HOUSE COMMITTEE ON
AGRICULTURE
REPUBLICANS

SUMMARY OF THE DIGITAL COMMODITY EXCHANGE ACT OF 2022

The Digital Commodity Exchange Act (DCEA) provides certainty and clarity to the digital commodity marketplace by creating a regulatory framework for digital commodity developers, dealers, and exchanges. It fills gaps between the Commodity Futures Trading Commission's (CFTC) and the Securities and Exchange Commission's (SEC) regulation of the digital asset marketplace and is complementary to existing regimes.

NEW FRAMEWORK FOR DIGITAL COMMODITY EXCHANGES AND CUSTODIANS

The DCEA is grounded in the Commodity Exchange Act (CEA) provisions, which the CFTC has used to efficiently and effectively regulate the commodity derivatives markets for decades.

It provides digital commodity trading venues with federal registration as an alternative to multi-state money transmitter licenses while building on the efforts of state and federal banking regulators to register and supervise digital commodity custodians.

Digital Commodity Exchanges

Similar to CEA provisions for designated contract markets and swap execution facilities, the DCEA authorizes the CFTC to register and regulate trading venues offering spot or cash digital commodity markets as digital commodity exchanges (DCE).

DCEs must register with the CFTC if they want to offer leveraged trading or list for sale digital commodities that were distributed to individuals before being available to the public. Trading venues not offering those products are not required to register with the CFTC as a DCE but may continue to be regulated and supervised by the states via their respective money transmitter licensing regimes.

Under the bill, a registered DCE must monitor trading activity, prohibit abusive trading practices, establish minimum capital requirements, report certain trading information publicly, avoid conflicts of interest, establish governance standards, and adopt cybersecurity measures. Consistent with CEA provisions for futures commission merchants, the DCEA requires DCEs to segregate customer assets and incorporates DCEs into existing commodity broker bankruptcy protections.

Qualified Digital Commodity Custodians

A registered DCE must hold customer digital commodity assets in a qualified digital commodity custodian*,* which is defined as a custodian recognized by the CFTC as appropriately regulated and adequately supervised by a state, federal, or international banking regulator.

IMPROVING THE PROCESS OF TRADING DIGITAL COMMODITIES

The DCEA simplifies how new digital commodities are brought to market by creating clear jurisdictional lines between the CFTC and the SEC and establishing a more collaborative, flexible process to evaluate whether digital commodities should be made available for trading on a registered exchange.

Clear Rules of the Road

The DCEA does not disturb the SEC's jurisdiction over securities offerings that involve digital assets. Nor does it impact the SEC's jurisdiction over digital assets that represent some form of ownership or investment in a business. However, if a digital asset does not convey rights and obligations typically associated with a security, then it is considered a digital commodity and subject to the CFTC's regulatory regime as provided in the DCEA.

Pre-Sold Digital Commodities

Under the DCEA, a "digital commodity presale" occurs when a developer delivers or promises to deliver a digital commodity to certain individuals as part of a securities offering or an investment contract. Recipients of pre-sold digital commodities are limited to selling them on a DCE, through a securities offering, or to an accredited investor. Holders of pre-sold commodities can also use them for their intended purpose (i.e., as utility tokens) or seek a public interest exemption from these trading restrictions from the CFTC.

Digital Commodity Listing Process

The DCEA expands the CEA's self-certification process to DCEs seeking to list new digital commodities for trading. Through this process, DCEs are required to demonstrate to the CFTC that the new digital commodity complies with the requirements of the CEA. If the CFTC fails to deny the DCE's self-certification within a set time, the DCE may list the digital commodity for trading.

Unlike the self-certification process for derivatives contracts, the DCEs would be required analyze the mechanics of the digital commodity, including its purpose, functionality, governance structure, distribution, and participation. Generally, a DCE must certify that a digital commodity is "not readily susceptible to manipulation" before it can list any tokens. In addition, the DCE is required to make two specific determinations related to decentralization before certain digital commodities can trade:

- The DCE is prohibited from permitting trading in any digital commodity if it is reasonably likely that any person or group of people acting collectively can fraudulently alter its transaction history.
- The DCE is prohibited from permitting trading in any pre-sold unit of a digital commodity if it is reasonably likely that any person or group of people under common control can materially alter its functionality or operation.

Voluntary Registration of Digital Commodity Developers

To assist digital commodity developers in preparing their projects for an eventual listing on a DCE, the DCEA provides them with a means to register with the CFTC and make required disclosures. Registration ensures the public information available about a digital commodity is standardized and records relating to pre-sold digital commodities are accurate.

No digital commodity developer would be required to register, but registration could help facilitate the eventual public trading of the digital commodity.

PROTECTING CUSTOMERS UTILIZING STABLECOINS

The DCEA provides a new regulatory regime for certain stablecoins based on the CFTC's successful regimes to protect customers and customer assets across the wide range of commodity market intermediaries.

Registering Fixed-Value Digital Commodity Operators

The DCEA permits asset-backed stablecoin operators to register with the CFTC as fixed-value digital commodity operators (FVDCO). Registration requires an FVDCO to meet certain obligations, including publicly sharing essential operational information about the fixed-value digital commodity (FVDC), protecting the assets backing the FVDC, mitigating and disclosing conflicts of interest, and retaining books and records for examination by the CFTC.

Registration provides a simplified path for FVDCs to be utilized on registered DCEs, encouraging compliance.

Full Accounting of FVDC Assets and Liabilities

The DCEA requires FVDCOs to be subject to a comprehensive reporting and auditing regime to ensure assets backing the FVDC are fully accounted for and there are sufficient resources available to meet redemption obligations fully.

SIMPLIFYING DIGITAL COMMODITY DEALING AND PROTECTING CUSTOMERS

Permitting FCMs to Participate in Digital Commodity Markets

The DCEA expands the CEA's definition of a futures commission merchant (FCM) to regulate entities holding customer funds, and serving as intermediaries for a registered entity or acting as counterparties for the spot or leveraged trading of digital commodities.

Under the bill, current law is preserved, and entities undertaking such activities may continue to seek and hold multi-state money transmitter licenses instead of registering with the CFTC as an FCM.

Protecting Customers During a Bankruptcy

By allowing FCMs to expand their business to encompass new digital commodity activities, the customer assets held at the FCM are brought into the CFTC's segregation and bankruptcy rules. The DCEA creates a new segregation category at the FCM for digital commodity customers engaged in spot and leveraged trading. This will protect digital commodity customers and the traditional customers of FCMs engaged in derivatives transactions.