuals who live paycheck to paycheck and need access to cash quickly to cover basic living expenses.²⁰

Advocates' claims that crypto assets can bolster financial inclusion typically include several points, including that crypto is easier to access than traditional financial services because it only requires having internet and a device; that crypto assets can help the unbanked accumulate savings without needing a bank account; that crypto assets can help the unbanked make payments more easily than using existing financial services; and that crypto assets can help the unbanked invest their money without the need for traditional intermediaries such as banks. While this claim that crypto supports financial inclusion may be true in certain instances—indeed, some crypto transactions may be cheap, much as how some traditional money transfers may be outrageously expensive—it does not necessarily hold for the entire industry.

This rhetoric is faulty on several counts. First, even though fees for money transfers and bank accounts can be high, crypto asset fees are often even higher.²¹ Crypto networks charge transaction fees, often at a steep rate, even for small transactions.²² Second, the inherently speculative nature of crypto assets is at odds with the purpose of financial inclusion. Crypto assets are still an especially risky form of investment, and as explained above, consumer protections are lax. Further, crypto assets are scarcely used for normal payments at present.²³ Third, individuals still typically require a bank account to use crypto assets. In order to purchase

¹⁸Asli Demirguc-Kunt, Leora Klapper, and Dorothe Singer, “Financial Inclusion and Inclusive Growth: A Review of Recent Empirical Evidence” (World Bank Group: 2017), available at <https://documents1.worldbank.org/curated/en/403611493134249446/pdf/WPS8040.pdf>.

¹⁹ Stein Berre, Kristian Blickle, and Rajashri Chakrabarti, “Banking the Unbanked: The Past and Future of the Free Checking Account” (Federal Reserve Bank of New York: 2021) <https://libertystreeteconomics.newyorkfed.org/2021/06/banking-the-unbanked-the-past-and-future-of-the-free-checking-account/>.

²⁰ Catalini, Christian and Lilley, “Andrew, Why is the United States Lagging Behind in Payments?” (2021), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3893937.

²¹ Alexis Leondis, “Beware PayPal’s New Fees for \$100 Crypto Trades,” February 18, 2022, available at https://www.washingtonpost.com/business/beware-paypals-new-fees-for-100-crypto-trades/2022/02/18/0593f9f2-90dd-11ec-8ddd-52136988d263_story.html.

²² Kenneth Rapoza, “Cryptocurrency Exchange Fees Are A Mess. Will They Ever Improve?,” Oct 17, 2021, available at <https://www.forbes.com/sites/kenrapoza/2021/10/17/cryptocurrency-exchange-fees-are-a-mess-when-will-they-ever-improve/?sh=71e403d52f4c>. Recent investment enterprises such as ConstitutionDAO—in which organizers crowdfunded millions of dollars in an unsuccessful effort to purchase a copy of the Constitution but then struggled to return funds to investors and accumulated high fees while doing so—have demonstrated both how quickly fees can pile up and that such fees are most likely to hurt the smallest investors. See Jacob Kastrenakes, “Almost buying a copy of the Constitution is easy, but giving the money back is hard,” The Verge, November 24, 2021, available at <https://www.theverge.com/2021/11/24/22800995/constitutiondao-refund-progress-steep-gas-fees-cryptocurrency>.

²³ Rod Garratt, Michael Lee, Antoine Martin, and Joseph Torregrossa, “The Future of Payments Is Not Stablecoins,” February 7, 2022, available at <https://libertystreeteconomics.newyorkfed.org/2022/02/the-future-of-payments-is-not-stablecoins/>.

crypto on a reputable exchange, customers must deposit funds in an online account from a debit card or bank account and when holders need to sell their crypto for cash, they usually require a bank account to deposit the cash they received.²⁴ While it is true that trading crypto assets technically only requires internet access and a device, the same can be said about having a bank account—and research has shown that lack of internet access itself increases one’s probability of being unbanked and outside the financial system.²⁵

Finally, and perhaps most importantly, crypto assets do not appear to fundamentally fix the problem that financial inclusion seeks to solve. The goal of financial inclusion is more than just easier and more accessible financial transactions; it is making sure individuals and households have better financial stability and economic well-being. Crypto assets use a new technology that can sometimes make old processes more efficient, but there’s no proof they reduce income inequality or put more money into people’s pockets.²⁶ Crypto simply offers a new way for individuals to transact and speculate with the money they already have. In fact, a recent survey by the Pew Research Center indicates that, of the U.S. adults who have invested in crypto assets, 78% say they did so as “a different way to invest” and 75% say they thought crypto investing was “a good way to make money.”²⁷ And because that survey found that 46% of Americans who have invested in cryptocurrency say it’s “done worse than expected,” compared to only 15% who say their investments have done better, encouraging people to use their hard-earned paychecks or savings to buy highly risky assets could actually harm the goals of financial inclusion.

The Existing Crypto Regulatory Regime

Crypto assets exist and trade on blockchains, a relatively new form of technology that can be used for many public and private purposes. Blockchain technology is unique in that data are shared among the nodes of computer networks and organized as irreversible chains of blocks.²⁸ But at their core, blockchains are functionally similar to traditional databases or ledgers in that their basic purpose is to store information. The novelty and innovative nature of the technology does not change the fact that assets that are stored on blockchains are the same types of assets that have always existed. Just as the evolution of stocks from physical pieces of paper to digitized certificates stored in computer depositories did not change the fundamental economic characteristics of the assets, for example, the fact that a token representing the sale of a security exists on a blockchain does not mean it should be treated any differently than traditional securities from an economic or regulatory standpoint. When traded publicly, crypto assets that

²⁴ Coinbase, “How to Buy BTC,” available at <https://www.coinbase.com/buy-bitcoin> (last accessed August 2022); “How to sell Bitcoin: 5 ways to ‘cash out’ your BTC holdings,” Coin telegraph, available at <https://cointelegraph.com/bitcoin-for-beginners/how-to-sell-bitcoin-5-ways-to-cash-out-your-btc-holdings> (last accessed August 2022).

²⁵ Nathaniel Karp and Boyd W. Nash-Stacey, “Technology, Opportunity & Access: Understanding Financial Inclusion in the U.S.” (BBVA Research: 2015), available at https://www.bbva.com/wp-content/uploads/2015/07/WP15-25_FinancialInclusion_MSA.pdf.

²⁶ Annie Nova, “Cryptocurrencies could lead to financial instability, author warns,” October 13, 2021, available at <https://www.cnn.com/2021/10/13/cryptocurrencies-could-lead-to-financial-instability-author-warns.html>.

²⁷ Michelle Favero and Navid Massarat, “46% of Americans who have invested in cryptocurrency say it’s done worse than expected,” August 23, 2022, available at <https://www.pewresearch.org/fact-tank/2022/08/23/46-of-americans-who-have-invested-in-cryptocurrency-say-its-done-worse-than-expected/>.

²⁸ Adam Hayes, “Blockchain Explained,” Investopedia, March 5, 2022, available at <https://www.investopedia.com/terms/b/blockchain.asp>.

exist on blockchains can be securities, commodities, banking products, or non-fungible tokens, subject to existing statutory provisions.²⁹

- Securities are fungible (i.e., interchangeable) and tradeable financial instruments—including stocks, bonds, notes, and other evidences of indebtedness—that are used by corporations, governments, and other entities to raise capital. Crypto assets are “crypto securities” when they meet the same legal requirements as other securities.
- Commodities are “goods sold in the market with a quality and value uniform throughout the world.”³⁰ Commodities are fungible, do not represent legal claims, and have prices that float based on supply and demand, and crypto assets that meet this categorization are “crypto commodities.”³¹
- Banking products can be functionally equivalent to securities or commodities, but when issued by a bank they may be subject to different regulatory provisions.
- Non-fungible tokens (NFTs) are unique crypto assets that can be used to represent something else, such as physical or virtual assets. Much like works of art, NFTs can be bought and sold by collectors with prices that fluctuate due to demand for NFTs with certain characteristics (e.g., location of the represented real property, identity of the issuer).³²

Statutes that Congress has enacted over many decades to protect investors and the financial system give regulators broad authority to address many of the risks posed by crypto assets, even though those risks are fairly new.³³ Like traditional financial products, some crypto assets or crypto market infrastructure may be under the jurisdiction of multiple regulators. Importantly, despite the age of these laws, they are sufficiently flexible to allow regulators to amend existing regulations or simply apply them to new situations in ways that protect investors and consumers while still permitting legitimate financial services companies to operate and grow. Below are

²⁹ Todd Phillips and Alex Thornton, “Congress Must Not Provide Statutory Carveouts for Crypto Assets,” Center for American Progress, March 1, 2022, available at <https://www.americanprogress.org/article/congress-must-not-provide-statutory-carveouts-for-crypto-assets/>.

³⁰ Mitchell Prentis, “Digital Metal: Regulating Bitcoin As A Commodity,” *Case Western Reserve Law Review* 66 (2) (2015): 609-38, available at <https://core.ac.uk/download/pdf/214103464.pdf>.

³¹ *In the Matter of Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan*, CFTC Docket No. 15-29 (September 17, 2015), available at <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinfliprorder09172015.pdf>; Commodity Futures Trading Commission, “Retail Commodity Transactions Involving Certain Digital Assets,” 85 Fed. Reg. 37734 (2020); *Commodity Futures Trading Commission v. McDonnell*, 287 F. Supp. 3d 213, (E.D.N.Y. 2018); *Commodity Futures Trading Commission v. My Big Coin Pay, et al.*, 334 F. Supp. 3d 492, (D. Ma. 2018).

³² Elizabeth Howcroft, “NFT sales hit \$25 billion in 2021, but growth shows signs of slowing,” Reuters, January 11, 2022, available at <https://www.reuters.com/markets/europe/nft-sales-hit-25-billion-2021-growth-shows-signs-slowing-2022-01-10/>. Importantly, ownership of an NFT may, but does not necessarily, grant the holder legal rights over the unique asset represented by the NFT; there have been instances of issuers creating and selling NFTs of assets to which the issuer has no legal rights, or creators maintaining intellectual property ownership of images backing NFTs. Sarah Kearns, “A Group of Anonymous Creators Is Selling NFTs of Olive Garden Locations,” HypeBeast, December 24, 2021, available at <https://hypebeast.com/2021/12/olive-garden-franchise-restaurants-nft>.

³³ See generally Todd Phillips and Alex Thornton, “Congress Must Not Provide Statutory Carveouts for Crypto Assets.”

descriptions of some authorities that financial regulators maintain over crypto assets. Other laws, such as criminal statutes, may also apply. Appendix A provides the below information as a chart.

Securities and Exchange Commission

The Securities Act of 1933, the Securities Exchange Act of 1934, and regulations thereunder require the issuer of a security—including a crypto security—to register the security with the Securities and Exchange Commission (SEC) and issue a prospectus before marketing and selling the security to the general public³⁴ and file quarterly, annual, and other disclosure reports.³⁵ These filings provide important information to investors, including the terms governing the security,³⁶ finances and governance of the issuer,³⁷ and how the issuer intends to use the proceeds.³⁸ These laws also ensure that all market participants have the same information about crypto securities, and prohibit insider trading.

Consistently applying the federal securities laws to crypto securities would address many of the largest abuses. At minimum, registration requirements would provide two significant benefits to the crypto markets. First, if a crypto security is unregistered, and no exemption is claimed, investors or investment advisers can know that it is likely a scam. Second, unregistered crypto securities cannot be traded on registered exchanges, limiting the reach of that scam.

The SEC also has broad authority over those who assist in the buying and selling, as well as custody, of securities. Some companies provide custody services for crypto assets, either holding clients' wallets or holding clients' crypto assets directly in the companies' own wallets. Depending on the roles they play, wallet providers could be regulated as securities brokers, which are required to register with the SEC and become a member of a national securities association (e.g., FINRA).³⁹ Brokers are also limited in how they may use clients' securities in short sales or other hypothecation activities, and have capital requirements to protect investors' assets.⁴⁰ Further, brokers are also prohibited from engaging in manipulative, deceptive, or otherwise fraudulent activities, again protecting investors against abuses.⁴¹ Brokers are also regulated by Securities Investor Protection Corporation (SIPC), which protects client assets.⁴² Lastly, the SEC requires brokers to maintain protections against cybersecurity incidents.

The SEC could also regulate wallet providers as clearing agencies, which act as intermediaries in the buying and selling of securities, helping ensure settlement or reduce the number of settlement transactions by holding securities in custody for clients.⁴³ Traditionally, securities clearing agencies take the form of the DTCC, a private company that holds securities in trust and permits transactions to occur on its proprietary ledger, easing market transactions (it cleared \$1.6

³⁴ 15 U.S.C. § 77e.

³⁵ 15 U.S.C. § 78m.

³⁶ 17 C.F.R. § 229.202.

³⁷ 17 C.F.R. Subpart 229.300.

³⁸ 17 C.F.R. § 229.504.

³⁹ 15 U.S.C. § 78o.

⁴⁰ 17 C.F.R. § 240.15c2-1.

⁴¹ FINRA, "2020. Use of Manipulative, Deceptive or Other Fraudulent Devices," available at <https://www.finra.org/rules-guidance/rulebooks/finra-rules/2020> (last accessed January 2022).

⁴² 15 U.S.C. § 78ccc.

⁴³ 15 U.S.C. § 78c.

quadrillion in transactions in 2014).⁴⁴ Requiring wallet providers to register as clearing agencies would help safeguard clients' securities by allowing the SEC to impose regulations on providers and prohibit providers from providing services to prior bad actors, among other restrictions.⁴⁵

Crypto securities often trade on exchanges and venues that are similar to securities exchanges, alternative trading systems (ATS), and broker-dealer internalizers. Any entity that “constitutes, maintains, or provides a marketplace or facilities for bringing together purchasers and sellers of securities” is required to register with the SEC or qualify for an exemption.⁴⁶ SEC oversight of crypto securities trading venues would enable the SEC to ensure that those venues have rules and procedures to “prevent fraudulent and manipulative acts and practices,” “promote just and equitable principles of trade,” and prohibit “unfair discrimination” in trading.⁴⁷ Further, applying oversight to crypto securities trading venues also entails the imposition of listing standards, which may include prohibiting venues from listing crypto securities that fail to meet certain income, liquidity, or other thresholds so that investors know that they are investing in reputable securities.⁴⁸ The SEC could also impose business continuity standards so that crypto exchanges remain accessible to traders in times of market volatility or natural disasters, and against cybersecurity incidents.

Commodity Futures Trading Commission

The Commodity Exchange Act provides that it is illegal to manipulate or provide false or misleading information regarding the markets for commodity and commodity derivative contracts, and that the Commodity Futures Trading Commission (CFTC) has authority to write rules clarifying what types of activities are manipulative.⁴⁹ Applying these prohibitions to the market for crypto commodities would protect traders, as the CFTC could sue for market manipulation like churning, wash trading, spoofing, and other manipulative acts and practices. The prohibitions on fraud and manipulation apply not only to traders transacting in commodities, but the market infrastructure surrounding those transactions, including crypto commodity issuers, wallet providers, and exchanges. The CFTC can enforce the fraud prohibition on wallet providers that fail to provide custody protections offered, and on crypto commodity exchanges that promise traders specific protections against manipulation on their platforms but fail to deliver.

The CFTC also regulates the market for commodity derivatives, which are financial instruments with a value based on the value of something else; for example, a future is a contract between two parties to sell a commodity at a certain date in the future for a price determined today. The CFTC has full regulatory authority over exchanges that facilitate the trading of commodity derivatives, including derivatives of crypto commodities. Under the Commodity Exchange Act, there are two types of exchanges—designated contract markets (DCMs) and swap execution

⁴⁴ Jonathan Shapiro, “Quadrillion dollar corporation at the heart of the financial system,” *Financial Review*, July 7, 2015, available at <https://www.afr.com/companies/financial-services/quadrillion-dollar-corporation-at-the-heart-of-the-financial-system-20150707-gi6w7b>.

⁴⁵ 15 U.S.C. § 78q-1.

⁴⁶ 15 U.S.C. §§ 78c, 78f.

⁴⁷ 15 U.S.C. § 78f.

⁴⁸ *Ibid.*

⁴⁹ 7 U.S.C. § 9.

facilities (SEFs)—that execute or trade commodity derivatives contracts, and they must register with the CFTC.⁵⁰ Requiring registration of exchanges that facilitate transactions in derivatives of crypto commodities would require the exchanges to “establish and enforce ... rules that will deter abuses,” to limit trading of only those swaps “not readily susceptible to manipulation,” and address conflicts of interest, among other requirements.⁵¹ It would also require exchanges to have a chief compliance officer and allow the CFTC to write extensive regulations ensuring that investors are protected.⁵²

The Gap in Existing Regulation

The most prominent gap in the regulation of crypto assets is in the crypto commodity spot markets (that is the sale of an item for immediate delivery, or “on the spot”). Although the CFTC may enforce prohibitions against fraud and market manipulation, Congress has not previously granted agencies regulatory authority in these areas; previously, corporations such as grain elevators served as commodity exchanges and federal regulation was largely unnecessary. Today, however, regulations governing crypto commodity spot markets would be beneficial. For example, with spot exchange registration requirements, regulators could easily shut down unregistered spot brokers and exchanges that may be harming their clients; failure to register or false statements on registration documents are easier to prove than fraud, market manipulation, or unfair practices. Spot exchange regulations would also enable regulators to require exchanges to actively prevent fraud and market manipulation, as the SEC requires of securities exchanges, and regulatory authority would give the CFTC easy access to the quote and trade data that allows them to identify market manipulation more easily.

Security or a Commodity?

One of the biggest questions in crypto today is whether any particular fungible token is a security or a commodity, and significant legal implications turn on the determination. Traditionally, securities are issued by companies, municipalities, non-profits, or individuals to raise capital to develop products and provide holders with legal rights vis-à-vis the issuers (e.g., voting rights, dividends). Unlike securities, commodities like gold or corn have no central issuer and generally do not provide owners with legal rights.

One classic problem in financial markets is information asymmetry: the sellers of financial products may have access to material information affecting the value of an investment of which the buyer is not aware. Congress attempted to mitigate this problem with the passage of the Securities Act and Securities Exchange Act in 1933 and 1934, the core of which involve requiring entities issuing and trading securities to provide detailed disclosures of information about their business practices.⁵³ Such disclosures are critical to well-functioning markets because they allow investors to make informed judgments about how to best allocate their capital based on expected risks and rewards.

⁵⁰ 7 U.S.C. §§ 1a, 7, 7b–3.

⁵¹ 7 U.S.C. § 7b–3.

⁵² Ibid.

⁵³ Congressional Research Service, “Federal Securities Laws: An Overview,” (Washington: 2020), available at <https://crsreports.congress.gov/product/pdf/IF/IF11422>.

To determine whether the sale of an asset constitutes a security, courts use two different tests. The test most applicable to the sale of crypto assets is the Howey Test, under which a contract is an “investment contract,” and therefore a security, if there is (1) an investment; (2) in a common enterprise; (3) with a reasonable expectation of profits; (4) to be derived from the entrepreneurial or managerial efforts of others.⁵⁴ This four-part test was crafted to appropriately include within the scope of the securities laws those financial instruments for which investors would benefit from the laws’ applications and exclude those for which investors would not. Investors in instruments largely reliant on product developers or centralized promoters to create profit need information about how those profits will be or are being created. However, investors in contracts that do not meet the Howey Test are unlikely to need protection from the securities laws; investors do not need securities-specific disclosures if there is no investment, no expectation of profit, no central promoter, or if they themselves are central to an enterprise’s profitmaking activities.

Although whether or not a particular crypto token is a security under the Howey Test is a facts-and-circumstances determination, prior case law indicates that many crypto assets are likely to be deemed securities by courts; the application of the securities laws to sales of crypto assets would benefit investors, as investors would be served by knowing who is developing the product, how investments are being used, what the product will look like, and what the investment risks are.⁵⁵

For example, even when an issuer sells crypto assets that do not grant the token holder voting rights or claims to coupon or dividend payments like holders of stocks and bonds, Securities Act disclosures provide investors in the initial sale with information that will help them understand whether their tokens can be resold for a profit.⁵⁶ When an issuer airdrops/gifts crypto tokens to provide secondary market liquidity that allows the issuer to raise capital in secondary market offerings, the Securities Exchange Act’s disclosures may help new investors understand issuers’

⁵⁴ See *Securities and Exchange Commission v. Life Partners, Inc.*, 87 F. 3d 536, (D.C. Cir. 1996). See also *Securities and Exchange Commission v. Howey Co.*, 328 U.S. 293 (1946). Under the second test, the *Reves* Test, a “note” is presumed to be a security, but that presumption may be rebutted if the note bears a “family resemblance” to other assets that are not securities. Courts look at 1) whether the issuer is raising capital for business purposes and the purchaser “is interested primarily in the profit;” 2) whether the instrument is distributed in a manner similar to other securities; 3) whether the public reasonably expects the securities laws to apply; and 4) whether another regulatory scheme applies, such as the banking laws. See *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

⁵⁵ Legal decisions have rebuffed attempts to evade the securities laws with creative structuring, and this flexibility is important given the myriad ways crypto assets have been issued. For example, the “investment” prong of the Howey Test applies to cash, “goods and services,” and any other “exchange of value,” including, for example, gift recipients selling their securities and making a market. *Teamsters v. Daniel*, 439 US 551 (1979); *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989); *SEC v. Sierra Brokerage Services Inc.*, 608 F. Supp. 2d 923 (S.D. Oh. 2009). The “expectation of profit” prong merely requires some expectation of financial return from either the issuer or by selling in the secondary market, rather than of “a commodity for personal consumption.” *Gary Plastic v. Merrill Lynch*, 756 F.2d 230 (2d Cir. 1985); *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975). And the “derived from the efforts of others” prong refers to instances in which a promoter makes managerial decisions even though investors may be “required to perform some duties, as long as they are nominal or limited.” *Lino v. City Investing Co.*, 487 F. 2d 689 (3d Cir. 1973).

⁵⁶ Securities and Exchange Commission, “Spotlight on Initial Coin Offerings (ICOs),” available at <https://www.sec.gov/ICO> (last accessed January 2022).

ongoing activities.⁵⁷ And although many crypto projects are open source (e.g., anyone may suggest edits to an application’s code and holders of “governance tokens” may vote on whether those edits are adopted) there may be instances in which a primary developer or central promoter remains sufficiently in control of the application’s development. In such cases, investors deserve to know that primary developer or central promoter’s future plans.

For these reasons, it is reasonable to expect the courts to deem many tokens issued by so-called decentralized finance (“DeFi”) apps (Dapps) or decentralized autonomous organizations (DAOs) to be securities. Although many Dapp and DAO token promoters claim that they are decentralized, in reality, Dapps and DAOs have characteristics akin to traditional corporations: Single developers or managers are often actively involved in the administration of a given project and many tokens have characteristics akin to traditional stocks such as giving holders the ability to vote on governance proposals and permitting profit-sharing arrangements akin to dividends.⁵⁸ This type of structure can be susceptible to manipulation and attacks, such as a recent instance involving the DeFi project Beanstalk Farms, in which an attacker used a DeFi product called a flash loan to borrow crypto for a short period of time in order to quickly gain possession of a majority of Beanstalk governance tokens and vote through a governance proposal giving itself over \$180 million worth of crypto.⁵⁹ However, if Beanstalk Farms had been registered with the SEC and the securities laws were applied, it is possible the manipulation and attacks could have been mitigated in part because investors would have access to greater information about the project and investment risks, as well as investor protections and SEC oversight of flash loan platforms.

Benefits of the Digital Commodities Consumer Protection Act

Although I expect many crypto assets would be deemed securities under the Howey Test, courts may decide that some or all Dapp and DAO tokens are not securities following facts-and-circumstances examinations of their issuance and governance. For example, courts could determine that a Dapp’s governance is sufficiently distributed such that investors would not be served by the application of the securities laws. If courts were to make such determinations, federal regulators would be quite limited under current law in their ability to regulate these assets. Further, there are some crypto assets, such as bitcoin, where there is broad consensus that they are not securities, including by SEC Chair Gensler.⁶⁰ Today, bitcoin accounts for nearly 40% of the crypto market by volume, and the United States lacks a regulatory regime for it.

⁵⁷ See, e.g., Securities and Exchange Commission, “SEC Bars Perpetrator of Initial Coin Offering Fraud,” Press release, August 14, 2018, available at <https://www.sec.gov/news/press-release/2018-152>; William Hinman, “Digital Asset Transactions: When Howey Met Gary (Plastic),” June 14, 2018, available at <https://www.sec.gov/news/speech/speech-hinman-061418>.

⁵⁸ See, e.g., Yennie Geller, “The Basics of The Uniswap Token and Its Platform,” Change Now, November 18, 2020, available at <https://changenow.io/blog/the-basics-of-the-uniswap-token-and-its-platform>.

⁵⁹ Corin Faife, “Beanstalk cryptocurrency project robbed after hacker votes to send itself \$182 million,” The Verge, April 18, 2022, available at <https://www.theverge.com/2022/4/18/23030754/beanstalk-cryptocurrency-hack-182-million-dao-voting>.

⁶⁰ See, e.g., Kevin Helms, “SEC Chair Gensler Affirms Bitcoin Is a Commodity — ‘That’s the Only One I’m Going to Say,’” Bitcoin.com, June 27, 2022, available at <https://news.bitcoin.com/sec-chair-gensler-bitcoin-is-a-commodity/>.

Oversight of the market for bitcoin and any other crypto commodities is limited to the CFTC's anti-fraud and -manipulation authorities.

This gap in federal law wherein no regulator has full legal authority to oversee the commodity spot markets harms investors and the credibility of the markets themselves. Crypto commodity investors deserve better.

I support the Digital Commodities Consumer Protection Act (DCCPA) because it would appropriately fill in that gap by providing the CFTC with the desperately needed authority to oversee these markets without affecting other regulators' jurisdiction and legal authorities. Below are explanations of some of the most important provisions of the bill.

Retains SEC Authority Over Crypto Securities

While the DCCPA would grant the CFTC regulatory authority over digital commodities,⁶¹ the bill would exclude from the definition of "digital commodity" anything that is a "security."⁶² Accordingly, the securities laws would appropriately continue applying to crypto assets identified by the courts as securities.

Implements Appropriate Customer Protections

The DCCPA would implement appropriate consumer protections for assets subject to the bill's provisions.

Because it is easier for retail traders to buy and sell assets that are listed on platforms than to trade bilaterally, the securities laws have long provided the SEC with the authority to limit which assets exchanges list to those appropriate for retail investors.⁶³ One of the biggest improvements made by the DCCPA would be that the CFTC could prohibit trading platforms (i.e., trading facilities, brokers, dealers, custodians) from listing any crypto assets that are "readily subject to manipulation," protecting the customers that may decide to invest in those assets.⁶⁴ Specifically, the DCCPA would permit the CFTC to limit the listing of crypto assets to those in which "the operating structure and system of the digital commodity is secure from cybersecurity threats, including the possibility of material alterations by persons acting collectively" and "the functionality of the digital commodity will protect holders from operational failures," among other restrictions. This would help address, for example, problem that Beanstalk Farms assets were siphoned off following a change in governance by a single bad actor.

The DCCPA would also ensure crypto commodity investors receive consolidated disclosures. Whereas investors in securities have ready access to a variety of written disclosures (e.g., S-1s, 10-Ks, 10-Qs), investors in crypto commodities currently lack any such disclosures; instead, they are largely limited to scouring projects' discord servers for project updates. To address the lack of consolidated disclosures, the DCCPA would require crypto commodity platforms to disclose

⁶¹ Digital Commodity Consumer Protection Act, S. 4760, 117th Cong. § 4 (2022) (henceforth "DCCPA"), proposed Commodity Exchange Act (CEA) section 2(c)(2)(F).

⁶² DCCPA § 4, proposed CEA section 1a(18).

⁶³ See U.S. Securities and Exchange Commission, "Listing Standards," available at <https://www.sec.gov/education/smallbusiness/goingpublic/listingstandards> (last accessed August 2022).

⁶⁴ DCCPA § 4, proposed CEA section 5i(d)(5)(B).

to customers “conspicuous” and “plain language” information about “the operating structure and system of” listed crypto commodities,⁶⁵ as well as about “the material risks and characteristics of any applicable digital commodity contracts.”⁶⁶ This information will better enable crypto commodity investors to understand the risks and opportunities of their investments. Having this information in one central location is even more helpful.

Further protecting investors is the DCCPA’s broad prohibitions on fraud, deceit, and manipulation. The bill would prohibit all platforms from “engag[ing] in any act, practice, or course of business ... that is fraudulent, deceptive, or manipulative.”⁶⁷ In addition, trading facilities would be required to ensure “a competitive, open, and efficient market ... that protects the price discovery process,” to “protect markets and market participants from abusive practices” on their platforms, and to “monitor trading in digital commodities to prevent manipulation, price distortion, and disruptions of the delivery or settlement process;”⁶⁸ and brokers and dealers would only be permitted to “trade, or arrange a trade, in a in a contract for a digital commodity that is not readily susceptible to manipulation,”⁶⁹ and would be required to conform with “business conduct standards... relating to fraud, manipulation, and other abusive practices.”⁷⁰ All of these provisions would ensure that crypto commodity markets are fair and equitable and that retail investors may make decisions based on truthful information.

Currently, some crypto platforms trade against their clients⁷¹ or engage in what is effectively insider trading,⁷² and there is little regulators can do to stop it so long as these practices are disclosed in the platforms’ fine print. These types of activities are explicitly prohibited by the securities laws, as they are contrary to the concept of fair dealing.⁷³ The DCCPA would address crypto commodity platforms’ conflicts of interest by requiring the CFTC to “establish structural and institutional safeguards ... to minimize conflicts of interest that might potentially bias the judgment or supervision of a digital commodity platform and contravene the core principles of fair and equitable trading ... including conflicts arising out of transactions or arrangements with affiliates.”⁷⁴ Among other things, the DCCPA would also permit the CFTC to require “information partitions and the legal separation of different categories of digital commodity platforms” so that these activities cannot occur.⁷⁵ Brokers and dealers would also be required to “establish prices fairly and objectively,” “disclose the basis for those prices,” and “shall not

⁶⁵ DCCPA § 4, proposed CEA section 5i(d)(8).

⁶⁶ DCCPA § 4, proposed CEA section 5i(f)(1)(A).

⁶⁷ DCCPA § 4, proposed CEA section 5i(h).

⁶⁸ DCCPA § 4, proposed CEA section 5i(b)(2)(C).

⁶⁹ DCCPA § 4, proposed CEA section 5i(e).

⁷⁰ DCCPA § 4, proposed CEA section 5i(b)(3)(C).

⁷¹ See Brian Evans, “SEC chief Gary Gensler says crypto exchanges are 'market making against their customers',” May 11, 2022, available at <https://markets.businessinsider.com/news/currencies/crypto-exchanges-market-making-against-customers-sec-gary-gensler-2022-5?op=1>

⁷² See, e.g., Kate Irwin, “Coinbase Has a Serious Insider Trading Problem, Study Claims,” August 17, 2022, available at <https://decrypt.co/107671/coinbase-insider-trading-problem-study>

⁷³ See, e.g., “Obligations to Your Customers,” Financial Industry Regulatory Authority, available at <https://www.finra.org/registration-exams-ce/manage-your-career/obligations-your-customers> (last accessed August 2022)

⁷⁴ DCCPA § 4, proposed CEA section 5i(b)(4)(C).

⁷⁵ Ibid.

disrupt market functioning or hinder the price discovery process.”⁷⁶ Further, the bill would also require the CFTC to adopt “standards governing digital commodity platform marketing and advertising, including testimonials and endorsements” to avoid misleading advertisements like those that occurred during the “Crypto Bowl.”⁷⁷

Finally, the DCCPA would protect investors by requiring platforms to hold customer assets “in a manner that minimizes the risk of loss of, or unreasonable delay in access to, the customer property,” including segregating funds and prohibiting the comingling with the property of the platform.⁷⁸ Further, just as the securities laws permit of the SEC,⁷⁹ the DCCPA would permit the CFTC to regulate or even prohibit platforms to rehypothecate (i.e., lend out) client crypto commodities.⁸⁰ And to address issues being faced today with the bankruptcy of crypto lending platforms like Celsius, the DCCPA would update the bankruptcy code to provide that crypto commodities held by platforms are assets of the platforms’ clients.⁸¹

Provides for Effective Federal Oversight of Crypto Commodity Platforms

Unlike some other bills that have been introduced this Congress,⁸² the DCCPA would require the mandatory registration, oversight, and inspection of crypto commodity platforms.⁸³ The importance of this oversight cannot be overstated. Most importantly, permitting platforms to avoid registration would simply lead to a race to the bottom; if one platform gains a competitive advantage by not registering, it is likely that others will decide not to register either, causing a deterioration of customer protections.

Further, in order to effectively enforce prohibitions on fraud and market manipulation, regulators must have ready access to pre- and post-trade data from platforms, allowing regulators to more easily identify spoofers, inside traders, and other market manipulators.⁸⁴ Yet today, the CFTC’s lack of detailed information about transactions on crypto platforms inhibits its ability to enforce its existing anti-fraud and -manipulation authority over crypto commodities. Importantly, while many crypto asset transactions occur on blockchains, transactions facilitated by crypto exchanges occur on the exchanges’ own ledgers. A recent investigation “of 157 crypto exchanges” using data reported to research firms “finds that 51% of the daily bitcoin trading volume being reported is likely bogus,” resulting from wash trades and other market manipulation.⁸⁵ However, because

⁷⁶ DCCPA § 4, proposed CEA section 5i(b)(3)(A).

⁷⁷ DCCPA § 4, proposed CEA section 5i(f)(3); *see generally* Tiffany Hsu, “Prepare Yourself for This Weekend’s ‘Crypto Bowl’,” *New York Times*, February 11, 2022, available at <https://www.nytimes.com/2022/02/11/business/media/super-bowl-commercials.html>.

⁷⁸ DCCPA § 4, proposed CEA section 5i(b)(4)(H).

⁷⁹ 15 U.S.C. § 78h.

⁸⁰ DCCPA § 4, proposed CEA section 5i(b)(4)(H)(iii)(III)(aa).

⁸¹ DCCPA § 5(i).

⁸² *See, e.g.*, Digital Commodity Exchange Act, H.R. 7614, 117th Cong. (2021).

⁸³ DCCPA § 4, proposed CEA section 5i(a)(1).

⁸⁴ CFTC, Division of Enforcement Annual Report FY 2020 at page 10, available at <https://www.cftc.gov/PressRoom/PressReleases/8323-20>.

⁸⁵ Javier Paz, “More Than Half Of All Bitcoin Trades Are Fake,” *Forbes*, August 26, 2022, available at <https://www.forbes.com/sites/javierpaz/2022/08/26/more-than-half-of-all-bitcoin-trades-are-fake/>.

the CFTC does not have access to the trade data, it is difficult if not impossible to effectively enforce the market manipulation prohibitions currently applicable to bitcoin.

The DCCPA would address this lack of information by requiring all crypto commodity platforms to engage in extensive recordkeeping and provide that information to the CFTC upon request.⁸⁶ Specifically, trading facilities would be explicitly required to “capture information that may be used in establishing whether rule violations have occurred,”⁸⁷ and brokers and dealers would be required to “keep full, complete, and systematic records (including all pertinent data and memoranda) of all transactions relating to its business of dealing or brokerage in digital commodity transactions,” as well as “all oral and written communications provided or received concerning quotes, solicitations, bids, offers, instructions, trading, and prices.”⁸⁸ Brokers and dealers would also be required to become members of a self-regulatory organization, which would impose additional oversight of these entities.⁸⁹

Importantly, the definitions of digital commodity broker, dealer, and trading facility in the DCCPA are sufficiently broad as to cover defi trading platforms, not just centralized platforms.

In addition, the DCCPA would permit trading platforms to list both crypto securities and crypto commodities, allowing traders to buy and sell all crypto assets on a single platform, so long as the platform is dual-registered with the SEC as a securities exchange, broker, or dealer.⁹⁰ In this sense, the DCCPA would allow the crypto commodity and security markets to continue developing as a singular entity but would not permit issuers to choose their regulator.

Prevents Systemic Risks

As crypto markets continue developing, they have the potential to become highly integrated into traditional financial markets. The DCCPA contains several provisions that would help ensure that crypto markets do not become a systemic risk. Specifically, the DCCPA would provide the CFTC with the explicit authority to “make, promulgate, and enforce such rules governing margined, leveraged, or financed digital commodity trades.”⁹¹ Congress granted regulators similar authority over the trading of securities on margin following the Great Depression to ensure that overly-leveraged trading does not again cause the securities markets to fail, which also applies to crypto securities,⁹² and it is important that crypto commodities be covered by similar provisions. Further, the DCCPA requires crypto commodity trading facilities to “provide for the exercise of emergency authority” by the facility or CFTC when markets go haywire, “including the authority to liquidate or transfer open positions in any digital commodity or to suspend or curtail trading in a digital commodity.”⁹³ This provision is extremely important; in a market event where crypto prices drop precipitously, platforms’ automated systems could close

⁸⁶ DCCPA § 4, proposed CEA section 5i(b)(4)(A).

⁸⁷ DCCPA § 4, proposed CEA section 5i(b)(2)(A).

⁸⁸ DCCPA § 4, proposed CEA section 5i(b)(3)(B).

⁸⁹ DCCPA § 4, proposed CEA section 5i(i).

⁹⁰ DCCPA § 4, proposed CEA section 5i(j).

⁹¹ DCCPA § 4, proposed CEA section 5i(c).

⁹² 15 U.S.C. § 78g.

⁹³ DCCPA § 4, proposed CEA section 5i(b)(2)(F).

traders' positions and cause a cascading effect, whereas halting trading could bring stability to the markets.

Addresses Climate Change and Financial Inclusion

As noted above, two significant concerns about crypto assets are their implications for climate change and financial inclusion. Importantly, the DCCPA works towards addressing these worries. Regarding climate change, the bill requires the CFTC and other federal agencies to “examine ... the energy consumption and sources of energy used in connection with the creation and transfer of the most widely traded digital commodities” and publish “an estimate of the energy consumption and sources of energy used in connection with the creation and transfer of” those assets.⁹⁴ With the disclosure of this information, traders would be able to understand how energy efficient a crypto asset is and whether added costs due to using energy-intensive blockchains could reduce potential investment returns, thereby yielding better capital allocation in the market.⁹⁵ As a result of such disclosures, token issuers may be incentivized to migrate to more energy efficient blockchains and miners and stakers may be incentivized to utilize cleaner electricity as investors migrate their capital following the environmental impacts of their investments.

Regarding financial inclusion, the DCCPA would require the CFTC to study the participation of historically underserved communities in crypto markets. Specifically, the CFTC would be required to “examine the racial, ethnic, and gender demographics of customers participating in digital commodity markets” and issue a report “describing how those demographics will inform the rules and regulations of the Commission relating to customer protection” and how the CFTC “can provide outreach to historically underserved customers” and “provide [for] appropriate protection, outreach, or other similar activities relating to historically underserved customers participating in digital commodity markets.”⁹⁶ This study is important. There are deep concerns about whether crypto assets and blockchain technology will truly lead to financial inclusion; as Black, Hispanic, and Asian Americans are more likely to have invested in crypto assets than White Americans, they are likely to have been harmed by the recent crypto downturn.⁹⁷ While other regulators examine the potential for crypto to be used in payments or banking, it is important that the CFTC evaluates racial, ethnic, and gender differences in crypto investing and applies those lessons to its rulemakings.

Additional Important Provisions

The DCCPA contains three additional, positive provisions that warrant mentioning.

First, the bill would permit the CFTC to collect fees from crypto commodity platforms registrants “used to recover the annual costs of” regulating the crypto commodity markets.⁹⁸

⁹⁴ DCCPA § 4, proposed CEA section 5i(g).

⁹⁵ Todd Phillips, “The SEC’s Regulatory Role in the Digital Asset Markets” (Washington: Center for American Progress, 2021), available at <https://www.americanprogress.org/article/secs-regulatory-role-digital-asset-markets/>.

⁹⁶ DCCPA § 7.

⁹⁷ Michelle Faverio and Navid Massarat, “46% of Americans who have invested in cryptocurrency say it’s done worse than expected,” August 23, 2022, available at <https://www.pewresearch.org/fact-tank/2022/08/23/46-of-americans-who-have-invested-in-cryptocurrency-say-its-done-worse-than-expected/>.

⁹⁸ DCCPA § 4, proposed CEA section 5i(k).

Although these user fees would be used to offset congressional appropriations, rather than supplementing or replacing those appropriations as is preferable, these offsetting user fees may encourage Congress to raise the CFTC’s total appropriations to a more effective level.

Second, the bill would preempt State money transmission, virtual currency, and commodity broker registration requirements. This provision is appropriately limited, and explicitly does “not affect the applicability of State antifraud laws.”⁹⁹

Lastly, the DCCPA would require all digital commodity platforms to comply with federal anti-money laundering (AML) laws.¹⁰⁰ These entities are already largely required to comply with AML laws, but the bill would make this requirement explicit.¹⁰¹

Recommended Amendments

Following public release of the DCCPA, several provisions have been identified for which the Committee may wish to consider amendment.

First, the DCCPA’s definition of “digital commodity” explicitly provides that the crypto asset Ether is a commodity. Sometime this year, the Ethereum blockchain will be undergoing changes to make it more energy efficient, and there is debate within academia and the crypto industry about whether this change will make Ether a security under the Howey Test.¹⁰² The Committee may wish to consider removing reference to specific crypto assets from its definition.

Second, there is some concern that the listing of a digital asset on a digital commodity platform may result in a legal presumption that the asset meets the definition of digital commodity under the DCCPA. This is especially a concern given that the DCCPA appropriately does not limit digital commodity platforms from listing only digital commodities; in fact, it expects dual registration as a securities platform and the listing of securities.¹⁰³ The Committee may wish to clarify that the listing of a digital asset on a digital commodity platform does not provide a presumption that the asset is a commodity. A similar change could be made to provide that the fact that the CFTC has not stayed a listing does not imply that the CFTC considers that asset to be a digital commodity under the DCCPA.

Third, the DCCPA’s definition of “digital commodity” is limited to those assets that can be “transferred person-to-person without necessary reliance on an intermediary.”¹⁰⁴ The implication of this prong is that crypto miners and stakers—upon which crypto transactions rely—are not intermediaries. However, these entities may be considered intermediaries as they may have the

⁹⁹ DCCPA § 4, proposed CEA section 5i(n).

¹⁰⁰ DCCPA § 5(g).

¹⁰¹ Financial Crime Enforcement Network, “Application of FinCEN’s Regulations to Certain Business Models Involving Convertible Virtual Currencies,” May 9, 2019, available at <https://www.fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf>.

¹⁰² Frederick Munawa, “What’s at Stake: Will the Merge Turn Ether Into a Security?,” CoinDesk, August 10, 2022, available at <https://www.coindesk.com/tech/2022/08/10/whats-at-stake-will-the-merge-turn-ether-into-a-security/>.

¹⁰³ DCCPA § 4, proposed CEA section 5i(j).

¹⁰⁴ DCCPA § 2(a)(7), proposed CEA section 1a(18).

capacity to rearrange the order in which crypto transactions are validated.¹⁰⁵ The Committee may wish to consider adding a prong to the definition of “digital commodity” that explicitly includes that assets that are “transferred on a blockchain or similar technology.”

Fourth, the DCCPA as written would potentially remove the SEC’s jurisdiction over some transactions that include securities as the bill would provide the CFTC with exclusive jurisdiction over agreements, contracts, or transactions involving digital commodities.¹⁰⁶ This exclusive jurisdiction language could, for example, strip the SEC of concurrent jurisdiction over transactions for which crypto commodities are exchanged for securities, including crypto securities. Accordingly, the Committee may wish to consider amending the proposed section 1a(c)(2)(F)(i) to read something like “shall have exclusive jurisdiction over, any account, agreement, contract, or transaction involving a digital commodity trade, except in instances where such an account, agreement, contract, or transaction involves trading a digital commodity for a security in which the Securities and Exchange Commission may have concurrent jurisdiction under the securities laws.” The Committee may also wish to include language in the DCCPA providing that “Before commencing any rulemaking or issuing an order regarding an agreement, contract, or transaction involving both a digital commodity and a security, the Commodity Futures Trading Commission shall consult and coordinate to the extent possible with the Securities and Exchange Commission and the prudential regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible.” This language is similar to that which Congress included in Title VII of the Dodd-Frank Act.¹⁰⁷

Conclusion

In sum, the Digital Commodities Consumer Protection Act is important legislation that Congress should take up. The bill would impose significant customer protections for traders of crypto commodities; provide the Commodity Futures Trading Commission with much needed regulatory authority to oversee crypto commodity brokers, trading facilities, and other platforms; and contains provisions to help address systemic risks, crypto’s consequences for climate change, and the problems with financial inclusion. Importantly, the DCCPA would ensure that the Securities and Exchange Commission retains authority over crypto assets that are appropriately deemed securities. I encourage this Committee to approve this bipartisan bill and Congress to enact it expeditiously.

Thank you, and I am happy to answer any questions.

¹⁰⁵ See Carol Robinson, “Bitcoin Mining – How Do Miners Process Transactions Inside The Blockchain?,” CryptoAdventure, May 23, 2020, available at <https://cryptoadventure.com/bitcoin-mining-how-do-miners-process-transactions-inside-the-blockchain/>.

¹⁰⁶ See DCCPA § 3, proposed CEA section 2(c)(2)(F)(i).

¹⁰⁷ See 15 U.S.C. § 8302.

Appendix A

Regulator Authority by Crypto Asset Type				
	Crypto Security	Crypto Commodity	Non-Fungible Token	Stablecoin
Securities and Exchange Commission	Full authority			Full authority if assets invest in securities and not issued by a bank
Commodity Futures Trading Commission		Anti-Fraud Authority		Full authority if not invested and not issued by a bank
Bank Regulators		Full authority if issued by a bank	Full authority if issued by a bank	Full authority if issued by a bank
Federal Trade Commission		Authority over unfair or deceptive acts or practices in spot transactions not involving banks		
Consumer Financial Protection Bureau		Regulatory authority if a consumer financial product or if used as payments		Regulatory authority if a consumer financial product or if used as payments
Financial Stability Oversight Council	Designate systemically important issuers and market infrastructure			Designate systemically important issuers and market infrastructure