

Statement of Dan M. Berkovitz
Former Commissioner, U.S. Commodity Futures Trading Commission and
Former General Counsel, U.S. Securities and Exchange Commission
before the
Committee on Agriculture
U.S. House of Representatives

The Future of Digital Assets: Measuring the Regulatory Gaps in the Digital
Asset Markets
June 6, 2023

Chair Thompson, Ranking Member Scott, and Members of the Committee, thank you for the invitation to appear before you today to discuss gaps in the regulation of the digital asset markets. I offer you my perspective on the regulation of digital asset markets after having spent the past twenty-plus years in various regulatory, oversight, and private sector advisory capacities related to the commodity and financial asset markets. My appearance before you today is in my own personal capacity. I am not representing or speaking on behalf of any other person, governmental agency or private sector entity.

This Committee's series of hearings on the gaps in the regulation of digital assets is timely. Digital assets and the associated blockchain technologies have the potential to transform the availability, scope, and efficiency of financial services to American consumers and businesses and across the globe. As the events of the past year have demonstrated, however, as currently structured certain digital asset markets present significant risks to American consumers and business and even to the stability of banks and the overall financial system. It is critical that these markets operate in a manner that does not present undue risks to market participants and the financial system.

In this testimony I will describe the gaps in the regulation of the digital asset markets in the U.S. and offer a blueprint for how to close these gaps. Closing the gaps in the regulation of these markets would improve the protections for investors in the digital asset markets, bolster the integrity of these markets, reduce potential systemic risks to the financial system, provide greater clarity and certainty regarding the legal status of digital assets traded in these markets, and thereby foster our nation's leadership in financial markets and technologies.

Summary

There is a significant gap in the regulation of the digital asset markets. No federal agency has regulatory authority over the trading of non-security, non-derivative commodities. The U.S. Securities and Exchange Commission (SEC) regulates the trading of digital assets that are

securities. The U.S. Commodity Futures Trading Commission (CFTC) regulates the trading of derivatives on digital assets. Neither the CFTC nor the SEC has regulatory authority over the cash or “spot” market for non-security digital assets.

There is an urgent need to close this gap. These unregulated markets are operating in a manner that present significant risks to customers and investors in these markets, including risks from information asymmetries, abusive trading practices, manipulation, and conflicts of interest in the operation of trading infrastructures. These unregulated markets also present broader risks to the financial system.

Although both the SEC and the CFTC have the expertise to regulate the non-security spot digital asset markets, the CFTC already regulates the futures markets for digital assets and conducts surveillance of the underlying spot markets as part of its oversight of the futures markets. Providing the CFTC with regulatory authority over these spot markets would leverage its current enforcement authority in these markets.

Legislation to provide the CFTC with this additional CFTC regulatory authority over non-security spot digital markets should require that trading facilities for non-security spot digital assets must be licensed by the CFTC. The legislation also should provide for the regulation of intermediaries in the non-security spot digital asset markets, similar to the CFTC’s regulation of intermediaries in the derivative markets.

The legislation should establish a set of core principles that provide basic standards for the licensing and operation of a digital asset trading facility. These core principles should be consistent with best practices for trading facilities in other CFTC-regulated asset classes, such as the CEA sets forth for designated contract markets for the trading of futures contracts and swap execution facilities for the trading of swaps.

The legislation should establish a dual track for the review of applications by the trading facility for the approval of digital assets proposed to be listed for trading. On one track, the SEC would review the proposed listing to determine whether the digital asset proposed to be traded on the facility is a security. Digital assets determined to be securities would not be eligible for trading on the CFTC-licensed facility and would continue to be regulated under the securities laws. On the other track, the CFTC would review the proposed listing to determine whether the digital asset will be traded in accordance with the CFTC’s listing standards, disclosure requirements, and trading facility core principles.

The CFTC should be provided with a dedicated source of funding for the regulation and oversight of the non-security digital asset spot market. Current CFTC resources are not sufficient to undertake this additional responsibility without compromising the CFTC’s ability to oversee the traditional commodity markets.

Apart from closing the gap in this manner, the legislation otherwise should maintain existing agency jurisdictions and authorities. The CFTC and SEC have the necessary and appropriate authorities to regulate the derivative and security markets. Amendments to the

SEC's authorities over one particular asset class, such as digital assets, would be unwarranted, unnecessary, and potentially counterproductive. Creating new authorities based on a particular technology or newly defined asset class could disrupt decades of securities law precedent, create additional uncertainty about the meaning and interpretation of both new and existing statutory terms and classifications, and generate opportunities for regulatory arbitrage in the capital markets based upon technology upon which the asset is created or distributed rather than the functional nature of the asset or instrument.

Legislation as outlined above, confined to closing the gap, would provide important protections to members of the public and other investors in digital assets, as well as to the financial system more generally. It would eliminate much of the regulatory arbitrage that currently exists between CFTC- and SEC-regulated markets due to regulatory gaps. Further, the proposed dual track process for the review of digital assets proposed to be traded on the facility would provide regulatory certainty as to the legal status of a digital asset prior to the trading of such asset on the facility. Together, these reforms would enable the U.S. to maintain its global leadership in financial technology and markets.

The Regulatory Gap in Digital Asset Markets

Under the Commodity Exchange Act (CEA), the CFTC has exclusive jurisdiction over most transactions involving commodity derivatives, such as contracts for future delivery and swaps whose value is based on the price of an underlying commodity.¹ This jurisdiction includes authority to prescribe requirements for transactions involving commodity derivatives—generally called “regulatory authority”—and authority to bring enforcement actions for violations of such requirements.

The CFTC's authority over the spot market for commodities is much more limited. The CFTC does not have regulatory authority over the spot market for commodities. In these spot markets the CFTC only has enforcement authority to bring post-event enforcement actions for fraud or manipulation.

The CEA defines commodity broadly. It includes specified agricultural commodities, called “enumerated commodities,” “all other goods and articles, except onions . . . and motion picture box office receipts,” “and all service, rights, and interests . . . in which contracts for

¹ CEA §2(a)(1), 7 U.S.C. §2(a)(1). The CFTC's jurisdiction over commodity derivatives is not exclusive if the instrument is a future or swap on a security, in which cases jurisdiction is joint with the SEC. For a fuller description of the CFTC's jurisdiction over commodities, including how it relates to the SEC's jurisdiction over securities, see Letter from Robert A. Schwartz, Deputy General Counsel, CFTC, to The Honorable P. Kevin Castel, U.S. District Judge, *Re: SEC v. Telegram Group, Inc., et al.*, No. 1:19-cv-09439 (PKC), Feb. 18, 2020 (“Schwartz letter”); available at:

<https://storage.courtlistener.com/recap/gov.uscourts.nysd.524448/gov.uscourts.nysd.524448.203.0.pdf>.

future delivery are presently or in the future dealt in.”² Since 2015 the CFTC has asserted that digital currency is a commodity.³

CFTC Chair Behnam recently summarized the limited nature of the CFTC’s authority over the spot market for digital assets:

[T]he CFTC does not have direct statutory authority to comprehensively regulate cash digital commodity markets. Its jurisdiction is limited to its fraud and manipulation enforcement authority. In the absence of direct regulatory and surveillance authority for digital commodities in an underlying cash market, our enforcement authority is by definition reactionary; we can only act after fraud or manipulation has occurred or been uncovered.⁴

The SEC’s authority under the securities laws is comprehensive with respect to securities, but does not extend generally to non-security instruments or assets. Hence, neither the CFTC nor the SEC have comprehensive regulatory authority over non-security digital asset spot markets. This is a major regulatory gap.

Need to Close the Gap

In its recent report on Digital Asset Financial Stability Risks and Regulation, the Financial Stability Oversight Council (FSOC) identified a variety of risks to investors and financial stability that arise as a result of the gap in the regulation of non-security digital assets.⁵ The FSOC noted that “[t]he spot market for crypto-assets that are not securities provide relatively fewer protections for retail investors compared to other financial markets that have significant retail participation.”⁶ The FSOC observed that the trading platforms in these non-security digital asset markets “engage in practices that a commonly subjected to greater regulation in other financial markets.” These include the

² CEA §1(a)(9), 7 U.S.C. §1(a)(9).

³ *CFTC v. My Big Coin Pay, Inc.*, 334 F. Supp. 3d 492, 495-98 (D. Mass. 2018) (citing cases); *In re BFXNA Inc. d/b/a Bitfinex*, CFTC Dkt. No. 16-19, 2016 WL 3137612, at *5 (CFTC June 2, 2016) (“Bitcoin and other virtual currencies are ... properly defined as commodities.”). *See* Schwartz letter, *supra*.

⁴ Testimony of Chairman Rostin Behnam Before the U.S. Senate Committee on Agriculture, Nutrition & Forestry, Oversight of the Commodity Futures Trading Commission, March 8, 2023 (footnote omitted); available at: https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam32#_ftnref10.

⁵ FSOC, Report on Digital Asset Financial Stability Risks and Regulation 2022 (Oct. 2022); available at: <https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf>.

⁶ *Id.* at 113.

operation of order-book style markets that typically are subject to trading rules regarding trade execution and settlement, custody requirements, and operational security and reliability requirements.

Overall, the FSOC concluded, “[s]ignificant market integrity and investor protection issues may persist because of the limited direct federal oversight of these spot markets, due to abusive trading practices, inadequate protection for custodied assets, or other practices.”⁷ The FSOC warned that if the scale of crypto asset activities increased rapidly, these issues could pose broader financial stability issues. The FSOC recommended that Congress pass legislation to provide for regulatory authority over non-security digital assets.⁸

These concerns are widespread. The Financial Stability Institute of the Bank of International Settlements issued a recent paper that warned more generally that the digital assets markets “pose risks which, if not adequately addressed, might undermine consumer protection, financial stability and market integrity.”⁹ The International Monetary Fund published a study that identified numerous risks with cryptocurrency exchanges, including “market abuse risks,” information asymmetries, “high risk of market manipulation,” weak price discovery functions, and, more specifically, wash trading, pump-and-dump schemes, and whale trades.¹⁰

The risks to participants in the U.S. digital asset markets are real. “[B]asic customer protections are often missing in the crypto industry”¹¹ Many customers that have been exposed to practices that are prohibited in regulated markets have been harmed

⁷ *Id.* at 114.

⁸ FSOC Report, at p. 111.

⁹ Denise Garcia Ocampo, Nicola Branzoli and Luca Cusmano, Financial Stability Institute, Bank of International Settlements, *Crypto, tokens and DeFi: navigating the regulatory landscape*, May 2023, at p. 4; available at: <https://www.bis.org/fsi/publ/insights49.pdf>.

¹⁰ Parma Bains, Arif Ismail, Fabiano Melo, Nobuyasu Sugimoto, International Monetary Fund, *Fintech Notes, Regulating the Crypto Ecosystem, The Case of Unbacked Crypto Assets*, Sept. 2022, at pp. 18-19; available at: <https://www.imf.org/en/Publications/fintech-notes/Issues/2022/09/26/Regulating-the-Crypto-Ecosystem-The-Case-of-Unbacked-Crypto-Assets-523715>.

¹¹ Keynote address by Commissioner Christy Goldsmith Romero at the Wharton School and the University of Pennsylvania Carey Law School, *Crypto’s Crisis of Trust: Lessons Learned from FTX’s Collapse*, Jan. 18, 2023 (cataloging abusive practices, governance failures, inadequate disclosures, deficient recordkeeping, and conflicts of interest); available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/oparomero5>.

as a result. These practices include the use of customer funds to support trading by affiliates,¹² the use of funds of one customer to satisfy an exchange's liabilities to another customer,¹³ and trading against customers by exchanges.¹⁴ Although in some instances agencies have been able to bring retrospective enforcement actions for fraud or misappropriation of customer funds, these retrospective actions have been brought after customers have been harmed. A regulated trading environment where customer safeguards are mandatory will significantly increase customer protections that will help prevent those harms from occurring.

Additional CFTC Authority Over Non-Security Digital Assets

The CFTC is well-positioned to undertake regulation and oversight of the non-security digital asset spot market. The CFTC already regulates the futures markets for key digital assets, such as Bitcoin and Ether. The spot markets for these assets provide the settlement prices for these futures contracts, so as part of its oversight of the futures markets for these assets the CFTC currently conducts surveillance of the spot markets. The CFTC already has experience and is familiar with these spot markets.

Legislation expanding CFTC authority to regulate the non-security digital asset spot markets should include the following:

¹² See, e.g., *CFTC v. Samuel Bankman-Fried, FTX Trading Ltd. d/b/a FTX.com, and Alameda Research LLC*, Case 1:22-cv-10503 (SDNY Dec. 13, 2022) (“Throughout the Relevant Period, at the direction of Bankman-Fried and at least one Alameda executive, Alameda used FTX funds, including customer funds, to trade on other digital asset exchanges and to fund a variety of high-risk digital asset industry investments.”), at p. 3; available at: <https://www.cftc.gov/PressRoom/PressReleases/8638-22>. Mr. Bankman-Fried has contested the charges, but several of his associates have entered guilty pleas in the related criminal cases. See, e.g., Corinne Ramey and David Michaels, *Caroline Ellison, Associate of FTX Founder Sam Bankman-Fried, Pleads Guilty to Criminal Charges*, Wall Street Journal, Dec. 21, 2022.

¹³ See, e.g., Final Report of Shoba Pillay, Examiner, *In re Celsius Network LLC, et al., Debtors*, United States Bankruptcy Court, Southern District of New York, Chapter 11, January 30, 2023, at p. 12; available at: <https://cases.stretto.com/public/x191/11749/PLEADINGS/1174901312380000000039.pdf>.

¹⁴ See, e.g., Eva Szalay, *Crypto exchanges' multiple roles raise conflict worries*, Financial Times, Nov. 14, 2021 (“Rather than being a neutral party to transactions, like a stock exchange, a crypto platform can trade against customers, creating a situation where, for one side to win, the other must lose — meaning that retail clients are at risk of being treated unfairly.”); available at: <https://www.ft.com/content/8b8e6d72-b1d2-435c-88c1-4611e3a98da5>; see also Allyson Versprille and Olga Kharif, *SEC's Gensler Says Crypto Exchanges Trading Against Clients*, Bloomberg, May 10, 2022; available at: <https://www.bloomberg.com/news/articles/2022-05-10/sec-chief-questions-whether-crypto-exchanges-bet-against-clients?sref=DzeLiNol>.

- **Registration and regulation of trading facilities.** Trading facilities for non-security digital assets must be licensed by the CFTC.
- **Registration and regulation of intermediaries.** The CFTC's authority over intermediaries in the futures and swaps market for digital assets should be extended to include intermediaries who perform similar intermediary functions in the non-security spot digital asset markets.
- **Core Principles for trading facilities.** CFTC-licensed trading facilities for non-security digital assets must operate in accordance with core principles for facility licensing and operation.
- **Digital asset listing standards.** To be eligible for trading on a CFTC-licensed trading facility, the trading facility must submit a proposed digital asset listing in accordance with digital asset listing standards. The digital asset listing standards should include disclosures regarding the nature of the digital asset to be listed for trading and other information demonstrating the digital asset will be traded in compliance with the core principles.
- **Dual track review of proposed digital asset listings.** On one track, the SEC would review the proposed listing and determine whether the digital asset to be traded is a security subject to SEC regulation. Digital assets determined by the SEC to be a security would need to be traded in accordance with the security laws and would not be eligible to be listed or traded on the CFTC facility. On the other track, for non-security digital assets, the CFTC would review the proposed listing to determine whether the digital asset will be traded in accordance with the listing standards, core principles, and CFTC regulations.
- **Dedicated funding source for expanded CFTC responsibility.** The legislation should provide a dedicated source of funding for these additional CFTC responsibilities.
- **Maintain current authorities over digital asset markets.** The legislation should otherwise maintain the existing authorities of the SEC and CFTC, respectively, over the securities and derivative markets.

Each of these features is explained more fully below.

Registration and regulation of trading facilities. Any trading facility that provides for the trading of non-security spot digital assets must be registered with the CFTC and operate in accordance with its license. Registration and regulation of these trading facilities in accordance with core principles established by the legislation and implemented by the CFTC can address many of the risks currently presented by the trading of non-security digital assets in unregulated spot markets.

Registration and regulation of intermediaries. Brokers, dealers, associated persons of brokers and dealers, commodity pool operators, and commodity trading advisors in non-security spot digital assets should also be regulated. To the extent that these types of intermediaries

facilitate customer transactions and investments in non-security spot digital assets, they should be regulated in a similar manner as other types of intermediaries performing similar functions with other CFTC-regulated asset classes. In the Dodd-Frank Act Congress added swaps to the types of instruments to which these categories of registration for intermediaries applied. Congress could similarly expand these categories of registration to include non-security spot digital assets.

Core principles for trading facilities. Similar to the licensing requirements for a designated contract market (DCM) or swap execution facility (SEF), the legislation should establish core principles for facility licensing and operation. As with the DCM and SEF core principles, the CFTC should be provided with authority to prescribe the manner in which these core principles must be implemented by the trading facility. Consistent with the best practices reflected in the DCM and SEF core principles, and in light of the specific risks presented by digital assets, the core principles should establish the following:

- Listed digital assets should not be readily susceptible to manipulation;
- A competitive, open and efficient market for executing transactions;
- Protection of market participants and markets from abusive practices, including fraud and manipulation;
- Monitoring, surveillance, and enforcement to prevent manipulation, price distortions, and disruptions;
- Recordkeeping and public disclosure of trading information;
- Public disclosure of general information about trading rules, regulations, fees, disciplinary procedures, and dispute resolution;
- Governance standards, including fitness standards for directors and officers;
- Prohibitions of conflicts of interest in the management of the facility, including conflicts of interest with customers;
- Adequacy of financial resources for facility operations;
- System safeguards, including operational resilience, disaster recovery, back-up resources, and cyber security;
- Protection of customer assets, including segregation requirements and bankruptcy protections;
- Emergency authority;
- Know-your-customer and anti-money laundering requirements; and
- Disclosure requirements for listed digital assets.¹⁵

¹⁵ The list here is consistent with list presented to the Committee's Subcommittee on Commodity Markets by former CFTC Chairman Massad. *See* Written Statement of Timothy G. Massad before the Subcommittee on Digital Assets, Financial Technology and Inclusion U.S. House of Representatives Financial Services Committee and the Subcommittee on Commodity Markets, Digital Assets and Rural Development U.S. House of Representatives Committee on Agriculture

Consistent with its current authorities over DCMs and SEFs, the CFTC also should be provided authority to conduct examinations of licensed facilities, including inspections of books and records.

Product Listing standards. The core principles for a non-security digital asset trading facility should include a requirement providing for the disclosure of key information about the digital asset. These disclosures could include information about the issuer of the asset, the risks presented by the asset, the technology underlying the asset, rights and obligations that may attach to the asset, and the market capitalization of the asset. Providing disclosures about the key features of the digital assets to be traded will promote market integrity and fairness by reducing information asymmetries in the trading of these assets. These disclosures could be modeled on the disclosures currently required for the registration of digital asset securities, but potentially modified as appropriate to take into account the non-security nature of these assets.¹⁶

Dual track review of proposed digital asset listings. A proposed listing of a digital asset for trading on a trading facility for non-security digital assets should be subject to a dual track review by the SEC and the CFTC. On one track, the SEC would review the proposed listing to determine whether the digital asset to be traded on the facility is a security subject to the SEC's regulations. Digital assets that are securities would continue to be subject to the securities laws and not eligible for trading on the facility. Proposed listings that are determined not to be securities could be traded on the facility.

On the other track, the CFTC would review the proposed listing to determine whether the required disclosures have been provided and the digital asset would be traded in accordance with the core principles and CFTC regulations. The SEC and CFTC would consult with each other during their respective reviews to minimize duplication and maximize efficiency.¹⁷ The final

“The Future of Digital Assets: Measuring the Regulatory Gaps in the Digital Asset Market” May 10, 2023, at pp. 9-10; available at: <https://docs.house.gov/meetings/AG/AG22/20230510/115893/HHRG-118-AG22-Wstate-MassadT-20230510.pdf>.

¹⁶ See, e.g., Chris Brummer, *Disclosure, Dapps and DeFi*, Stanford Journal of Blockchain Law & Policy, Vol. 5.2, at p. 137 (2022); available at <https://assets.pubpub.org/efeeza8o/01656289809141.pdf>.

¹⁷ Under current law, the CEA specifies a timeframe for the CFTC to make a determination on a request for prior approval of a contract to be traded on a DCM, CEA §5c, 7 U.S.C. §7a-2, and the Securities Exchange Act specifies a timeframe for the SEC to approve or disapprove a rule (which could specify a new product to be traded on an exchange) submitted for approval by an exchange, SEA §19(b), 15 U.S.C. §78s(b). The ability of each agency to approve a contract or rule depends upon each agency having complete and accurate information about the proposed contract or rule in a timely manner. For the SEC and CFTC to make their respective determinations on a proposed digital asset listing in a timely manner, it would be necessary to ensure that each agency has the authority to request and obtain in a timely manner complete and

determinations of the CFTC and SEC with respect to proposed product listings would be subject to judicial review.

The dual track review process for digital asset listings would address the criticisms of the current regulatory process whereby SEC determinations regarding the status of a digital asset generally occur retrospectively, in the context of enforcement actions after trading has commenced. The process outlined above would provide for prospective SEC determinations of the status of a digital asset prior to trading. This would provide regulatory certainty for market participants and infrastructures regarding the status of digital assets traded on the facility.

For this process to be effective, the SEC should be provided sole responsibility for the determination as to whether the digital asset is a security. Under current law the SEC has the sole responsibility and expertise to determine whether a particular instrument or asset is a security.¹⁸ Authorizing another agency to make this determination with respect to a digital asset proposed for listing on a trading facility would create a significant risk of conflict and confusion with SEC determination regarding the underlying asset. In addition to a determination of the status of the digital asset to be traded on the trading facility, it still would be necessary to preserve the SEC's authority and responsibility to make determinations regarding the status of the digital asset in its primary and other distributions, which may be integrated with the distribution of the asset on a trading facility. Splintering the authority to make determinations regarding the status of a digital asset as a security based on the manner of its secondary distribution would be inconsistent with current law and a recipe for future conflict, confusion, and uncertainty, as multiple agencies would have the authority to make determinations regarding

accurate information regarding the digital asset, including ensuring that the SEC has the authority to obtain such information as may be necessary from the issuer of the digital asset, in addition to such information as may be need to provided by the trading facility proposing to list the asset. Failure of an issuer or trading facility to provide information necessary to determine the digital asset can be traded on the facility would be a basis for a negative determination.

¹⁸ The status of a digital asset as a commodity does not affect whether or not that asset is a security. As the CFTC's Office of General Counsel has explained, "the Commodity Exchange Act [] provides that many securities are commodities to which the securities laws apply. Thus, any given digital asset may or may not be subject to the securities laws, but that does not depend on whether the asset is a commodity. It depends on whether the asset is a 'security' within the meaning of the [Securities Act of 1933]." Schwartz letter, *supra*, at pp.1-2. Whether an asset is a security subject to the SEC's jurisdiction is a matter to be determined by the SEC under the securities laws. *See also* CFTC Commissioner Dawn D. Stump, Digital Assets Authority Infographic, Digital Assets: Clarifying CFTC Regulatory Authority & the Fallacy of the Question, "Is it a Commodity or a Security?" August 23, 2021 ("[T]o say that a particular digital asset is a 'commodity' is unremarkable".); available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement082321>.

the legal status of a particular digital asset. Such an approach would not provide any regulatory certainty as to the legal status of the digital asset.¹⁹

It also has been suggested that the SEC and CFTC could jointly regulate digital asset spot markets. In my view and experience, joint regulation is cumbersome, diffuses accountability, is inflexible, and should be used sparingly only in the narrow circumstances where there is a significant likelihood the two agencies, acting within their respective authorities, would issue inconsistent or conflicting determinations on the same issue or matter.

Dedicated source of funding. The CFTC should be provided with a dedicated source of funding so that it can undertake these significant new responsibilities without compromising its current responsibilities for regulation, oversight, and enforcement of the derivative markets currently within its jurisdiction. If legislation to close the gap along these lines is enacted, the CFTC will be required to conduct a number of rulemakings to implement the new statutory requirements for digital asset infrastructures and intermediaries, review licensing applications, review proposed digital asset listings, and conduct surveillance of the non-security digital asset spot markets. It will need significant additional resources to perform these new responsibilities in a timely manner.

Most other federal financial regulatory agencies are funded at least in part by a dedicated source of funding. A dedicated funding source can help provide stability to an agency's budget, and help ensure that the beneficiaries of the regulated activities pay the costs of regulation rather than the general taxpayers.

Maintain current authorities over other digital asset markets. Apart from closing the current gap regarding the regulation of the non-security digital asset spot markets, legislation should maintain existing agency jurisdictions and authorities. The CFTC has the necessary and appropriate authority to regulate the derivative markets. The SEC has necessary and appropriate authority to regulate the securities markets. There is no demonstrated need to alter or amend these basic authorities, including with respect to digital assets.

Amendments to the CFTC's or the SEC's authorities over derivatives or securities in general, or digital assets in particular, are not only unwarranted and unnecessary, they would be counterproductive. The CEA and the securities laws are technology neutral. The Supreme Court has made it clear that in determining whether something is a security "form should be

¹⁹ Authorizing another agency to make determinations regarding the status of an instrument as a security also could undermine the SEC's regulation and enforcement of the securities laws more generally. To the extent that another federal agency opines on the application of the securities laws to one class of assets in a manner that differs from the manner in which the SEC applies and enforces the securities laws, the SEC could have more difficulty enforcing those requirements more generally.

disregarded for substance.”²⁰ Amending existing authorities based on a particular technology would disrupt decades of precedent, create additional uncertainty about the meaning and interpretation of both new and existing statutory terms and classifications, and generate opportunities for regulatory arbitrage in the capital markets based upon technology upon which the asset is created or distributed rather than the functional nature of the asset or instrument.²¹ Legislation to close the gap with respect to the regulation of non-security digital asset spot markets should stay focused on closing that gap and not disrupt current law and create new uncertainties where there is no gap.

Conclusion

Cryptocurrencies are bought and sold by a significant number of persons in the U.S. Last week, the Federal Reserve reported that in 2022 one in ten adults surveyed held or used cryptocurrency.²² Extrapolated to the public-at-large, this means millions of American consumers and households may be conducting transactions in the spot digital asset markets. The American consumers and households transacting in these markets are currently exposed to numerous market risks, including abusive trade practices, market manipulation, conflicts of interest, governance deficiencies, the failure to segregate customer funds, and inadequate disclosures.

Extending the CFTC’s regulatory authority over the non-security digital asset spot market would help protect customers and investors in these digital asset markets and reduce potential systemic risk. Authorizing the SEC to review proposed listings for the trading of spot market digital assets on these licensed trading platforms would provide market participants with regulatory certainty regarding the legal classification and status of those assets prior to the trading of those assets on the facility. Protecting American consumers and investors and providing market participants with regulatory certainty would help maintain our nation’s leadership in financial markets and technologies.

²⁰ *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967). Further, “the emphasis should be on the economic realities underlying a transaction, and not on the name appended thereto.” *United Housing Found. v. Forman*, 421 U.S. 837, 849 (1975).

²¹ *See also* Massad Statement, note 15, at 5 (Amending the existing securities or commodities laws, or changing the definition of security, “might not only fail to bring clarity to crypto; that might unintentionally undermine decades of regulation and jurisprudence as it applies to traditional securities and derivatives markets. . . . [T]he law should make clear that the SEC and CFTC would retain their existing authority.”).

²² Board of Governors of the Federal Reserve System, *Economic Well-Being of U.S. Households in 2022*, May 2023, at p. 41; available at: <https://www.federalreserve.gov/publications/files/2022-report-economic-well-being-us-households-202305.pdf>.