

**Minority Day Hearing on American Innovation and the Future of Digital Assets: From
Blueprint to a Functional Framework**

Before the U.S. House of Representatives Committee on Financial Services

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Prepared Statement

**Hilary J. Allen, Professor of Law
American University Washington College of Law**

Chair Hill, Ranking Member Waters, and Members of the Committee:

Thank you for inviting me to testify at today’s hearing. My name is Hilary Allen, and I am a Professor of Law at the American University Washington College of Law. I teach courses in corporate law and financial regulation, and my research focuses on financial stability regulation and financial technologies. I have authored multiple law review and popular press articles about the dangers that crypto poses for investors and our economy more broadly. I have also written a book, *Driverless Finance: Fintech’s Impact on Financial Stability*, that explores the threats that crypto and other fintech innovations pose to our financial system. Prior to entering academia, I spent seven years working in the financial services groups of prominent law firms in London, Sydney, and New York. In 2010, I worked with the Financial Crisis Inquiry Commission, which was appointed by Congress to study the causes of the financial crisis of 2007-2008.

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1. Introduction

When we hear from the crypto industry that existing regulation is incompatible with their technology, that is a misdirection. It is entirely possible for a blockchain-based technology

business to comply with existing investor protection and financial stability regulation. However, for many crypto businesses, it may be true that existing regulation is incompatible with the economics of their business model, especially if their business model depends on doing things that we have learned, over the years, tend to harm people. But we have little to lose as a society from limiting the profitability of this kind of business model; unfortunately, the contemplated bill is designed to supplant existing law in order to ensure the profitability of the crypto industry.

The bill offers fewer investor protections than the existing securities laws, and was intentionally designed in this way in order to accommodate the crypto industry's current market structure. This bill will also give crypto assets a veneer of legitimacy, making it easier for fiduciaries operating pension funds and 401k plans to invest in them. Also, the deregulation facilitated by these kinds of bills can run both ways: by providing the crypto industry with "lighter touch" regulation than traditional finance, they encourage traditional financial institutions to refashion their services as crypto services in order to be able to take advantage of the lighter touch regime.

2. The relationship between innovation and the law

Technology businesses are influenced by existing laws, and by how those laws are or aren't enforced. When laws that protect the public are enforced against new tech-based businesses, that sends a signal to similar businesses to minimize their harms and fit within the four corners of those laws. If those laws aren't enforced, that works as a green light for tech businesses to move fast and break things. That green light is a kind of subsidy, one that gives tech-based businesses a competitive edge over the industries they're trying to disrupt (which *do* have to comply with existing laws). These "green light subsidies" can prop up technologies and business models that might have little to recommend them on a level legal playing field.

Unfortunately, the US Supreme Court has recently made life harder for regulators who want to apply existing rules to tech businesses. By making it easier to fire the leaders of regulatory agencies, ending long-standing deference to expert agency decision-making, and embracing doctrine that raises questions about whether an agency can tackle novel issues without express Congressional authorization, the Supreme Court has made it easier for Silicon Valley to stare down their regulators. Against this backdrop, it's concerning to see Congress considering digital assets legislation that would harden the crypto industry's challenges to existing laws into a permanent legislative permission structure. As the Consumer Financial Protection Bureau's former Chief Technologist Erie Meyer put it, "I think Americans give up a lot of power if we agree with the premise that new technology requires new rules of the road."¹

If this market structure bill were to become law, that would be tantamount to the government picking winners among businesses, allocating a subsidy (in the form of not requiring the crypto industry to play by the rules that govern the rest of the financial industry) to those who use blockchain technology at the expense of other technological rails. Picking winners in this way would be problematic even if blockchain technology had many benefits, but it is particularly concerning given the technology's insuperable inefficiencies and operational fragilities. More than 1500 independent computer scientists, software engineers, and other technologists signed on

¹ <https://www.politico.com/newsletters/digital-future-daily/2025/04/11/5-questions-for-erie-meyer-00286906>

to a letter to US Congressional leaders in 2022 that clearly stated that “[b]y its very design, blockchain technology is poorly suited for just about every purpose currently touted as a present or potential source of public benefit.”² The chief appeal of blockchain technology thus far has been as a way of avoiding regulatory oversight – using an inefficient technology that doesn’t scale very well might still seem very efficient to a business if it allows that business to justify things that would otherwise be illegal.

If Congress passes this bill, it will essentially bless the evolution of a parallel financial system beyond the boundaries of democratic accountability and oversight. Their legislative subsidy of blockchain technology will encourage adoption of a flawed technology and will distort our financial markets. If this bill is enacted, the subsidy it confers is likely to be particularly robust given the current status of the administrative state. Critical implementing rules for this legislation will be established by government agencies with decimated levels of staff, often led by political appointees with ties to the crypto industry, and any attempts to create new rules that do indeed rein in the harms of the crypto industry are unlikely to find much support from the Supreme Court.

Ultimately, regulation isn’t an obstacle to innovation; it channels innovation to reflect priorities determined through the democratic process. Right now, Congressional appropriations to fund scientific and other important technological innovations are not being distributed, so that begs the question of why blockchain innovation is being prioritized by our elected representatives at this moment. The primary use cases for crypto are speculation and funding illicit activity. If the crypto industry has socially useful capital formation benefits to offer beyond that, it should be able to demonstrate that within the existing securities laws framework that protect investors and ensure compliance with anti-money laundering requirements. Legislation exempting the crypto industry from existing regulation is being rushed through without full consideration of its many unintended consequences: like the paradigmatic butterfly flapping its wings, this bill will have ripple effects for our financial markets and our democracy. It is not something to be adopted lightly, especially because the vast majority of Americans do not view crypto as a priority.

The Federal Reserve recently reported that 2% of surveyed adults said they used cryptocurrency to make a financial transaction even once in a twelve month period.³ The St Louis Fed reported that about 4.3% of U.S. households owned any cryptocurrency in 2022.⁴ Tellingly, although the crypto industry was responsible for 44% of all corporate expenditures on the 2024 election cycle,⁵ the advertisements funded by that money did not mention crypto. The notion of the “crypto voter” is by and large a myth.

And lest you think this limited uptake is an argument in favor of making crypto more readily available, let me emphasize that crypto is not a solution to financial precarity in America. It is much more likely to make people financially worse off. Wages have been shrinking due to forces beyond workers’ control, and safety nets have been drying up. With roughly half of all Americans already living paycheck-to-paycheck, it is not surprising that many Americans have turned to gambling in search of a lifeline. Even for those who wouldn’t otherwise be tempted to

² <https://concerned.tech/>

³ <https://www.federalreserve.gov/publications/files/2024-report-economic-well-being-us-households-202505.pdf>

⁴ <https://www.stlouisfed.org/on-the-economy/2025/mar/cryptocurrency-ownership-us-households>

⁵ <https://www.citizen.org/article/big-crypto-big-spending-2024/>

gamble much, financial precarity can make risky betting seem like a rational thing to do with one's spare money (or, more dangerously, with money that's been borrowed and needs to be paid back win or lose). Some of the crypto industry's limited success with consumers so far has come from exploiting people's financial precarity by dangling hopes of winning "generational wealth." So-called bitcoin ATMs are springing up alongside payday lending and check cashing operations in lower-income US neighborhoods – these kiosks allow people to use cash to buy crypto, but almost never allow users to withdraw cash. If Congress strips even more of the social safety net away and tariffs make goods more expensive, people will grow even more vulnerable to exploitation by the crypto industry.

Gambling is a zero-sum game and the house tends to win. Technology doesn't change those odds. True investing is supposed to be for the socially useful purpose of raising capital for productive activities, where there's a possibility of a win-win outcome for both the investor and the business using the investor's capital. Because there is no productive capacity behind crypto assets, it is inevitably a zero-sum game where any profits that the crypto industry and crypto "whales" make are at smaller investors' expense. In these kinds of situations, "democratizing" is tantamount to throwing the little fish to the sharks. The only reason why most crypto assets have any value is because of the possibility that someone else might be willing to pay a higher price for it. Without any productive capacity or assets behind them, the price of crypto assets can drop to zero very quickly. Unless an everlasting supply of new money can be drawn into buying the crypto asset, then its price will start to go down whenever the larger holders cash out, potentially toppling the whole edifice. There are many things that Congress could do to address the financial precarity of the American people; expanding crypto access is not one of them.

3. The dangers of disturbing the current financial regulatory framework

The proposed market structure bill is an intensely complex piece of legislation that will, if it becomes law, upset bedrock legal structures that undergird our financial system. It is impossible to fully predict all the unintended consequences of this bill becoming law. Lawyers will certainly profit from testing and exploiting the law's loopholes, but for those who value certainty and stability in our financial markets, there are many dangers that will only be revealed with the passage of time (to be clear, there are also many obvious dangers associated with this bill, which I will discuss below). To reiterate the point made above, it is somewhat shocking that Congress is considering legislation that risks undermining the stability of our financial markets when so few Americans show any interest in crypto or its underlying blockchain technology. It is even more shocking that the bill is being moved through Congress so quickly given its intricacies and potential disruptions.

To make a provocative point, the proposed Section 4(a)(8) exemption stands out from existing securities exemptions both because of its size (an issuer can raise \$150 million from retail investors in any 12 month period, which is orders of magnitude larger than current crowdfunding offerings which are capped at \$5 million) and because it allows for general solicitations of retail investors. If the goal were simply to deregulate securities offerings and weaken investor protections, an exemption could simply stop there and avoid all this bill's complexity – there would be no need for hundreds of pages of new concepts and legislative text tying itself in knots in an attempt to establish that there's something special about securities whose ownership is recorded on the blockchain.

Blockchain provides a new kind of technological infrastructure for delivering financial services, but that technological infrastructure will not create neutral or self-executing financial markets. Blockchain-based finance needs at least as many regulatory guardrails as existing financial markets – given the track record of the crypto industry thus far, more intense regulatory scrutiny is warranted, not less. The impacts of any technology are inextricably intertwined with the people who use it, and the existence of blockchain technology does nothing to change the economic incentives of those deploying it. If the primary motivations of the people and businesses deploying blockchain technology are rent-seeking, predation, or externalization of costs, then those are harms that the law must continue to address.

We have decades, sometimes centuries, of experience with financial predation and destabilizing crises, and our existing body of financial regulation reflects hard-earned knowledge about how financial services businesses can harm people, and we should not dispense with that regulation lightly. The primary purpose of financial regulation is to protect the public from harm, not to support the profitability of the crypto industry – and the crypto industry is (at best) blind to the harm its business models are inflicting on the public.

The securities laws were created in the wake of the stock market collapse of 1929. In adopting the Securities Act of 1933, Congress outlined the kinds of harms that the legislation sought to protect against:

During the postwar decade some 50 billion of new securities were floated in the United States. Fully half or \$25,000,000,000 worth of securities floated during this period have been proved to be worthless. These cold figures spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years of effort, in these worthless securities. The flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealing that should be basic to the encouragement of investment in any enterprise.

Alluring promises of easy wealth were freely made with little or no attempt to bring to the investor's attention those facts essential to estimating the worth of any security. High pressure salesmanship rather than careful counsel was the rule in this most dangerous enterprise.⁶

These harms, outlined by Congress almost one hundred years ago, resonate today. People losing their life savings after investing in worthless assets supplied by unscrupulous dealers who did not provide any meaningful disclosure – that would sound very familiar to those who invested using centralized crypto platforms like Celsius and FTX, and using DeFi platforms like Terra/Luna. And while these are the most catastrophic crypto failures we've seen so far, losses have been widely distributed among other crypto investors as well. According to crypto researcher Molly White's *Web3 is going just great* tracker, the total amount lost to crypto industry "gifts and disasters" as of May 2025 was more than \$78 billion.

⁶ H.R. Rep. No. 85, 73d Cong., 1st Sess. 2 (1933).

Securities regulation is primarily focused on protecting investors from harm. Financial regulation also seeks to protect the stability of the financial system, which in turn protects everyone. Because the broader economy relies on the financial system for payments services, to manage risks, and to amass and allocate capital, financial system failure has significant implications for the people and businesses that make up the broader economy, as we saw in 2008. Research from the Bank for International Settlements has concluded that “while the [2022] crypto collapse may have affected individual investors, the aggregate impact on the broader system was limited.”⁷ This is good news, and it was not an inevitable outcome – if crypto *had* integrated with the traditional financial system prior to 2022, then the fallout from the failures of Terra/Luna, Celsius, FTX might not have been limited to investors. All of us would have been harmed if there had been a crypto crash-inspired financial crisis. But today, there are many efforts afoot to further the integration of crypto and traditional finance. From the approval of crypto ETPs to bills blessing stablecoins to tokenization of real world assets on crypto blockchains to authorizing 401k plans to invest in crypto, this integration makes it unlikely that we will be spared from the fallout of the next crypto crash. And so those who choose not to buy crypto themselves are increasingly vulnerable to the consequences of its volatility and vulnerabilities.

4. Other harms associated with legitimizing crypto

The market structure bill is primarily targeted at excluding crypto from existing financial regulatory regimes, but if it achieves its end goal of increasing crypto adoption, then there will be many other non-financial harms associated with crypto proliferation. I provide here just a few examples of the dangers of encouraging the evolution of a parallel blockchain-based financial system. I would add the caveat, though, that many in the crypto industry don’t use blockchain technology for their operations, preferring to use traditional databases given the blockchain’s limitations. While limited use of blockchain would ameliorate some of the concerns I raise here, it also completely undermines arguments for why this bill is necessary. Before proceeding with this bill, I would respectfully recommend that Congress gather information about the extent to which the crypto industry is actually using blockchain technology.

Privacy

When it comes to privacy, blockchain technology offers the worst of all worlds. Blockchains – and all of the transactions recorded on them – are publicly visible. Unless a crypto user takes advantage of software tools like tumblers and mixers, anyone who knows that user’s unique identifier can trace their entire transaction history, and that transaction history can sometimes reveal data about a person’s location. This is highly concerning for victims of stalkers and abusive partner violence, or for those being unjustifiably targeted by law enforcement officials. Sophisticated criminals and national states seeking to evade sanctions, however, take advantage of tumblers and mixers to disguise their transactions and avoid detection.

Crypto is also being used to fund other kinds of privacy incursions. Take Sam Altman’s “World” project, which uses a device known as “The Orb” to collect biometric data by scanning retinas. In exchange for their biometric data, people receive the crypto asset WorldCoin.

⁷ Giulio Cornelli, Sebastian Doerr, Jon Frost, and Leonardo Gambacorta, *Crypto Shocks and Retail Losses*, BIS BULLETIN No. 69, 4 (Feb. 20, 2023), available at <https://www.bis.org/publ/bisbull69.pdf>.

WorldCoin can't be used for much right now, but the vision is that ownership of WorldCoin will onboard holders into a new, blockchain-based version of the internet that will be known as Web3. Previously deployed primarily in countries with fewer legal protections, World launched in San Francisco in April 2025. People are giving up their unique biometric data for highly volatile crypto assets: priced at over \$11 in March 2024, one WorldCoin was worth less than \$1 a year later.⁸ Also like other crypto, there are reports of users permanently losing their WorldCoin through hacks and other technological snafus.

Environment

Different blockchains use different kinds of mechanism to verify transactions, but the bitcoin blockchain notably relies on something referred to as “proof-of-work” or “bitcoin mining.” Essentially, companies expend significant amounts of electricity and use highly specialized computer equipment to guess a string of numbers that will give them the right to add transactions to the bitcoin blockchain. The winning miner gets paid; the environmental costs of all the other inherently wasteful guesses are borne by all of us. Bitcoin mining uses roughly as much energy as an entire country like the Netherlands; the specialized mining computers burn out after a couple of years, also generating roughly as much hazardous electronic waste as the Netherlands.

The vast majority of Bitcoin mining was done in China, until the Chinese government kicked the mining companies out in 2021. Bitcoin mining business then took root in the United States in what the New York Times has described as “a boon for the fossil fuel industry.”⁹ Mining costs are felt most keenly by the communities located near the mining companies’ warehouses, who often see their power bills skyrocket and are tormented by noise that has been compared to having a jet engine in your backyard that never leaves.¹⁰ Republican legislatures in Arkansas, Louisiana, Montana, and Oklahoma have already passed “Right to Mine” legislation modeled on a bill prepared by the Satoshi Action Fund (a non-profit with reported links to the Koch Brothers’ fossil fuel interests and the Project 2025-authoring Heritage Foundation).¹¹ This legislation undermines local government efforts to require crypto mining companies to comply with noise and zoning ordinances, and prohibits state utilities from setting electricity rates for crypto miners that are different from other industrial rates – even though crypto mining can put severe stress on electrical grids and increase energy prices for neighboring households.

National Security

It is surprising that members of Congress are comfortable with the fact that bitcoin mining operations throughout the United States have reported links to the Chinese government.¹² It is also surprising that members of Congress are willing to accept the national security risks that would come from building a parallel financial system on flawed and fragile blockchain infrastructure.

⁸ <https://coinmarketcap.com/currencies/worldcoin-org/>

⁹ <https://www.nytimes.com/2023/04/09/business/bitcoin-mining-electricity-pollution.html>

¹⁰ <https://www.washingtonpost.com/business/interactive/2022/cryptocurrency-mine-noise-homes-nc/>

¹¹ <https://jacobin.com/2025/01/dark-money-bitcoin-reserve-lobby>

¹² <https://www.nytimes.com/2024/05/13/us/bitcoin-mine-biden-ban.html>

A blockchain is software, and software is not “set and forget:” as it interacts with other software it can decay as well as develop security vulnerabilities. Big tech platforms and traditional financial institutions employ armies of engineers to maintain their software; when it comes to important financial services infrastructure, there are internationally accepted regulations that require providers to have policies and procedures in place regarding maintenance, cybersecurity, and recovery from major disruptions. When it comes to blockchains, though, no one is in charge of or accountable for performing these kinds of functions – and there’s no guarantee that the foundations and other *ad hoc* maintainers that fill the breach will always have the best interests of blockchain users at heart. Wall Street Journal reporting has indicated that the handful of people who maintain the bitcoin blockchain software are often funded through ad hoc foundation arrangements¹³ – it is entirely possible that hostile nation states could pay these software maintainers to compromise the blockchain’s software.

Even without altering the software of blockchains, their game-theory based verification mechanisms remain vulnerable. In 2022, the cybersecurity firm Trail of Bits was engaged by the Department of Defense’s research agency DARPA to investigate just how decentralized blockchains actually were from a security perspective. With regard to the Bitcoin blockchain, they found that “the vast majority of nodes do not meaningfully contribute to the health of the network” and that “the core developers and maintainers of blockchain software are a centralized point of trust in the system, susceptible to targeted attack.”¹⁴ They concluded that, at that time, four pools of bitcoin miners working in concert could disrupt the bitcoin blockchain if they wanted to – or they could be hacked. Transaction validation on the Ethereum blockchain is also concentrated in a few hands: a 2024 report from the Federal Reserve Bank of New York found that “even though there are 156,150 block proposers, five large staking pools capture more than 50% of all the proposer revenue and blocks proposed.”¹⁵

5. Specific problems with the bill

These operational vulnerabilities can also be exploited by hackers, and there is nothing in this legislation that addresses these risks – financial market utilities in the traditional markets are governed by the internationally accepted Principles for Financial Market Infrastructure. There is no equivalent in this bill, which is a gaping omission that makes any user of blockchain-based finance more vulnerable. As mentioned earlier, legislation this complex will inevitably have unintended consequences. In particular, this bill suffers from trying to tie law too specifically to crypto technology and business models at this particular moment in time, ensuring that technological innovation could be used to arbitrage the law if enacted, quickly rendering the investor protections that *are* included in the bill obsolete. While it is not clear precisely how the inevitable arbitrage will play out, there are already clear and predictable problems associated with the bill as drafted. I provide here not an exhaustive list, but a sample of things to be concerned about.

Value derived from use of blockchain

¹³ Paul Kiernan, *Bitcoin’s Future Depends on a Handful of Mysterious Coders*, WALL ST. JOURNAL (Feb. 16, 2023).

¹⁴ <https://blog.trailofbits.com/img/wpdump/7539c81d4b8e441403714a6c53dc14d3.pdf>

¹⁵ https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr1102.pdf?sc_lang=en

This bill refers to digital commodities that have “a value that is substantially derived from the adoption, use, and functioning of the blockchain system.” To highlight the absurdity of this kind of approach, I would ask whether the “value” of a share is derived from its relationship to the databases maintained by the DTCC on which ownership is recorded? Or whether the value of a bank account is derived from the type of software a bank uses to maintain its deposit records? The answer is obviously no – no value is conferred by the type of technological plumbing used to record ownership. This is a foundational concept for the bill, and it makes no sense.

Decentralization fairy tales

The concept of decentralization is a linchpin of this bill. Both the intended new exception from the Securities Act’s registration requirements and the provisions relating to DeFi are premised on the idea that blockchain technology will be able to force economic decentralization. This is an entirely unrealistic and flawed premise. This Committee has already received testimony from Mark Hays of Americans for Financial Reform on the concentrations of economic control in nominally decentralized finance,¹⁶ and so I offer just one illustration here. Uniswap is a nominally decentralized exchange, controlled by the holders of distributed governance tokens. But researchers have found that as of 2022, less than 10% of Uniswap token holders bothered voting (whereas the shareholder participation rate in US public companies is more like 70%). And even if all of those token holders did participate (voting is done by delegating tokens to a delegate), ownership of Uniswap tokens is so concentrated that those researchers found that only 11 delegates need to agree on any change for it to go through.¹⁷

This market structure bill recognizes that centralized control of blockchains will be necessary and can be exercised in emergencies; if control can be exercised to protect blockchain users, it can also be weaponized against those blockchain users. What is even more shocking is that mere aspirations to decentralization are considered sufficient to invoke this regulatory regime. We don’t let tweens drive cars today because they aspire to one day be mature enough to do so; we shouldn’t let issuers of what would otherwise be securities escape the securities laws because they hope to one day reach decentralization nirvana. If we accept the fiction that there is no issuer of these assets, then harmed investors will have no recourse against the people who actually issue these assets.

A blockchain is a spreadsheet or database that you can add information to, but not delete information from. The main thing that sets blockchains apart from other databases is that instead of having trusted authorities who are charged with adding and removing entries, a blockchain theoretically allows any computer or “node” hosting a copy of the database to add entries to that database so long as some kind of validation mechanism is satisfied that those new entries should be added (entries can’t be removed without taking drastic steps to remake the database in a process known as “forking,” which is a significant problem for consumers who have made a mistake or been the victim of a fraudulent transaction). The purported absence of any trusted authority charged with updating the database is often referred to as “decentralization.”

¹⁶ https://ourfinancialsecurity.org/wp-content/uploads/2024/10/MHays.AFR_.Testimony.HFSC-Digital-Assets-Subcommittee.DeFi-Hearing.Sept-10-2024.pdf

¹⁷ <https://www.sciencedirect.com/science/article/pii/S2096720924000216>

However, a system needs to offer more than just the *opportunity* for decentralized control to actually *be* decentralized. Blockchains, and many of the things built on them, are technologically decentralized system in the sense that there are lots of nodes involved, but if one person can control lots of those nodes, or some nodes are more important than others practically speaking, then control of the system will become centralized and all that effort that went into technological decentralization will be for naught. For centuries, we’ve had the “technology” for decentralized organizations in the form of corporations that issue lots of shares, but the fact that I can buy a single share in a corporation doesn’t give me the right to have any meaningful say in how that corporation runs its business.

As technology publishing guru Tim O’Reilly observed, “history teaches us that there will always be new avenues for power to become centralized.”¹⁸ He then noted that “blockchain turned out to be the most rapid recentralization of a decentralized technology that I’ve seen in my lifetime.” Part of the explanation for why control tends to become centralized is that full participation in a decentralized system requires a user to do a lot of upfront work to figure out exactly how the system functions, and then to keep engaging after they’ve figured it out. Part of it is that it is very unwieldy for lots of people to have an equal say in how the system should run, particularly in an emergency when swift action is required. Having a hierarchy of control streamlines things in the face of uncertainty, and makes life easier for people who don’t want to invest heavily in learning the intricate workings of something. And when there are opportunities to make money from hierarchy and streamlining, the evolution of centralized intermediaries seems inevitable – someone will always rush to fill a profitable power vacuum. This is, of course, how our current internet became intermediated by Big Tech platforms like Google (now Alphabet) and Facebook (now Meta): they made the internet easy to use for those who didn’t understand how internet protocols actually worked, and became some of the largest companies in the world as a result. Once people have established control, they have the same incentives that intermediaries have always had to exploit and profit from that control.

If Congress exempts intermediaries from the securities laws just because they can tell a good story about a decentralized utopia, then that is a grave mistake. This fairy tale thinking infects other parts of the bill as well. For example, in trying to carve out underlying investment contract assets from the securities laws, the definition relies upon language that says that the asset can be transferred “without necessary reliance on an intermediary.” What this implies is that the use of intermediaries is permitted, but exemptions from the securities laws will be available so long as a good story can be told of the theoretical possibility of transactions processed without an intermediary. Elsewhere, Section 501 of the bill outlines “findings” that provide support for the enactment of the bill. These findings are, once again, built on crypto industry talking points rather than the realities of blockchain technology and the crypto industry that is built on it; they raise the specter that industry talking points about the necessity of other kinds of innovation will be used to justify deregulation more broadly (including a moratorium on AI regulation).

An invitation for regulatory arbitrage

¹⁸ <https://www.cbsnews.com/news/web3-cryptocurrency-nft-tim-oreilly/>

This bill seeks to remove the vast majority of crypto assets from the investor protection oversight of the SEC. It essentially seeks to codify certain parts of Judge Torres' ruling in the Ripple case: the Judge's reasoning on this point was roundly criticized both by academics and other judges for being backwards on investor protection. This approach would offer securities law protections to sophisticated industry participants who buy crypto directly from the seller, but leave regular people who buy on the secondary markets without those protections. This is backward from the perspective of investor protection, but perhaps consistent with the currently prevailing trend of benefiting insiders at the expense of everyday Americans.

By removing crypto from the SEC's jurisdiction, the bill would give more jurisdiction to the CFTC. The CFTC is widely regarded to be the crypto industry's preferred regulator. It is a much smaller agency with a much smaller budget than the SEC, and unlike the SEC, it has no statutory investor protection mandate and limited experience regulating retail-dominated markets.¹⁹ The CFTC also allows exchanges to self-certify the assets they list (in a self-certification regime, an exchange is permitted to certify to the CFTC that an asset complies with the law, rather than putting the onus on the CFTC to ensure compliance).²⁰ Doing so would deprive investors of the protections afforded by the SEC's registration and disclosure regime for public offers and sales of securities, as well as the protections of securities broker/dealer and exchange registration requirements that would help mitigate the conflicts of interest inherent in the crypto exchange business model. Furthermore, this bill would create regulatory arbitrage opportunities outside of the crypto industry: while crypto advocates have sought a bespoke regulatory regime for crypto, issuers of other types of securities would also have incentives to migrate into the new, lighter-touch regime (which would seemingly be accessible to them if they simply recorded ownership of their securities on a blockchain).

Conflicts of interest at exchanges

Securities exchanges are not allowed to also be securities brokers and vice versa, because of the conflicts of interest such a relationship might entail. This bill blesses these conflicts of interest for crypto exchanges and allows them persist. As such, there's the possibility that a crypto exchange could manage trades in ways that benefit its high-paying customers over other customers, particularly if that exchange is also a blockchain validator and therefore in a position to dictate the order in which certain transactions are processed (and auction that off to the highest bidder). Crypto exchanges are also allowed to have venture capital firm affiliates. This conflict of interest runs in both directions: an exchange has incentives to pump startups funded by their venture affiliate; the venture affiliate has incentives to fund lots of digital asset projects that can then be traded on the exchange in order to generate more transactional fees for the exchange.

6. Possible legislative reforms

¹⁹ Dennis M. Kelleher, *10 Key Questions that Must Be Answered Regarding the Senate Agriculture Committee's Crypto Legislation that FTX Endorsed*, BETTERMARKETS (Nov. 30, 2022), available at https://bettermarkets.org/wp-content/uploads/2022/11/Better_Markets_Fact_Sheet_10_Questions_FTX_Hearing.pdf.

²⁰ For more on the CFTC and self-certification, see Lee Reiners, *Bitcoin Futures: From Self-Certification to Systemic Risk*, 23 N.C. BANKING INST. 61 (2019).

The crypto industry – rather than the public – is likely to be the primary beneficiary of this bill. Existing financial laws and regulations – particularly the securities laws – provide financial regulators with tools that can effectively address many of the harms associated with crypto business models. Robust enforcement of these laws and regulations is key to curbing the crypto industry’s harms, but this bill would undermine many of these laws and regulations and is therefore inferior to the status quo. If lawmakers are contemplating new legislation, however, there are some reforms that would further assist in this regard.

Banking regulation

As discussed above, banking regulation has performed reasonably well thus far in protecting the traditional financial system from the fallout of crypto industry implosions. That may not continue to be the case, though, given the current Administration’s encouragement of the integration of crypto and traditional finance. In this environment, legislation that formally recognizes the separation of banking and crypto – a type of “Glass-Steagall 2.0” – would be helpful. Such legislation should prohibit banks from investing in any crypto assets, or accepting them as collateral for loans. Banks should also be prohibited from holding stablecoin reserves in a deposit account, as those funds could disappear in the event of the run on the stablecoin, exposing the bank to the risk of a run itself. Insured depository institutions should also be prohibited from issuing their own stablecoins. Congress may also wish to reconsider the wisdom of allowing banks to record transactions on permissionless blockchains.

Investor protection regulation

If new crypto legislation is adopted, it should reaffirm the SEC’s jurisdiction over crypto assets. Legislation that amends the definition of “security” in the Securities Act of 1933 and the Securities Exchange Act of 1934 to categorically provide that all crypto assets are securities would mean that the Howey test would no longer be relevant to determining whether a crypto asset is a security. The crypto industry would know with absolute certainty that the securities laws apply to them, and that the SEC is their regulator.

A ban

The legislative reforms outlined so far seek to utilize and improve existing regulatory frameworks to curb the harms associated with crypto business models. However, the most effective way to protect both the stability of our financial system and individual investors would be to ban the issuance and trading of crypto assets. As this testimony has already explored, we have much to gain and little to lose from a ban on crypto (and the gains would go beyond investor protection and financial stability – they would also include limiting environmental damage and protecting national security).

It is sometimes said that such a ban would be impossible to enforce because of the decentralized nature of crypto. However, but there are many people against whom such a ban could be enforced. Most obviously, centralized exchanges serve as important gateways to the crypto markets. If they were banned from listing crypto assets, then the market for those assets would most likely diminish significantly. Alternative exchanges do exist that are operated by

DAOs rather than a single entity, but a ban could still be enforced against such exchanges. As already explored, DAO governance tokens are held by real people and those real people could be prohibited from holding governance tokens in a DAO operating a prohibited business. Practically speaking, ownership of these tokens tends to be reasonably concentrated with founders, venture capitalist funders, and crypto whales, so enforcement efforts would only have to target a limited number of holders to be effective. A ban is therefore feasible, and can be effective even if not 100% impermeable.

Gambling regulation

If Congress does not wish to implement a bank, they could also consider the recommendation of a UK parliamentary committee that crypto should be required to comply with existing gambling laws, rather than financial regulation. The committee reached this conclusion because of concerns that regulating crypto investments as a “financial service” could “create a ‘halo’ effect that leads consumers to believe that this activity is safer than it is, or protected when it is not.”²¹

²¹ <https://committees.parliament.uk/publications/39945/documents/194832/default/>