Summary of the Digital Commodity Exchange Act of 2020

The Digital Commodity Exchange Act (DCEA) is legislation to fill in the regulatory gaps that exist between the U.S. Commodity Futures Trading Commission (CFTC) and the U.S. Securities and Exchange Commission (SEC) in digital asset markets. It creates a framework to regulate trading venues which list emerging digital commodities, such as Bitcoin, Ether, their forks, and other similar digital assets, for public trading. Additionally, it provides a regulated process for presold digital commodities to become publicly available for trading without sacrificing protections for retail consumers.

New Framework for Digital Commodity Exchanges and Custodians

The DCEA builds on and extends the existing commodity markets framework which has served participants in futures markets for decades. It provides authority for the CFTC to register and regulate Digital Commodity Exchanges as a new type of registered entity with requirements which closely parallel the requirements for existing intermediaries in commodity derivatives markets.

The law simplifies the spot market for digital assets by providing trading venues an alternative to the cumbersome state-by-state money transmitter regulations. It also builds on the work done in many states by relying on state and federal banking regulators to license and supervise custodians.

Digital Commodity Exchanges

A registered Digital Commodity Exchange (DCE) would be subject to comprehensive CFTC oversight and regulations. Similar to how trading facilities such as Designated Contract Markets (DCMs) and Swap Execution Facilities (SEFs) are regulated by the CFTC, a registered DCE would be required to comply with regulations regarding 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. Exchanges would also be subject to limitations on which digital commodities they would be permitted to offer for trading.

Additionally, the proposed legislation builds on the existing commodity market practices required of Futures Commission Merchants (FCMs) to protect customer assets. DCEs would be required to segregate customer assets and hold them in separately regulated entities which are licensed to custody digital assets.

Registration with the CFTC would preempt the existing state-based money transmitter licensing regime trading venues are currently subjected to, which are not fit-for-purpose when applied to a spot trading market. The current regime is cumbersome, requiring separate licensing in each individual state of operation, and insufficient, failing to provide oversight of the trading and market activities that occur on the platform.

Voluntary Registration

The registration regime is voluntary, but with strong incentives for properly placed trading venues to seek registration.

Trading venues would be able to opt into the CFTC Digital Commodity Exchange regime or remain regulated under individual state money transmitter licenses. Trading venues will be incentivized to choose CFTC regulation in order to reduce their regulatory burdens by facing only one regulator, be eligible to offer leveraged trading, and be the point of entry for new digital commodities to the retail public.

Qualified Digital Commodity Custodians

A registered Digital Commodity Exchange would be required to hold customer digital commodity assets in a *Qualified Digital Commodity Custodian* which would be an entity regulated by a state, federal, or international banking regulator. The CFTC would set minimum standards for supervision and regulation a regulator would have to impose in order for an entity regulated under the regime to be deemed "qualified."

Improving the Process to Create Digital Commodities

The DCEA also simplifies the process of bringing new digital commodities to market by creating clear jurisdictional lines between the CFTC and the SEC, and establishing a more collaborative, flexible process to evaluate the appropriateness of making digital commodities available for public trading.

Compliance with Existing Securities Law

The DCEA would continue to require entities raising money to fund a digital commodity project to follow securities laws to accept funds from investors. This activity would continue to be subject to the jurisdiction of the Securities and Exchange Commission, under the existing rules for that activity.

However, if participation in a securities offering results in the promise or delivery of an asset which meets the definition of a digital commodity, transactions involving that asset would be subject to the regulatory regime provided in the DCEA.

Presold Digital Commodities

The DCEA defines the delivery or promise of a digital commodity in exchange for participating in a securities offering or investment contract as a "digital commodity presale." Participants in digital commodity presales would be subject to the new trading restrictions on the assets received through the presale until a registered digital commodity exchange listed the asset for trading and the asset is sold through a registered digital commodity exchange.

The proposed trading restrictions serve a similar customer protection function as trading restrictions in securities laws, but are tailored more appropriately to digital commodities, with a clear process for lifting the restrictions. Specifically, they would only permit the sale or transfer of a digital asset in limited instances:

- to another person who would have been eligible for the relevant securities offering;
- on a registered digital asset exchange;
- to utilize the digital asset for its intended purpose; or
- under a limited Commission-provided public interest exemption.

A Digital Commodity Exchange would be required to evaluate the digital commodity to determine that it is "not readily susceptible to manipulation" before it could be listed for trading and before the participants in the presale would be able to sell their holdings to the public. This process is intended to be similar to the existing process undertaken by DCMs in determining what contracts are available for trading on their exchanges, but focused on examining the mechanics of the digital commodity itself, including its purpose, functionality, governance structure, distribution, and participation.

Once a unit of a digital commodity is sold through a registered DCE, all trading restrictions on the asset are removed and it becomes freely usable by any market participant for any purpose.