

MEMORANDUM

To: Members of the Committee on Financial Services and Committee on Agriculture

From: Committee on Financial Services and Committee on Agriculture Majority Staff

Date: May 5, 2023

Re: Joint Hearing entitled, “The Future of Digital Assets: Closing the Regulatory Gaps in the Digital Asset Ecosystem

On Wednesday, May 10, at 9:30 a.m. (ET) in 1100 Longworth House Office Building, the HFSC Subcommittee on Digital Assets, Financial Technology, and Inclusion and the HAC Subcommittee on Commodity Markets, Digital Assets, and Rural Development will hold a hearing titled: “The Future of Digital Assets: Closing the Regulatory Gaps in the Digital Asset Ecosystem.” Testifying at the hearing will be:

- **Mr. Andrew Durgee**, Head of Republic Crypto, Republic
- **Mr. Matthew Kulkin**, Partner and Chair, Futures and Derivatives Practice, Wilmer Cutler Pickering Hale and Dorr LLP and former Director of the CFTC’s Division of Swap Dealer and Intermediary Oversight
- **Mr. Marco Santori**, Chief Legal Officer, Kraken Digital Asset Exchange
- **Mr. Daniel Schoenberger**, Chief Legal Officer, Web3 Foundation
- **Mr. Timothy Massad**, Research Fellow, Harvard Kennedy School Mossavar-Rahmani Center for Business and Government and Director, M-RCBG Digital Assets Policy Project
- **Mr. Michael Blaugrund**, Chief Operating Officer, New York Stock Exchange

Background

Under the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act), the SEC has full authority over the offer, sale, and the trading of securities, including investment contracts, and the derivatives trading of securities.¹ Under the federal securities laws, every offer and sale of securities must be either registered with the SEC or conducted under an exemption.

The Commodity Exchange Act (CEA) and the CFTC regulations promulgated thereunder provide a comprehensive regulatory regime for the trading of commodity derivatives (e.g., buying or selling futures contracts on corn, cattle, or oil). Under the CEA, the CFTC also has “after-the-fact” enforcement jurisdiction over fraud and manipulation in the “spot” or cash commodity markets (e.g., buying or selling bushels of corn, heads of cattle, or barrels of oil). The CFTC has no power to impose registration and regulatory requirements on participants in the

¹ U.S. Securities and Exchange Commission: The Laws That Govern the Securities Industry, *available at* <https://www.sec.gov/about/about-securities-laws>.

cash or spot commodity markets. Currently, there is no comprehensive federal regulatory regime for the spot trading of commodities.

Determining whether a digital asset is offered as part of an investment contract (i.e., meeting the definition of a security) or falling under the definition of commodity in the CEA has proven difficult in the United States. Until there is a consistent, clear framework in place, market participants, consumers, and investors will continue to seek regulatory clarity given the requirements that stem from the classification of a particular digital asset.

Jurisdiction of the U.S. Securities and Exchange Commission

The central question of whether the SEC has jurisdiction over a digital asset is whether it falls within the definition of a security. The Securities Act of 1933 (the “Securities Act”) requires every offer or sale of securities to be registered with the SEC or meet a condition for exemption from registration.² The Securities Act defines a security to include an “investment contract,” which was in turn defined by the Supreme Court in *SEC v. W.J. Howey Co.*³ Under *Howey* and the case law that followed, an arrangement qualifies an investment contract if it is: 1) an investment of money; 2) in a common enterprise; 3) with the expectation of profits; 4) derived from the efforts of others. The test is not a “balancing test,” rather, all four factors must be present for the arrangement to constitute an investment contract.⁴ Several characteristics of digital assets may cause it not to meet the *Howey* test.

Generally, the SEC and CFTC have attempted to resolve the legal question of whether a digital asset is a security or a commodity through enforcement actions. However, the agencies have not always agreed on which digital assets are considered securities and which digital assets are considered commodities. For example, last month, the CFTC brought an enforcement action against the trading platform Binance, asserting Binance’s BUSD stablecoin is a commodity.⁵ Separately, the SEC asserts the same stablecoin is a security in its investigation of another digital asset firm.⁶ Furthermore, in its complaint, the CFTC refers to bitcoin, ether, and litecoin as commodities.⁷ In contrast, Chair Gensler has stated that he considers all digital assets other than

² Paul Vigna, *SEC Clears Blockstack to Hold First Regulated Token Offering*, Wall Street Journal (Jul. 10, 2019), available at <https://www.wsj.com/articles/sec-clears-blockstack-to-hold-first-regulated-token-offering-11562794848>; Guillermo Jimenez, *SEC Greenlights a Second Crypto Offering: YouNow’s Props Tokens*, Yahoo Finance (Jul. 19, 2019), available at <https://finance.yahoo.com/news/sec-greenlights-second-crypto-offering-223301606.html>.

³ See *SEC v. Howey Co.*, 328 U.S. 293 (1946).

⁴ *Id.*

⁵ See CFTC, *Commodity Futures Trading Commission, v. Changpeng Zhao, Binance Holdings Limited, Binance Holdings (IE) Limited, Binance (Services) Holdings Limited, and Samuel Lim* (March 27, 2023), available at <https://www.cftc.gov/PressRoom/PressReleases/8680-23>.

⁶ See Paxos Press Release, *Paxos Issues Statement* (Feb. 13, 2023), available at <https://paxos.com/2023/02/13/paxos-issues-statement/>.

⁷ CFTC, *supra* note 5.

bitcoin to be securities.⁸ These conflicting positions demonstrate the necessity and urgency of congressional action.⁹

Jurisdiction of the Commodities Future and Trading Commission (CFTC)

The CFTC is the primary market regulator for derivatives in the United States. It is the sister agency to the SEC. A derivative is a financial contract whose value depends on an underlying asset, group of assets, or benchmark. While not regulated by the CFTC, perhaps the most widely known derivative is a stock option on a single stock. The CFTC regulates futures, options, and swaps, which reference commodities.

The term “commodity” is defined very broadly in statute.¹⁰ It includes the agricultural products that are the historic foundation of the futures markets. It also includes other physical commodities, such as metals, energy, refined products, and electricity; rates and benchmarks, such as interest rates, foreign exchange rates, and indexes of equities and debt instruments; and other incidents and actions such as environmental indicators, and events.

When a digital asset is considered a commodity, it is subject to the same jurisdiction of the Commission as any other commodity. In 2015, the CFTC established that virtual currencies are commodities for purposes of the CEA section 1a(9).¹¹ CFTC Chairman Behnam has expressed his view that a number of digital assets are considered commodities including bitcoin and ether, among others.

In general, the CEA provides the CFTC with two types of authority: (1) regulatory authority over derivatives which includes registration requirements, oversight, and principles-based regulation; and (2) enforcement authority that allows the CFTC to bring civil enforcement actions, such as anti-fraud and anti-manipulation actions.

⁸ Ankush Khardori, *Can Gary Gensler Survive Crypto Winter? D.C.'s top financial cop on Bankman-Fried blowback.*, New York Magazine (Feb. 23, 2023), available at <https://nymag.com/intelligencer/2023/02/gary-gensler-on-meeting-with-sbf-and-his-crypto-crackdown.html>.

⁹ There are also contradictions in the positions of state and federal regulators. For example, the New York State Attorney General is asserting in court that Ether is a security, while the CFTC states that Ether is a commodity. See *People of the State of New York against MEK Global Limited and Pheonixfin PTE LTD* (Mar. 9, 2023), available at https://ag.ny.gov/sites/default/files/2023.03.09_memorandum_of_law_people_v_mek_global_limited_and_pheonixfin_pte_ltd_dba_kucoin.pdf.

¹⁰ The term “commodity” means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in.

¹¹ In re Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan, CFTC Docket No. 15-29, 2015 WL 5535736, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 33,538 (CFTC Sept. 17, 2015) (consent order); In re TeraExchange LLC, CFTC Docket No. 15-33, 2015 WL 5658082, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 33,546 (CFTC Sept. 24, 2015) (consent order).

The CFTC's regulatory authority is limited to transactions, participants, and intermediaries in the commodity derivatives markets. Regulated intermediaries include designated contract markets, swap execution facilities, clearinghouses, futures commission merchants, introducing brokers, commodity trading advisors, and others. The Commission currently does not have regulatory authority over spot market transactions, unless the transaction is a margin, leveraged, or financed retail commodity transaction or retail foreign exchange transaction. As such, the CFTC currently does not have regulatory authority over spot market transactions or intermediaries in the digital commodity spot markets.

Legislative Proposals

H.Res. _____, Resolution Expressing Support for Blockchain Technology and Digital Assets (Rep. Johnson)

The Resolution expresses support for blockchain technology and digital assets.