RICH FEUER ANDERSON

Digital Assets State of Play

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OUR VIEW	Since our last update in March, Congressional hearings and debate have increased in frequency, but the overall regulatory landscape has not changed dramatically. Similarly, the White House and Treasury Department have been relatively quiet since the March Executive Order, but agencies continue working on their portions of the reports required by the EO. Sens. Lummis (R-WY) and Gillibrand (D-NY) introduced wide-ranging legislation this month, with legislation from Senate Agriculture Chair Stabenow (D-MI) and Ranking Member Boozman (R-AR) also in the works and expected to be released soon. We also understand House lawmakers are considering introducing identical companion bills for both proposals – although timing and bill leads are still unclear. The agreed-upon goal still remains the same from all interested parties – regulatory clarity – but a concrete regulatory solution that has unanimous approval is seemingly still far off. Lawmakers are still scattered, the turf war between the SEC and CFTC continues, all while headliner events and market swings seem ever present. Given these hurdles, we believe no legislation will be passed into law this year. That said, the two noteworthy bills mentioned above and other various legislation in the House of Representatives mark pivotal progress in this space and will serve as a basis for further discussions on the matter.
CONGRESS	We've continued to see an uptick in interest from Capitol Hill on digital assets and a growing number of lawmakers getting involved in digital asset legislation. However, a major process hurdle here is that without a definitive regulatory framework, there is not one Congressional committee with total jurisdiction over the industry – but there are many that want a stake. • The Senate Banking Committee, House Financial Services Committee, and Senate and House Agriculture Committees are expected to play primary decision-making roles, but additional committees have also looked to be involved. Senate and House Homeland Security Committees are engaging from a national security perspective, including two hearings in June focused on the role of crypto in terrorism, ransomware and cyberattacks. HFSC Democrats also held a crypto briefing late last week which focused on recent volatility in the markets, including crashes of Terra and Celsius, companies announcing major layoffs, and energy consumption. We expect another full HFSC hearing on crypto to occur in the coming months. • We've also seen hearings in other energy-focused Committees focused on the environmental impacts of crypto mining. As we've seen with other issues, such as data privacy, having various workstreams, committee jurisdictions and points of view can present serious challenges with reaching a compromise and advancing meaningful legislation. Additionally, late last week, the House Agriculture Committee's Subcommittee on Commodity Exchanges held a hearing, entitled "Future of Digital Asset Regulation," to emphasize why the CFTC is well-equipped to oversee the market. While there was no substantively new information shared, this exemplifies the continued push by some members of the Committee to provide the CFTC with primary oversight authority. However, we understand that the Chairman of the full committee, Rep. David Scott (D-GA) — who also serves on the Financial Services Committee — has reservations about overly restricting the SEC's role in overseeing digital assets. **Lummis-Gillibrand Legislation**

	The bill, S. 4356, which is titled, the "Responsible Financial Innovation Act," was formally introduced in early June. It's one of the most ambitious and certainly noteworthy pieces of legislation at this time and seeks to provide a regulatory framework for digital assets. The bill is very comprehensive and generally speaking, should be viewed as a starting point in the discussion of crypto's future regulatory landscape. That said, there are a number of complicating factors that will make it very challenging to pass into law, including the lack of support from leaders in the Senate Banking or Agriculture Committees. Below we've outlined what the bill does, reactions we've seen from relevant stakeholders, and additional factors to consider regarding its prospects. ***Key elements of the bill*:** • **Asset classification and Definitions:** The bill creates common definitions for the digital assets space and provides a clear standard for distinguishing between digital assets that are securities and those that are commodities by a strict interpretation of the *Howey* test. Of note, a press release for the bill states that "most digital assets are much more similar to commodities than securities." • **CFTC jurisdiction:** Grants the CFTC exclusive spot market jurisdiction over all fungible digital assets which are not securities and creates a pathway for digital asset exchanges to register with the CFTC to conduct trading activities. • **Tax:** Seeks to provide a workable taxation structure by creating a de minimis tax exemption of up to $200 per transaction via virtual currency and clarifying varying tax treatments. The bill addresses a recent area of contention by clearly stating that miners and other validators are not "brokers" for income tax purposes. • **Consumer protection:** Requires certain disclosures from digital asset providers to ensure consumers understand the products and risks and allocates enforcement authority. This includes information on things like bankruptcy treatment, source codes, risks of loss, and applicable fees, among others. • **Stablecoins:** Defines and creates requirements for stablecoins including by establishing 100% reserve, asset type and detailed disclosure requirements for all payment stablecoin issuers. • **Other:** Additional elements of the broad bill include provisions to develop principles-based cybersecurity guidance; study and report on the energy consumption of the industry; promote innovation by streamlining public-private sector collaboration in the financial technology space; study the risks and opportunities in the retirement savings space; and assess the impact of China's digital yuan. ***Responses*:** • **CFTC:** Chair Behnam was generally supportive of the bill, suggesting it does a good job of addressing one of the trickiest challenges – deciphering between asset classes. This is unsurprising as the bill provides his agency with the primary regulator role. Both Democratic Commissioners Kristin Johnson and Christy Goldsmith Romero provided similar sentiments, although each stopped short of endorsing the legislation. Meanwhile, Republican Commissioner Caroline Pham has suggested the CFTC already has sufficient existing authorities to oversee the crypto markets. • **SEC**: Not so surprisingly, Chair Gensler pushed back on the proposal, suggesting it could inadvertently "undermine" other market and investor protections. Republican Commissioner Hester Peirce has not directly commented on the bill, but the legislation is generally consistent with positions she has previously taken. Notably, the SEC has not backed down on its attempt to play a larger role in the space which was further exemplified in early May when the Commission announced plans to more than double the number of its crypto regulation staff (from 20 to 50). • **Industry:** The crypto industry has been generally supportive of the legislation, as it contains several big wins including giving primary jurisdiction to the CFTC (which industry has been pushing for) and clarifying a tax reporting issue for digital asset brokers that was part of the Bipartisan Infrastructure Package. Meanwhile, bank industry groups have expressed concern that section 702 of the bill would hold non-bank firms to a lesser regulatory standard than

	traditional banks and create an unlevel playing field by allowing financial technology companies easier access to Federal Reserve bank accounts.
	
	***Factors to consider*:**
	• Legislation by the Chair and Ranking Member of the Senate Agriculture Committee, Sens. Stabenow (D-MI) and Boozman (R-AR), is expected to be introduced in the next few weeks. Along with being a product of the Senate Agriculture Committee leaders, this legislation is expected to differ from Lummis-Gillibrand by being narrower in scope focusing solely on expanding the CFTC's authority to oversee the crypto spot market.
	• Some on Capitol Hill, including Senate Banking Committee (SBC) Ranking Member Toomey (R-PA), believe Congress could potentially reach an agreement this year on stablecoin legislation. If this is the case, or even if Congress makes some progress in this space, it could interfere with efforts to pass broader legislation.
	• SBC Chair Brown (D-OH) has taken a strong skeptical position towards cryptocurrency. While he hasn't come out directly against the Lummis-Gillibrand bill, he certainly won't support it and the bill would need to receive his support to have any chance of becoming law this year.
	
	Other bills
	• **H.R. 7614, the Digital Commodity Exchange Act of 2022 (DCEA)** **(Reps. GT Thompson (R-PA), Ro Khanna (D-CA), Tom Emmer (R-MN) and Darren Soto (D-FL)),** seeks to provide regulatory oversight for the digital commodity markets. A helpful summary can be found here.
	  o The bill has the support of industry and bipartisan lawmakers and is considered among the most relevant in the House at this point. That said, it's still not expected to be signed into law this year.
	• **S. 4147, the Financial Freedom Act** **(Sen. Tuberville (R-AL)),** would prohibit the Department of Labor (DOL) from restricting types of investments in 401(k) plans, including cryptocurrencies.
	  o The bill is a response to the DOL's guidance cautioning plan fiduciaries from including crypto in their investment lineups. Tuberville discussed the proposal during a June Senate HELP Committee markup on retirement savings legislation, but ultimately offered and withdrew it as an amendment. He withheld the bill in an attempt to garner bipartisan support, potentially from Sens. Gillibrand or Hickenlooper (D-CO). HELP Committee Chair Murray (D-WA) said she would work with Tuberville on a solution.
	  o It is probably unlikely the proposal will gain enough traction to make it into a final retirement package this Congress – which is the only likely vehicle for its passage. We expect this issue will continue to be a topic of discussion though – particularly if there is a change in leadership.
	• **H.R. 5496, the Clarity for Digital Tokens Act of 2021** (**Rep. McHenry (R-NC**)), would establish a regulatory "safe harbor" for startup digital asset projects (a concept initially introduced by SEC Commissioner Peirce).
	  o The bill seeks to help provide a pathway for crypto startups by allowing projects to offer tokens without registering with the SEC for up to three years.
	  o It is unlikely that this legislation makes it into any final comprehensive package this Congress. That said, the bill is worth noting as McHenry could try to build momentum for the proposal as the potential Chair of HFSC next Congress if Republicans win the House.
	• **The Stablecoin Innovation and Protection Act of 2022** **(Rep. Gottheimer (D-NJ)),** would establish a definition and requirements for a qualified stablecoin.
	  o The draft bill was initially circulated in February but has picked up some support from industry and was recently discussed at a HFSC hearing on June 23rd with Fed Chair Powell. While Powell didn't comment directly on the bill, he responded positively that it is "great Congress is looking at different approaches" here. We don't expect the bill to move this Congress, but given recent market events, including related to the collapse of Terra stablecoin, stablecoin-focused legislation could have greater legs in the near-term as compared to proposals to create a broader regulatory framework for crypto markets.
	  o Notably, additional similar legislation by Sen. Hagerty (R-TN) and Hollingsworth (R-IN) to bring greater transparency into the stablecoin marketplace is also floating. Their bills would require issuers to report on their reserves, but like Gottheimer's, seeks to bring quality standards and greater consumer protections into the stablecoin space.

REGULATORY	**Department of Treasury** Treasury has been tasked by the President's executive order on digital assets to produce a report on implications of developments and adoptions of digital assets and relative changes in financial market and payment system infrastructures. The EO called for the report within 180 days, although that date has been far surpassed. We understand the delay is largely due to the amount of interest in the issue both from within Treasury and from its relevant partner agencies and departments (i.e., FTC, Fed, CFPB, NEC, etc.). The substantial amount of input can be a positive, as it allows for a variety of perspectives, although creates serious hurdles in building out a report with consensus and in a timely fashion. We continue to hear the goal is to release the report before the end of the year. Outside of the EO directives, Treasury has taken minimal concrete action in the digital asset space thus far, aside from releasing the President's Working Group on Financial Markets Stablecoin Report and sanctioning different crime-affiliated cryptocurrency exchanges. Although, given recent volatility in the crypto markets, Treasury officials have made it known that they are paying closer attention. • Secretary Yellen continues to call for regulatory clarity in the space. At a recent HFSC hearing, Yellen said that FSOC is analyzing potential financial stability risks from digital assets writ large, especially stablecoins. That said, she underscored that FSOC has not deemed the asset class as a systemic risk at this time, but that the Council could act if Congress does not pass comprehensive crypto legislation. • Yellen has also expressed reluctance to firms allowing for cryptocurrency as an investment option in 401(k) retirement plans. She said it would be reasonable for Congress to regulate what could be included in retirement plans such as 401(k)s. • Deputy Secretary Wally Adeyemo, whose work has largely focused on the intersection of national security and economic policy (things like sanctions, illicit finance, and investment security) spoke recently of the risks and promises of crypto – with Russia and Afghanistan at the forefront of his work. He then highlighted two areas Treasury is focused on: Travel Rule compliance in the cryptocurrency sector and understanding the risks posed by unhosted crypto wallets due to their anonymous nature. • Notably, while Yellen has raised concerns about the use of digital assets to evade sanctions, she and other Treasury/FinCEN officials have indicated they see no evidence thus far that suggests digital assets have been widely used to aid Russia in their invasion against Ukraine. **CFTC/FTX proposal:** The CFTC is still weighing the innovative proposal from FTX US Derivatives in which the trading platform is seeking to offer clearing of margined products directly to participants. The proposal, which has undergone an open comment period that ended May 11th, was recognized by CFTC Chair Behnam as the first of many. Other Commissioners have made similar remarks, saying that this has opened the door to valuable conversations on the matter, but none have vocalized a definitive position at this point. The CFTC is expected to make a decision on the proposal before the end of Q3. • The proposal received about 1500 public comments, many of which expressed some level of support for the proposal. Positive comments focused on competition in the marketplace, greater market access for participants and stronger risk management – these themes were in line with FTX CEO Sam Bankman-Fried's comments. The most common concern was that the proposed non-intermediated type of model could expand into other not well-suited asset classes in the future. • The proposal also prompted an unusual amount of public attention – both a hearing in House Agriculture Committee in early May and a public staff CFTC roundtable on May 25th. In both settings, we expectantly saw incumbent players, including CME and ICE, make their opposition case, citing market stability risks, an already well-functioning market, and suggesting the proposal provides an over-dependence on algorithms. On the other hand, financial institution representatives generally remained neutral, expressing an interest without taking an affirmative positions. Many industry players recognized the potential benefits and need for greater competition in the marketplace, although emphasized approval should not be rushed and would

	likely require a broader update of U.S. clearing rules to ensure a level playing field between new market players and incumbents. **SEC** SEC Chair Gensler's perspective on the crypto market has not changed drastically over the last several months, and it is clear he is still pushing for a large stake in any resulting regulatory framework. This was further exemplified through his hiring of an additional 20 staff in crypto enforcement roles, and concerns voiced with the Lummis-Gillibrand legislation. The Commission's controversial Staff Accounting Bulletin No. 121 (SAB 121) on custody of digital asset securities also remains problematic for many financial institutions to implement and may be the subject of a Congressional hearing this summer. Notwithstanding, on June 22nd, the SEC put out its 2022 rulemaking agenda, which notably did not include any proposal to regulate crypto assets. Also notably, on June 24th, Chair Gensler said he is collaborating with other financial agencies, primarily the CFTC, on a "memorandum of understanding" related to crypto oversight. It's unclear what exactly this would entail, but Gensler said, "I'm talking about one rule book on the exchange that protects all trading regardless of the pair," referring to security tokens and commodity tokens. While this is not the first time Chair Gensler has suggested that both agencies should share oversight authorities and work together towards an appropriate framework, it does mark the first time he has done so without blatantly pushing for the SEC to have primary jurisdiction. We should also note a recent op-ed by CFTC Commissioner Caroline Pham and SEC Commissioner Hester Peirce regarding their coordinated work in the space. Although the two Republican Commissioners may not have significant sway over Chair Gensler, the op-ed does provide recommendations for the SEC and CFTC to coordinate, initially through a series of roundtables. • Given the ongoing Ripple case and the potential implications on the overall crypto regulatory space, we expect Gensler to await the ultimate ruling before taking more significant action in the space. Shortly put, a win for the SEC could enable the agency to delve further into regulating the space, while a loss would likely inhibit the Commission's broader crypto enforcement agenda — and would likely cause the SEC to request broader authority over digital assets from Congress. • While incoming Commissioners Lizarraga and Uyeda will inevitably be immersed in the ongoing debates, we still expect the SEC will operate in a top-down approach under Gensler's direction. Both Commissioners voiced an interest in crypto – acknowledging the potential benefits and risks – in their nomination hearing, but neither stated an affirmative position. Uyeda did say he has seen the significant concern from industry relating to SAB 121, and that he will bring this to the attention of broader SEC staff and relevant federal and state regulators. Senate Banking Committee GOP members, led by Sen. Hagerty (R-TN), also recently sent a letter to Gensler on the matter.