January 9, 2022

The Honorable Debbie Stabenow
Chairwoman
U.S. Senate Committee on Agriculture
328-A Russell Senate Office Building
Washington, D.C. 20510

The Honorable John Boozman
Ranking Member
U.S. Senate Committee on Agriculture
328-A Russell Senate Office Building
Washington, D.C. 20510

Re: Concerns About Provisions In the Digital Commodities Consumer Protection Act (DCCPA)

Dear Chairwoman Stabenow and Ranking Member Boozman:

As you know, Better Markets[1] has had a number of concerns about provisions in the last publicly available draft of the Digital Commodities Consumer Protection Act (DCCPA). While it has been reported that the last draft has changed, we nonetheless wanted to share with you some of our most significant concerns given reports that the Committee continues to work on that draft. We do not raise these concerns to endorse, support, or oppose any particular bill or legislation, but for informational purposes and for members to consider when deciding whether to support or oppose whatever bill or legislation, if any, might result.

However, while consideration of legislation may be appropriate, which importantly should include multiple public hearings airing viewpoints of all stakeholders including those representing the public interest, we do not believe it would be appropriate to mark up or pass legislation until much more is known about exactly what happened at FTX. While it would be unreasonable to wait for *all* the facts to be known, it would be equally unreasonable to act before *most* of the key facts are known and have been thoroughly considered.

<u>The DCCPA limits the authority of the Securities and Exchange Commission (SEC) in two very significant ways.</u>

**The DCCPA expands the definition of a "commodity" at the expense of the definition of a "security," which will result in significantly more litigation and invite regulatory arbitrage.**

While there is a broad consensus that Bitcoin (as currently constructed and organized) is a commodity, there is an ongoing debate over whether Ether is a commodity or a security under

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

longstanding, black letter law. The DCCPA nevertheless asserts as a matter of law and for all time that Ether is a commodity. By legislatively deciding that ongoing legal dispute (without any accompanying definitive legal analysis and in the face of ongoing litigation), the bill expands the definition of a commodity and restricts the historical definition of a security. That restricts the jurisdiction and authority of the SEC.

Such a provision will thereby likely result in significantly more litigation because the longstanding legal test for securities will likely have to change to take account of this legislative fiat. Additionally, such action will invite and incentivize regulatory arbitrage as the crypto industry tries to create products designed to look like Ether to try to avoid and challenge SEC jurisdiction.

**The DCCPA would allow crypto exchanges to self-certify their products and sell them to retail investors without adequate independent protections, review, or approval, which will make it extremely difficult for the SEC to challenge self-certified digital commodities that are in fact securities.**

Self-certification is an avenue for financial firms to quickly get their latest products into the markets and in front of retail investors usually without any significant review or oversight. Crypto exchanges have an economic incentive to list as many products as possible. Inevitably, the self-certification proposed in the DCCPA will be widely used by crypto commodity issuers and platforms.

Given the industry's history of breaking or ignoring clearly applicable and longstanding securities and commodities laws, it is only reasonable to assume some will use this process to self-certify products as digital commodities when they are in fact securities. Given the crypto industry vocally wants to avoid SEC regulation and desperately wants the CFTC as its regulator, this will result in digital commodity platforms wrongly, either by "accident" or purposefully, self-certifying securities products that trade on their platforms as "digital commodities." This will create an additional barrier for the SEC to overcome in determining whether a product is a security without having the time or potentially even the knowledge to have input into the review process. In light of these concerns, consideration should be given to whether self-certification should be allowed at all or whether an independent financial regulatory agency (fully funded to do this properly) be required to review and, if appropriate, approve products before they are pitched to unsuspecting investors. If that agency is the CFTC, then it should be required to provide the SEC with notice and a meaningful opportunity in the review process to raise an objection as to whether the product is, in fact, a security.

<u>The DCCPA does not provide an express investor protection mandate.</u>

Too few people are aware of or understand the profound differences between the commodities and securities markets and their primary regulators. The same is true as to the distinctions between customer protections and investor protections. Those fundamental differences must inform consideration of any legislation.

The CFTC regulates commodity and derivatives markets, which historically are overwhelmingly dominated by very large institutions with very little retail investor participation. As a result, the CFTC's role has mostly been a referee between very large and very well-funded purchasers and producers fully capable of and incentivized to protecting their own interests when seeking price discovery and hedging – the very reason commodity markets exist. However, the crypto industry is targeting retail traders who are likely to experience significant volatility and suffer losses in markets subject to fraud, manipulation and wash trading by large, established investors. With the almost certain influx of potentially millions -- if not tens of millions of retail investors (as just detailed by Bloomberg News regarding FTX's comprehensive retail investor targeting and marketing activities) -- into these institutional markets, the CFTC simply must have an express, clear mandate to protect investors. It must be required to enact rules implementing that mandate, including those related to how crypto and other products are marketed and sold to retail investors, and it must be provided with adequate funding to police and enforce those rules.

The DCCPA would result in the violation of the CEA's critically important prohibition on "excess speculation."

The Commodity Exchange Act (CEA) explicitly prohibits "excess speculation" for a critically important reason: in stark contrast to equity markets, speculation is only allowed in commodities markets to the limited extent that it facilitates trading by actual producers and purchasers who seek to engage in price discovery and hedging, which is critical for the delivery of vital commodities to every American when needed and at prices that reasonably reflect supply and demand. This prohibition against excessive speculation is essential to ensure that speculators do not dominate and overwhelm commodity markets, which would increase volatility, drive up prices, cause boom-bust cycles, and threaten shortages of vital commodities that all Americans need.

However, the DCCPA would open a pathway for the influx of tens of millions of retail investors into the commodity markets – all of whom would be speculating and none of whom would be taking actual delivery of any commodities. This would clearly violate the CEA's prohibition. Consideration must be given to addressing this inevitable excess speculation and how - and if - it can be limited to protect commodity markets as well as the American people.

The DCCPA expressly includes two specific financial products, which is unprecedented.

As mentioned above, the DCCPA expressly identifies Bitcoin and Ether and declares as a matter of law for all time that they are digital commodities. It is unprecedented for a statute to identify a specific financial product by name because, once included in a statute, that product is legislatively frozen in time. In stark contrast, financial products, their form, content, labeling, and uses frequently change over time, often dramatically, as Ether recently changed from proof-of-work to proof-of-stake. Given that it is impossible to know how those financial products will change over time in the future, consideration should be given as to whether the DCCPA should

include and codify the nature or legal status of specific financial products or digital commodities at all.

<u>The DCCPA preempts state registration requirements.</u>

The state pre-emption clauses in the DCCPA would limit the ability of state regulators to provide enhanced protection for their citizens via oversight of crypto commodities and other tokens, including securities. As happened with predatory subprime mortgages in the years before the 2008 financial crash, there are states that provide or might want to provide greater consumer, investor, and financial stability protections for their citizens. In fact, New York does that now with its BitLicense, which notably protected many citizens of New York from the FTX collapse. If New York law were preempted as the DCCPA provided, untold numbers of New Yorkers would have joined the millions if not tens of millions from other states who lost billions of dollars. Consideration should be given to setting a regulatory floor in the DCCPA, not a ceiling, ensuring that all states and markets meet sufficient common minimum standards, while not impeding the ability of states to take additional action or measures if such states determine that to be appropriate.

<u>The DCCPA does not address the reality that existing crypto exchanges will offer and trade digital commodities and securities while falsely suggesting they are a CFTC-regulated exchange with respect to all of their offerings.</u>

Crypto exchanges currently facilitate the trading of dozens if not hundreds of different crypto tokens on their platforms, many of which are unquestionably unregistered securities. The DCCPA only governs a small number of these offerings, namely digital commodities, which would give the illusion of regulation while these exchanges simultaneously offer lots of unregistered securities in violation of the securities laws on the same platform. At best, that would seem to guarantee investor confusion if not exploitation, among other things. One solution would be to require all crypto tokens that do not clearly meet the definition of a digital commodity must be treated as a security, subject to existing securities laws and regulations, and registered with the SEC. If the exchanges failed to comply, then their legal right to offer digital commodities would be denied.

<u>While the DCCPA provides for increased funding, the CFTC will need significantly greater funding, time, personnel, and expertise to come close to accomplishing the claimed goals.</u>

The CFTC has been so chronically and woefully underfunded for years that it cannot hope to fulfill its current statutory mandates, let alone a new set of regulatory responsibilities. It should not be required to undertake any additional duties unless and until its funding is sufficient to clearly and fully comply with current law. Moreover, as the only financial regulator not industry funded, a full and unrestricted funding mechanism should be enacted without delay. Finally, the Government Accountability Office should be asked to undertake a comprehensive bottom-up budget analysis of the duties currently imposed on the CFTC and determine what

would be an appropriate budget to actually fulfill those duties as well as any duties that would be required by the DCCPA if it were enacted.

With a relatively small budget and less than 700 employees (compared to the SEC's approximately 4,500 employees), there is little, if any, hope for the CFTC to also undertake regulating, supervising, and policing the vast, novel, complex, and growing crypto industry in addition to their current duties. While there are some funding provisions in the DCCPA, they are grossly inadequate and subject to too many restrictions. Additionally, protecting consumers, investors, and financial stability would seem to require any authorizing legislation to be *conditioned upon the appropriation and receipt of adequate funds by the CFTC* as well as a phased implementation over a sufficiently long time period to ensure that it has the personnel, technology, and expertise to actually do the new work and not be overwhelmed by the crypto industry (as, frankly, has already happened). The CFTC's funding needs to be dramatically increased, any limitations must be eliminated, and any new responsibilities should have a required phase-in to ensure that the agency can accomplish its current statutory mandates as well as any new responsibilities.

The DCCPA would confer legitimacy on digital assets, inducing many more people to invest and risk their hard-earned money.

After fourteen years of promises, crypto still has no independently verifiable use case to support any actual, legitimate economic activity. In fact, just the opposite has happened: the industry has proved itself full of charlatans and criminals relentlessly engaging in predatory and criminal conduct. FTX is just the latest example in a very long list. In the last year alone, (1) millions if not tens of millions of investors have suffered crypto losses approaching 70% on their crypto investments or more than $2 trillion; (2) numerous high profile crypto firms have gone bankrupt or are on the verge of bankruptcy; (3) many firms have been charged with blatant civil and criminal violations of numerous laws; and (4) the most high profile and supposedly credible crypto exchange in the world, FTX, collapsed into bankruptcy in just days due to egregious criminal conduct.

Even if the DCCPA were law, the CFTC would continue to have limited authority to reach beyond its regulated entities, resulting in CFTC-registered subsidiaries (like FTX's LedgerX) likely being compliant with CFTC rules and regulations, while affiliates and the parent company remain unregulated. Yet, the DCCPA would have a broad legitimizing effect whereby the affiliates of the CFTC-regulated subsidiary would appear to be within the regulatory perimeter even if the parent company and other affiliates engaged in reckless, predatory, or even criminal behavior.

Furthermore, by conferring legislative legitimacy even on those entities, which will have much less regulation than other financial firms, the DCCPA will expand the shadow banking system. That will invite, if not guarantee, regulatory arbitrage where yet more risk migrates from the more regulated financial system into the shadows.

There is also the risk that, if crypto has legislative and regulatory legitimacy, banks will do more business with crypto firms, and bank holding companies might even create crypto subsidiaries that will engage directly in crypto activities as well as create, trade, and hold innumerable crypto-related derivatives. As a result, the core of the banking system may become increasingly interconnected with the crypto industry, which makes contagion much more likely and poses a direct threat to the stability of the financial system.

Imagine if crypto had been deeply interconnected with the traditional banking system starting in November of 2021 and during the loss of more than two-thirds of value (more than $2 trillion) over the last year. It's not unreasonable to expect that numerous banks would almost certainly have been under extreme stress and, like the many crypto firms going bankrupt now, would have failed. The Federal Reserve would likely have had to intervene and bail out those banks and nonbanks as it did in 2008.

With no legitimate use case or any economic productive value, it does not make sense to confer legislative legitimacy on such an industry and financial activity, which the DCCPA risks doing.

Conclusion

We hope these thoughts are helpful and appreciate your consideration of them.

Sincerely,

Dennis M. Kelleher
Co-founder, President, and CEO

Cantrell Dumas
Director of Derivatives and Commodities Policy

CC: Members of the Senate Agriculture Committee
Members of the Senate Banking, Housing and Urban Affairs Committee