

Digital Asset Market Structure Discussion Draft
House Committee on Financial Services & House Committee on Agriculture
Summary

The current regulatory framework for digital assets hinders innovation and fails to provide adequate consumer protection. The House Committee on Financial Services and the House Committee on Agriculture are addressing these shortcomings by establishing a functional framework that works for both market participants and consumers. This functional framework would provide digital asset firms with regulatory certainty and fill the gap that exists between the authorities of the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC).

The Digital Asset Market Structure Discussion Draft (Discussion Draft) provides the CFTC with jurisdiction over digital commodities and clarifies the SEC's jurisdiction over digital assets offered as part of an investment contract. Additionally, the Act establishes a process to permit the secondary market trading of digital commodities, if they were initially offered as part of an investment contract. Finally, the Act imposes robust customer protections on all entities required to be registered with the SEC and CFTC.

Classification as a Security vs. a Commodity

The Act also builds on the current exemption regime for the offer and sale of digital assets pursuant to an investment contract including a disclosure regime to address the potential risks associated with digital assets. Under this exemption, digital asset issuers will need to demonstrate that their digital assets operate on a decentralized network and fulfill certain fit-for-purpose disclosure requirements. The Act specifies that a digital asset can be considered a digital commodity if certain conditions are met. This would be determined by the network being functional and considered decentralized.

The Act includes definitions for a decentralized network and a functional network and provides a certification process under which a digital asset issuer may certify to the SEC that the network on which the digital asset relates is decentralized. The SEC may object to the certification if the SEC determines the certification is inconsistent with the Act, but must provide a detailed analysis of its reasons for doing so.

Regulation of SEC Intermediaries

The Act would enable registration of digital asset trading platforms as an Alternative Trading System (ATS). The Act would prohibit the SEC from denying a trading platform from an exemption to operate as an ATS on the basis that the platform trades digital assets. It would also allow an ATS to offer digital commodities and payment stablecoins on their platforms. The Act also requires the SEC to modify its rules to allow broker-dealers to custody digital assets, if they meet certain requirements. Additionally, the Act would require the SEC to write rules to modernize certain regulations for digital assets.

Regulation of CFTC Intermediaries

The Act creates a Digital Commodity Exchange (DCE) framework that is similar to existing exchange frameworks in the Commodity Exchange Act (CEA) for Designated Contract Markets and Swap Execution Facilities. A registered DCE would be required to comply with requirements within the Act, certain longstanding CEA core principles, as well as CFTC regulations including the monitoring of trading activity, prohibition of abusive trading practices, minimum capital requirements, public reporting of trading information,

conflicts of interest, governance standards, and cybersecurity. DCEs must also register with a registered futures association and comply with its customer protection rules if it directly serves customers.

Additionally, before listing digital commodities, DCEs would need to certify with the CFTC that the digital commodity is not readily susceptible to manipulation before being listed to trade, including considering its availability, structure, functionality, and public information.

Further, the Act creates a Digital Commodity Broker (DCB) and a Digital Commodity Dealer (DCD) framework. Because they directly serve customers, all DCBs and DCDs are required to register with a registered futures association and meet prescriptive business conduct requirements related to minimum capital, fair dealing, risk disclosures, advertising limitations, conflicts of interest, recordkeeping and reporting, daily trading records, and employee fitness standards.

The proposed legislation also builds on the existing commodity market requirements imposed on Futures Commission Merchants (FCMs) to protect customer assets. DCEs would be required to segregate customer assets and hold them in digital commodity custodians, which will be subject to minimum standards for supervision and comprehensive regulation set by the CFTC. Further, the Act provides bankruptcy protections for customers when the FCM is acting as a counterparty.

Regulatory Coordination

The Act would permit a single CFTC entity to obtain multiple licenses with the CFTC, depending on the nature of the services the entity engaged in, except that no exchange would be permitted to be registered as a dealer directly. The Act would also permit certain entities to dually register with the CFTC and SEC to be permitted to facilitate transactions in multiple types of digital assets.

Innovation and Coordination

The Act codifies the establishment of both the Strategic Hub for Innovation and Financial Technology (FinHub) at the SEC and LabCFTC at the CFTC. The offices will serve as information resources for the Commissions on financial technology (FinTech) innovation. The offices will also make the Commissions more accessible to FinTech innovators and serve as a forum for innovators seeking a better understanding of the Commissions' regulatory frameworks.

The Act also establishes a Joint CFTC-SEC Advisory Committee on Digital Assets, which will consist of 20 market participants, who will provide advice to the CFTC and SEC related to digital assets. The Act requires the CFTC and the SEC to conduct a joint study on decentralized finance. The Act also requires the Department of Commerce, in consultation with the White House Office of Science and Technology, the SEC, and the CFTC to conduct a study on non-fungible digital assets.

Regulatory Transition

The Act provides for a transition period for entities to come into temporary compliance with both the SEC and CFTC immediately, while the Commissions are writing final rules to bring comprehensive oversight to these markets. Existing digital assets are eligible for a safe harbor under which they are permitted to trade during this period, until the SEC or CFTC issues a notice to the trading venue that they are not digital commodities.