

Myth vs. Facts: FIT for the 21st Century Act

Myth: All digital assets, other than bitcoin, are securities and should be regulated by the Securities and Exchange Commission (SEC).

FACT: Not all digital assets are securities. While some digital assets can be offered as part of an investment contract and some may be tokenized, a clear framework for determining when a digital asset is not a security is critical.

- The SEC relies on the Supreme Court’s Howey Test to characterize certain digital assets as securities because they may have been offered as part of an investment contract. There is significant ambiguity with respect to how the Howey Test should be applied to digital asset transactions.
- The XRP decision in July 2023 determined that XRP was only part of an investment contract when offered directly by Ripple to institutional investors. The decision called into question the SEC’s position that practically all digital assets are securities. The SEC’s policy was rejected by the court, which highlights the need for legislation.
- As the SEC, CFTC, and the courts have opined, some digital assets do not have the traditional characteristics of a security and therefore should be considered non-security digital assets. These digital assets cannot be regulated as securities.
- The digital assets that have been recognized as non-security digital assets (or digital commodities) account for approximately 70% of the market cap for digital assets.
- Today, there is no comprehensive federal regulation of the cash or spot trading of digital commodities. Additionally, there is no regulatory framework to address the circumstances in which a digital asset that is not itself a security, and was once offered as part of an investment contract, can be considered a digital commodity.
- To ensure customers are protected and preserve market integrity, Congress must establish a regulatory framework for the cash or spot trading of digital commodities. As such, the Act establishes a process to permit the secondary market trading of digital commodities which were initially offered as part of an investment contract but are not themselves considered securities.

Myth: Digital assets facilitate financial crimes, such as money laundering. Legislation would legitimize a harmful industry.

FACT: Blockchain technology allows for better transaction tracing and asset monitoring than what is available with traditional finance.

- Undoubtedly, bad actors exist and use any means necessary to commit crimes and evade law enforcement. Just like the internet and cash, digital assets have been used for malicious purposes, such as fraud and money laundering.
- Thanks to blockchain technology, digital assets have a built-in recordkeeping mechanism that makes them highly traceable. This is an incredibly valuable tool for law enforcement to protect consumers and thwart bad actors.
 - For example, in 2021, hackers took control of Colonial Pipeline’s computer network and forced it to pay \$2.3 million in bitcoin to regain control over the network. The FBI used the transaction history on the Bitcoin blockchain to find the bitcoin and return it to Colonial Pipeline.

Myth: Existing legal frameworks can accommodate digital assets. Digital asset market participants simply need to “come in and register” with the SEC to come into compliance with U.S. securities laws and operate legally.

FACT: The SEC’s existing regulatory regime is not designed to accommodate the registration and regulation of digital assets. The SEC has failed to provide the clarity these entities need to operate. Instead, the SEC has used its enforcement authority to regulate the market. The SEC must ensure that the rules and regulations provide the roadmap for all firms seeking to participate in the digital asset ecosystem.

- The securities laws and regulations do not account for many of the unique characteristics of digital assets. Just as the SEC has adjusted its regulatory framework for asset-backed securities, the SEC must adjust its regulatory framework for digital assets.
- While the SEC asserts publicly that companies should “come in and register,” behind the scenes, the Commission has opted to pursue enforcement actions rather than work with market participants. The SEC could issue rulemakings, solicit public comment, or hold roundtables to better understand the issues facing the ecosystem and support the registration of digital asset market participants. Instead, the Commission has refused to answer the legal questions around its approach and pursued enforcement actions instead.
- Legislation is needed to give the CFTC regulatory authority over the digital commodity spot markets. Given the SEC is unwilling to prioritize comprehensive rulemaking,

Congress must legislate to fill the regulatory gaps between the SEC and CFTC. This will provide much needed protections for individuals engaging in the market and allow for the digital asset ecosystem to operate in the United States.

Myth: Congress is working with the digital asset ecosystem to create light touch regulations and prevent the SEC from being able to police digital assets.

FACT: The digital asset market structure legislation updates existing securities law to give the SEC full authority over digital assets that are offered as part of an investment contract. It further updates existing commodities laws to provide the CFTC with legal authority over digital commodity markets.

- Under the legislation, the SEC will have clear authority over restricted digital assets which do not meet the proper decentralization and functionality requirements to be considered a digital commodity.
- Similarly, the CFTC will have clear legal authority over intermediaries in the digital commodity market that act as an exchange or who serve customers as brokers or dealers. The legislation imposes similar obligations on persons registered for these new activities as those imposed on existing persons registered as designated contract markets (a futures market), futures commission merchants (a futures broker), or a swap dealer.
- CFTC Chairman Behnam said it best at a recent House Agriculture Committee hearing:
 - “We are a principles-based regulator, so I think it is easy for critics...to say [the CFTC is] a “light touch” regulator because [the CFTC is] a principles-based regulator. That couldn’t be farther from the truth. ...if you look at our statute...the rules that we draft, driven from the law, are quite extensive, are more prescriptive, and are very specific to protecting customers and protecting markets. So, we are the farthest thing from a light touch regulator, and I think if you ask any of our registrants what they would say, I think they would agree with that.”

Myth: Congress is fundamentally reshaping time-tested U.S. securities and commodities laws to accommodate digital assets.

FACT: Congress is tailoring very specific sections of U.S. securities and commodities laws to ensure the SEC and the CFTC have the authority needed to regulate the digital asset markets.

- This legislation builds on existing SEC authorities, enabling the Commission to regulate intermediaries without stifling innovation. For example, the legislation creates a new *Digital Asset Trading System* at the SEC, which is modeled on existing authorities for the existing Alternative Trading Systems (ATS).
- The Act also allows for dual registration of entities overseen by the SEC and CFTC. This permits intermediaries to operate smoothly and support certain types of digital assets. The legislation also creates a new exemption built for digital asset issuers to raise capital and distribute their digital assets. This builds off the current exemptions widely used today.
- The legislation builds on the existing authorities in commodity laws. For example, similar to how the CFTC regulates derivatives exchanges, a registered digital commodity exchange would be required to comply with regulations regarding the monitoring of trading activity, prohibition of abusive trading practices, minimum capital requirements, public reporting of trading information, conflicts of interest, governance standards, cybersecurity, and more.
- For customer protection, all CFTC-registered digital asset intermediaries would be required to segregate and protect customer funds under the same robust customer segregation requirements as were imposed by Dodd-Frank.
- Additionally, just as derivatives exchanges have a pathway to list new products through a self-certification process, the bill provides digital commodity exchanges with a similar ability to list digital commodities.

Myth: The bill is a partisan pursuit of broad sweeping digital assets legislation that creates entirely new legal frameworks for the digital asset ecosystem when no financial regulators have called on Congress to do so.

FACT: Federal financial regulators have called for additional authorities to properly manage and police the digital asset ecosystem.

- In 2021, SEC Chair Gensler stated that there needed to be more investor protections for digital asset trading platforms and that he had asked Congress to consider the issue. Separately, SEC Commission Hester Peirce has consistently and publicly urged Congress to develop a regulatory framework for digital assets in order to provide clarity and certainty to these markets.

- In 2022, the Financial Stability Oversight Council (FSOC) issued a report on digital assets, Report on Digital Asset Financial Stability Risks and Regulation, in which it recommended that “Congress pass legislation that provides for explicit authority for federal financial regulators over the spot market for crypto-assets that are not securities.”
- CFTC Chairman Behnam has frequently and publicly called for additional legislation to close the “spot market gap” and provide the CFTC with the authority to register and regulate digital commodity trading platforms.
- In 2023, in testimony before the House Committee on Agriculture, Chairman Behnam emphasized he has, “consistently highlighted the need for Congressional action to address the lack of federal regulation over the digital commodity market.”
- In 2023, in testimony before the House Committee on Financial Services, Treasury Secretary Janet Yellen highlighted “there are some gaps like spot markets for crypto assets that are not securities. [Treasury] would like to see your regulatory framework over those markets and there are gaps in regulations.”
- Congress is responding to concerns voiced by both regulators and market participants, while fulfilling our duty to set clear rules for the digital asset markets.

Myth: Digital assets lack any real use case. Existing technologies and traditional financial systems can replicate any of the benefits claimed by digital asset supporters.

FACT: Digital assets offer a variety of unique and novel use cases that both supplement traditional financial and technological systems and offer new products and services. Digital assets also form the foundation of a new, decentralized internet that will grant individual users more ownership over their data, transactions, and finances.

- Criticisms of the digital asset ecosystem resemble the sentiment that condemned the Internet in its early days of adoption. For example, in 1998 economist Paul Krugman claimed that “by 2005 or so, it will become clear that the Internet’s impact on the economy has been no greater than the fax machines.”
- Blockchain technology provides an immutable public ledger that permanently records digital asset transactions without the use of an intermediary. As a result, digital asset transactions can be done more efficiently, more expediently, and less costly than services available in the traditional financial system.

- Digital assets also facilitate the creation of a new type of internet. Currently, the internet is highly concentrated, allowing a few entities to largely control internet traffic, commerce, and the rules of the road.
- Through blockchain technology, a new decentralized internet can be created that provides individuals with the power to create and use products and services apart from the frameworks established and controlled by the companies that currently dominate the internet. Blockchain technology is already being utilized to revolutionize a number of industries including file storage, supply chain management, and identity verification, among others.

Myth: The digital asset industry is slowly fading into oblivion. Congress should leave the industry to its own devices and let it implode.

FACT: A significant portion of Americans already own digital assets and the technology is not going away. If the U.S. does not provide a viable legal pathway to transact in digital assets, consumers will continue to engage in the digital asset ecosystem unprotected. Innovators seeking regulatory certainty will move their business offshore to potentially less regulated markets.

- Despite the volatility of 2022, the global digital assets market cap is currently over \$1 trillion. Nearly 20% of Americans own digital assets and more than 67% of Americans hope to use digital assets on “trusted, secure platforms.” Additionally, entrepreneurs continue to develop innovative new products and decentralized applications (dApps) for different blockchains, including dApps related to finance, art, and gaming.
- Outside of the United States, digital assets are rapidly gaining in popularity and adoption. The United Kingdom, European Union, Switzerland, Hong Kong, and other foreign jurisdictions have recognized the potential of digital assets and are prioritizing adopting clear regulations to attract digital asset companies and developers.
- The lack of regulatory certainty will drive innovation and growth overseas, putting the United States’ economy at a distinct disadvantage with respect to foreign jurisdictions with established digital asset regulation. This will also leave consumers at risk as they engage in digital asset related activity in foreign jurisdictions with minimal or insufficient regulation and governmental oversight.

Myth: The CFTC does not have the expertise or capacity to protect customers in the digital asset markets.

FACT: The CFTC is the primary market regulator for derivatives in the United States, overseeing the trillion-dollar industry. To date, the Commission has brought numerous enforcement actions against bad actors in the digital asset ecosystem. The [Digital Asset Market Structure Act] will provide more tools to the CFTC to go after additional bad actors as well as help entities register in a compliant manner.

- Since 2014, the CFTC has used its limited authority over fraud and manipulation to bring more than 80 enforcement actions against bad actors in this space. In order to stay on top of the technological advancements driving this market, the CFTC continues to manage a rising number of registrants offering derivative products based on digital assets.
- The CFTC’s regulatory authority is limited to transactions, participants, and intermediaries in the commodity derivatives markets. However, the CFTC’s enforcement authority extends to commodity spot market and derivatives market transactions, participants, and intermediaries, where the Commission has the authority to police for fraudulent and manipulative activity.
- To better protect customers in these markets, the CFTC and the National Futures Association (NFA) have worked diligently to update rules and guidance to address the rise of digital assets activity in CFTC-regulated derivatives markets and by NFA member firms.
- Under this legislation, the CFTC will be granted new regulatory authority over spot market transactions or intermediaries in the digital commodity spot markets. This authority will allow the CFTC to impose registration requirements on digital commodity exchanges, digital commodity brokers, and digital commodity dealers, in addition to providing comprehensive oversight of digital commodity markets.