

Written Testimony of
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The Future of Digital Asset Regulation

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Chairman Maloney, Ranking Member Fischbach and Members of the Subcommittee:

It is a distinct pleasure to be here with you today. The Agriculture Committee is home to many of my favorite members of Congress—which is saying something for a law professor—and I’ve long been impressed, and thankful for the bipartisanship this Committee has long embraced. Today’s hearing is yet another example.

With financial markets experiencing enormous volatility, and global monetary practice reversing decades long trends in old and new markets alike, I’ve been asked to talk about how best to strategically think about the regulatory future of digital assets, and the implications of digital asset markets for financial inclusion.

Either issue could be the subject of its own hearing, but they are not altogether unrelated. I’ll try my best to connect the dots where I can.

The Coming Work of Regulatory Agencies

If there is one thing I would like you to remember from my remarks today, it is that the future of digital asset regulation will require much more than just defining agency jurisdiction and placing digital asset products into varying governmental organizational charts. It will also, necessarily, involve revisiting longstanding assumptions about market infrastructures embedded in securities and derivatives law and adapting the regulatory system in creative ways that reflect the best of our experience and collective values.

Four years ago, near the height of the Initial Coin Offering (ICO) boom, I advised your colleagues in the Financial Services Committee that there would be significant work ahead for Congress and regulators seeking to tackle digital asset regulation, regardless as to how digital assets, ICOs

or otherwise, were classified.¹ Time has proven those comments correct, and given the limited advances regulatorily since then, they are as true today as ever. Irrespective of which agency is ultimately given more authority over digital assets markets, regulators need to undertake significant work with regards to upgrading systems to be mission ready. The jurisdictional question is but the tip of a much larger iceberg of issues confronting regulators and Congress today.

As a securities law professor, I like to use disclosure as a simple example. As some of you may recall, disclosure was the focus of my testimony when I spoke on ICOs.² Today, the topic of disclosure has once again been highlighted as retail investors have been too often caught unaware of the risks entailed when engaging in digital asset transactions with lending firms, custodians and complex intermediaries and protocols.

Yet deeming a digital asset a “commodity” or “security” will not magically passport digital assets to regimes ready built to provide proper or even efficient oversight or clarity. Financial futures on “commodities” like corn, gold, and oil may face grading and quality requirements, but spot commodity transactions are not automatically subject to any particular disclosure regime. Instead, the identification of a product as a commodity subjects those that transact on the spot market to a range of antifraud protections—effectively ‘negative’ disclosure requirements prohibiting misleading statements and market manipulation—as opposed to any substantive, positive disclosure demands.³

Calling a digital asset a “security” won’t solve the problem, either. This is because the SEC’s disclosure obligations largely fail to anticipate the particularities of blockchain infrastructures. Indeed, as I have consistently noted for lawmakers, even if one were to make the counterfactual assumption that all digital assets were securities, Regulation S-K, the disclosure template for Initial Public Offerings, is simultaneously under- and over-inclusive. As such, it fails in some instances to account for critical aspects of the digital assets ecosystem, and in others imposes obligations with little to no relevance, creating both a lack of clarity and inefficiency in compliance.

Complicating things even further, the infrastructure supporting digital assets presents novel policy and strategic questions on the part of any regulator. Traditionally, U.S. disclosure regimes

¹ See *What Should Be Disclosed in an ICO White Paper?*, Hearing Before the Subcomm. on Cap. Mkts, Sec. and Inv of H.R. Comm. on Fin. Servs., 115th Cong. (2018) (written testimony of Chris Brummer, Fac. Dir., Geo. U. L. Ctr.); See also an expanded analysis by Chris Brummer, Jai Messari & Trevor Kiviat in *What Should be Disclosed in an ICO?*, DIGITAL ASSETS: LEGAL, REGULATORY AND MONETARY PERSPECTIVES 157-202 (2019).

² For an overview of shortcomings of white paper disclosures, see Shaanan Cohny, David A. Hoffman, Jeremy Sklaroff, & David Wishnick, *Coin-Operated Capitalism*, 119 COLUM. L. REV. 608 (2019). These shortcomings have particular salience given the complexity of some services; See also Hilary Allen, *DeFi 2.0?*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4038788 (noting how complexity inherently makes risks harder to anticipate, and to understand, especially for retail participants). The FTC has attempted to, at least indirectly, quantify the extent of the problem, suggesting that losses from digital assets scams topped \$1 billion in 2021. Lesley Fair, *Reported digital assets scam losses since 2021 top \$1 billion, says FTC Data Spotlight*, FTC (June 3, 2022) available at <https://www.ftc.gov/business-guidance/blog/2022/06/reported-crypto-scam-losses-2021-top-1-billion-says-ftc-data-spotlight>.

³ See 17 C.F.R. §§ 180.1.

have rested on the assumption that the issuer is in possession of nonpublic material information that needs to be made broadly accessible to investors. This transparency is intended to allow investors to better understand the risks they face and to then respond to these dangers by appropriately pricing that risk or avoiding altogether by investing elsewhere. But in most digital asset contexts, particularly those involving more decentralized actors operating on public blockchains, much (although not all) information relevant to an investor or consumer is already visible to the public on chain—but it is accessible and understandable only to technologically sophisticated actors.

This feature takes on special importance when contemplating the basic goals of a disclosure system for digital assets. With vast quantities of complex information already encoded on public blockchains for sophisticated actors, any disclosure regime for digital assets should be geared to speak to everyday retail customers and investors. Yet for those with even a passing familiarity with today’s primary disclosure system, which applies to public companies, it is clear that disclosures are largely designed to be “filed and not read.” Submissions are voluminous and dense. They are written in legalese and filed on the SEC’s Edgar database, and often follow formats that respond to the demands of analysts at financial institutions, not retail investors.⁴

To truly protect participants in digital asset markets, another model is likely to be better suited for the diverse interests and backgrounds represented by retail investors. I have argued that we need to look much more carefully at consumer protection law’s focus on targeted, retail-friendly disclosures that are meant to be engaged with and digested by everyday participants, and not ignored because they are too inaccessible or overwhelming.⁵ Specifically, I’ve suggested building a better disclosure regime, one that could involve revamping Regulation S-K for the risks of digital asset applications and financial products—or a new regime that is developed from scratch employing the shorter, crisper disclosure approaches typically associated with consumer protection law. I’ve also drawn attention to the necessity of clarity and “Plain English” in disclosures for not just the business, but also the technology used to support different protocols.⁶

⁴ See Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L. J. 711, 713 (2006) (“Any serious examination of the role and function of securities regulation must sidestep the widespread, yet misguided, belief that securities regulation aims at protecting the common investor. Securities regulation is not a consumer protection law.”); see also Troy Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation 2* (St. Louis U., Faculty Working Paper Series, Paper No. 03-02-02, 2003) available at <http://ssrn.com/abstract=413180> (noting that “[s]ecurities regulation is motivated, in large part, by the assumption that more information is better than less,” but that it can create “information overload” for retail investors).

⁵ Chris Brummer, *Disclosure, Dapps and DeFi*, STAN. J. OF BLOCKCHAIN LAW & POLICY (Mar. 27, 2022 forthcoming) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4065143.

⁶ Notably, the SEC has implemented “Plain English” disclosure rules designed to reduce the jargon and difficulty often associated with reading registration statements. The most stringent requirements in Rule 421(d) articulate definitive prohibitions against “legal jargon” and “technical terms” in the summary, risk factors, and cover and back pages of a prospectus. Meanwhile, under Rule 421(b), the Commission has outlined a number of norms such as “short sentences whenever possible,” “bullet points,” and “descriptive headers” while advising that prospectus drafters avoid “legal and highly technical business terms,” “legalistic, overly complex presentations,” “vague boilerplate,” “excerpts from legal documents,” and “repetition.” As such, the Plain English rules speak to the overly complex business narratives and communications that have traditionally made securities offerings indecipherable for everyday investors. Plain English disclosures apply, however, only to the front and back pages, and summary and risk factors, of prospectuses included in registration statements filed with the SEC. They do not relate to the disclosures consumers may need most, like the more in-depth descriptions of relevant tokens or supporting technologies that are often critical to understanding a dapp as an investment thesis. *Id.*

I've also made the case that serious regulation, irrespective of which regulator is in charge, requires courageous creativity and a *builder's mentality*. Strong and rigorous enforcement is essential—particularly where rules are reasonably clear and bad actors ignore them or exploit ambiguities. But it's still just one tool—and by definition involves waiting for problems to arise instead of nipping them in the bud and preventing them before they happen.

A safer, fairer, and more efficient system requires additional building blocks. Gatekeepers suited to the environment are an obvious starting point. Auditors of a blockchain or protocol's code will be as important in digital asset ecosystems as auditors of a public company's financial statements. Purpose-built operational systems will be critical as well. Just this month, an anonymous hacker was served with a restraining order via an NFT delivered to the perpetrator's wallet.⁷ In a similar guise, I've written about using NFTs for disclosure delivery in some DeFi settings, incentivizing investors to read disclosures (through rewards or whitelisting) in ways that improve their disclosure experience in meaningful ways that advance consumer protection.⁸ My point then, as now, is that a functioning system that safeguards consumers and investors will need more than just (re)drawing the regulatory perimeter, and punishing actors after the damage has been done. Proactive, creative steps will also be necessary to make the system work well for everyone—steps that acknowledge the strengths and weaknesses of not only emerging financial technologies, but also those of the legacy regulatory system.

CFTC as Crypto-Regulator

With that said, there is the obvious question for this Subcommittee as to whether the CFTC in particular is up to the task of regulating digital asset markets. It is in many ways a surprising question—even with the work ahead, few doubt that the United States enjoys not one, but two world class markets regulators. The SEC can and should regulate digital asset securities. The question is whether the CFTC could – or should – regulate the spot market for those digital assets which are “commodities” and not securities. I believe both agencies could do the job. But each would bring to the table different comparative advantages.

The CFTC's experience lies in effective and nimble deployment of its own limited authority, which has enabled it to be an important cop on the beat of Bitcoin spot markets. Although the agency does not have the power to set standards for digital asset commodity spot markets—or for that matter compel the registration of spot digital asset commodity exchanges—it does have the authority to police fraudulent and manipulative activities in digital asset commodity markets.⁹ Additionally, CFTC jurisdiction covers digital asset commodity products, including

⁷ Sam Bourgi, *Anonymous hacker served with restraining order via NFT*, COINTELEGRAPH (June 9, 2022) available at <https://cointelegraph.com/news/anonymous-hacker-served-with-restraining-order-via-nft>.

⁸ Brummer, *supra* note 5 at 35-37.

⁹ Stephen M. Humenik et. al., *CFTC and SEC Perspectives on Cryptocurrency—Vol. 1: A Jurisdictional Overview*, K&L Gates (May 6, 2022) available at <https://www.klgates.com/CFTC-and-SEC-Perspectives-on-Cryptocurrency-and-Digital-Assets-Volume-I-A-Jurisdictional-Overview-5-6-2022>. Notably, in the past fiscal year, the CFTC filed 23 digital asset-related enforcement actions, nearly half the total number of digital asset-related enforcement actions brought by the CFTC in the 2015-

products offered to retail investors and end users, that provide for margin or leverage and is offered to retail customers.¹⁰ Thus to the extent that spot digital asset commodity trading relies on margin or leverage to U.S. persons, it already falls under the CFTC’s broader and more comprehensive registration jurisdiction—and the agency enjoys the authority to declare that those products be traded on an exchange and/or through a registered FCM.¹¹ Extending oversight of cash digital asset commodity markets, from this perspective, could be interpreted as a natural evolution of existing oversight.

The CFTC has also gained unique regulatory experience dealing with the risks entailed in substantively regulating digital asset infrastructures. As early as 2014, the CFTC granted under CFTC Chairman Timothy Massad approval for trading the first Bitcoin denominated swaps, options and NDFs on CFTC registered Swap Execution Facilities.¹² Several years later in 2017, the CFTC under CFTC Chairman Chris Giancarlo permitted the first Bitcoin futures contract to be listed on CBOE Futures and CME.¹³ Similar to today’s environment, critics panned the move, doubting both the asset and the CFTC’s ability to oversee the market and arguing that the oversight would create a bubble. Subsequent studies by the San Francisco Fed would, however, confirm the opposite, that not only were the markets functioning properly—but that, if anything, the introduction of the futures market helped push Bitcoin’s price down, not up. Through it all, the CFTC gained expertise in overseeing the institutionalization of significant infrastructures intersecting directly with the digital asset commodity spot market, something that the SEC, which has yet to approve a spot Bitcoin or digital asset commodity ETF, has arguably only accomplished in attenuated fashion through multiple Bitcoin Futures ETFs.¹⁴

Where the CFTC’s expertise *is* less developed than the SEC’s is in the domain of disclosure. With nearly 90 years of history, the SEC has established itself as the nation’s premier (but not sole) information regulator, with particular expertise where transactions involve an investment of money, in a common enterprise, with the expectation of profits, that is dependent on the efforts of others.¹⁵ But where the target of regulation is fully decentralized assets, even disclosure principles would, as noted above, need a fundamental rethink by any regulator, including the SEC, and a revamp of existing legal infrastructure. And the SEC would have to pivot to doing things in ways that speak to the challenge and the times—and to *build* the infrastructure to do it properly. The SEC would have a head start in this particular area, but given the kind of conceptual agility needed, its already packed agenda, and the comparatively

2021 period. James Rubin, *CFTC Chair Indicates Agency Will Increase Crypto Enforcement: Report*, COINDESK (May 19, 2022) <https://www.yahoo.com/video/cftc-chair-indicates-agency-increase-233028535.html>

¹⁰ See Commodity Exchange Act, 7 U.S.C. §2(c)(2)(D).

¹¹ *Id.*

¹² Joon Ian Wong, *CFTC Chairman: We Have Oversight of Bitcoin Derivatives*, COINDESK (Dec. 11, 2014)

<https://www.coindesk.com/markets/2014/12/11/cftc-chairman-we-have-oversight-of-bitcoin-derivatives/>

¹³ *Bitcoin makes debut on futures market*, AP (Dec. 10, 2017) <https://www.theguardian.com/technology/2017/dec/11/bitcoin-makes-debut-futures-market-cboe-chicago-board-options-exchange>.

¹⁴ *Pressure on SEC to Approve First Bitcoin ETF Ratchet Up*, PYMNTS (Apr. 25, 2022),

<https://www.pymnts.com/blockchain/bitcoin/2022/pressure-on-sec-to-approve-first-bitcoin-etf-ratchets-up>.

¹⁵ SEC v. W.J. Howey Co., 328 U.S. 293 (1946); Securities Act 1933 § 2(a)(1) Pub. L. No. 112-106, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a et seq.)

higher hurdle of establishing its jurisdiction (e.g. the existence of a security), perhaps not as much as one would assume.

The CFTC is also well behind the SEC in terms of resources. The CFTC is but a quarter of the size of the SEC (700 vs. 4,000 full time employees), and enjoys a fraction of the SEC's budget (\$350 Million v. \$2.5 Billion). To build an architecture for regulating digital assets comprehensively will require considerably more resources than are currently available,¹⁶ and unlike the SEC, which is able to move resources around the agency to meet staffing needs pertaining to digital asset regulation, the CFTC—an agency long under resourced—would presumably have little room to maneuver if proper resources were not allocated.¹⁷

Financial Inclusion

Where, however, I think the builder's mentality is most critical in the digital assets conversation is in the context of financial inclusion. Digital assets are, like most technologies, a tool whose benefits will depend on how the technology is used, and for whom. Skeptics have claimed that digital assets present no benefits for inclusion, or for that matter, anything else. Industry, meanwhile, has all too often touted inclusion without thinking seriously about what it means, or how to achieve it concretely.

To its enormous credit, the digital assets debate has opened up a long overdue dialogue on just how much the legacy financial system continues to fail many communities—and how overlooked communities, and especially minority communities, build wealth. But critics and proponents alike tend to miss the forest for the trees, and dwell almost entirely on the wisdom of a particular asset class (“Is Bitcoin a good or bad investment for Black Americans?”) without tackling the larger, thornier issue head on: *how do we ensure communities traditionally left out of our capital markets participate in a meaningful and diversified way, over the longer term, and earlier in sectors' life and economic cycles, when value is created?* It's a question that digital assets prompt, but which is much larger than “crypto.” And when digital assets are the avatar through which the conversation takes place, policy debates are invariably fixated on daily or weekly price movements instead of on basic principles of investing and on reforms needed to address a sprawling wealth gap.¹⁸

¹⁶ CFTC Chairman Rostin Benham has indicated that the CFTC would need about \$100 Million in additional funding to handle regulating the spot Digital Asset commodities market, and varying proposals, and some Industry officials, have suggested a range of transaction taxes or fees to meet the challenge.

¹⁷ What maneuverability the agency would have is hard to estimate. There is precedent suggesting that the CFTC's ability to make the most of the budget is considerable. Despite the staffing and funding differentials Congress ended up giving the CFTC, not the SEC, 95% of the swaps market jurisdiction under Dodd Frank. And despite largely missing out on commensurate increases in funding, even when compared with the SEC, the CFTC is widely viewed as a successful regulator of that market, despite its hamstrung resources. However, stacking additional responsibilities on top of an already resource poor agency, without the necessary funding, could end up not only hampering supervision of digital asset markets, but also disrupting other critical agency functions.

¹⁸ Instead of focusing on whether people of color invest in any particular digital asset, the healthy policy discussion would center on the appropriate portfolio of low, medium and high-risk investments investors should have in order to build their economic lives—and ideally, overcome historic and growing wealth inequality. From this standpoint, basic principles of investing dictate that most investors should try to have some (modest) exposure to a diversified slice high risk or alternative assets—whether it be digital assets, high end art, silver, private securities, etc.—alongside a much larger swath of medium and low risk assets, de-

Focusing on digital assets as an *investment* also diverts attention from what is likely the far more relevant question, at least from the standpoint of financial inclusion—namely whether there are parts of the ecosystem’s *technology stack* that can be leveraged to open opportunities for the underserved here in the United States.

I have been frank, at times painfully so, about the shortcomings in the digital assets and fintech ecosystem where I see them.¹⁹ But for all of the challenges, the core attributes of immutability, programmability, transparency, and publicness are truly novel—and position it in ways, if done well, to supplement, and positively disrupt, a payments and financial system long tilted towards the wealthy. And it is these features that present a unique opportunity to experiment and think seriously about how to upgrade our financial system in ways that can uplift noncoastal, rural and minority populations.

Remittances have long been highlighted in Congressional hearings as obvious use cases, especially for immigrant communities facing predatory fees for cross border payments. (They also helpfully distinguish the interest many people have in using digital assets vs. investing in them.) But there are many other digital asset and blockchain-related projects currently under development that target financial inclusion and the democratization of opportunity even more directly for the U.S. context, and with obvious relevance to working class people and communities of color:

- Opportunities like decentralized identity, which can enable individuals to collect verifiable credentials with any constellation of actors-like banks, schools, employers, post offices, and more-that can be mixed and matched to prove not only who you are for any range of governmental purposes from voting eligibility, jury duty, "sophistication" for accredited investor status, etc.).
- Opportunities to build new kinds of reputation to open the credit box through decentralized credit scoring, or leverage decentralized credit scoring alongside decentralized IDs and credentials (e.g. landlords and utility companies issuing credentials relating to a solid repayment history).
- Opportunities for using tokenized, real world assets as collateral for borrowing.
- Opportunities to not only reduce closing costs for home purchases and mortgage closing costs with portable credentials from mortgage agents, but to store title certificates as NFTs on blockchains.

risking the portfolio as a person nears retirement. Policy proposals should focus on whether or not the market, and regulatory policy, support enabling such longstanding, long proven, and nonpartisan insights. For communities of color that have long been underinvested in capital markets and have traditionally lacked access to the fastest growing parts of the economy and technology, this work is especially critical.

¹⁹ See *99 Problems, Hearing Before the H.R. Comm. On Fin. Servs.*, (July 17, 2018) (written testimony of Chris Brummer, Prof. of Law Geo. U. L. Ctr.); See also Chris Brummer, *Fintech’s Race Problem*, MEDIUM (June 9, 2020), <https://chrisbrummer.medium.com/fintechs-race-problem-856df6351695>.

- Opportunities to build a decentralized net for community banks and minority depository institutions to process AML/KYC requirements associated with new bank accounts and in the process dramatically reduce their operational costs.
- Opportunities to escape predatory payments and banking fees, and access faster and cheaper financial rails via stablecoins (or CBDC) for quickly paying part time, remote and gig workers living check to check.

These kinds of innovations and projects are being explored, and in some instances built, with blockchains and digital asset technology, and could end up being massively profitable as well as socially useful. But in a world of sensational Twitter posts, big personalities and mega deals, they don't get the attention they deserve, from industry or national media. Meanwhile, regulatory agencies aren't in the business of financial inclusion, either—indeed, the Fed, SEC and CFTC all lack a financial inclusion mandate—and there is little incentive to take the time to ask what reforms are possible that could help direct energies towards positive social uses, or to ensure that the industry reaches its espoused potential of democratizing economic opportunities for everyone.

As I said four years ago, and at the outset of my remarks here today, the future of digital asset regulation will require much more than just defining agency jurisdiction and placing various digital assets into governmental organizational charts. More legal and regulatory brainpower will be needed, and lawmakers have a unique opportunity to step into the void, especially in periods of crisis or uncertainty, to make a real difference. But moving the dial, whether it be on consumer and investor protection, or financial inclusion, requires understanding the technology, its limitations, and opportunities. And having a builder's mentality.

Thanks so much to you all for the invitation to speak to you today. I look forward to your questions.