BETTER MARKETS

FIT 21

FACT SHEET

Questions to Consider on the Financial Innovation and Technology for the 21st Century Act

May 21, 2024

Better Markets has previously identified several significant questions regarding the Financial Innovation and Technology for the 21st Century Act (FIT 21), which was passed by the House Financial Services Committee in July 2023. Those questions remain just as relevant today—even more so—with the latest version of the bill. Regardless of one's views on FIT 21, here are some key questions to ask:

Would FIT 21 Open Loopholes for People to Avoid SEC Regulation, Similar to Unregulated Derivatives Before the 2008 Crisis?

FIT 21 claims to seek to modernize the regulation of investment contracts by creating a new category called "investment contract assets." These assets are excluded from the definition of a "security," likely eliminating SEC oversight. This approach is reminiscent of the strategies employed in the Commodities Futures Modernization Act of 2000 (CFMA), which aimed to avoid regulation of swaps and other derivatives, leading to rapid market growth but also substantial systemic risks. The definition of investment contract assets under FIT 21 includes digital assets that can be transferred directly between individuals without an intermediary and recorded on a secure public ledger. By not classifying these assets as "securities," issuers are exempt from SEC registration, disclosure, and antifraud requirements. This regulatory exclusion would likely result in a surge of asset issuances without the necessary transparency and guardrails, thus increasing fraud and market manipulation.

Lessons from the CFMA of 2000 highlight the potential dangers of such deregulation. The CFMA led to rapid growth in the derivatives market in the early 2000s but also introduced significant systemic risks due to the lack of oversight. This deregulation was a driving factor behind the 2008 financial crisis, demonstrating the perils of inadequate regulation of so-called novel, innovative financial products. Similarly, the bill claims to streamline regulations for digital assets, potentially opening loopholes for issuers to avoid regulation, reminiscent of the unregulated derivatives before the financial crisis. The reduced oversight could lead to a lack of transparency, increased fraud, and systemic risks. Drawing parallels with the CFMA and the subsequent 2008 financial crisis, balancing claimed innovation within a robust regulatory framework is crucial to avoid repeating catastrophic mistakes like those that led to the 2008 financial crash and Great Recession.

Are Agency Resources Proposed in This Bill Sufficient to Prevent Main Street Consumers, Commodity Markets, Farmers, and Other Commodity Producers from Paying the Price?

For years, the CFTC has been chronically underfunded with less than 700 employees (compared to the SEC's approximately 4,500 employees). It does not have the funding to fulfill all its current statutory mandates. For example, the CFTC's budget for 2024 remains unchanged from its 2023 budget at $365 million (compared to the SEC's 2023 budget of $2.1 billion). FIT 21 would heap a whole new set of responsibilities on the CFTC, making it the de facto regulator of countless new crypto exchanges and broker-dealers, and it would charge the agency with implementing numerous resource-intensive and lengthy notice-and-comment rulemakings. The CFTC will also have to implement, interpret, and enforce those rules. the proposed bill only authorizes the CFTC to collect a fixed amount of registration and annual fees from exchanges and brokers, up to an annual maximum of $40,000,000, regardless of the number of registered exchanges and brokers or the actual workload imposed. This fixed cap is especially problematic given the hundreds of exchanges currently offering bitcoins and the need for the CFTC to hire staff, draft regulations, acquire technology, and enforce the provisions of the bill and the new rules. Moreover, the bill only allows the collection of these fees for four years, at which point this funding will be cut off. This is grossly insufficient for an agency already underfunded to fulfill its current mission of regulating and overseeing the vast and complex derivatives markets, including futures, options, and the $400 trillion (notional value) swaps markets.

Adding yet more mandates to the CFTC, especially when it is currently underfunded, will inevitably and significantly compromise the agency's ability to fulfill its vital role—maintaining stable commodity prices — that all Americans depend on and benefit from. Fully funding the CFTC should be the priority, and only then should any consideration be given to adding more work.

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It must be recognized that the securities and commodities markets are not preordained to remain the preeminent markets in the world. They have achieved that status because they have the trust and confidence of investors and customers worldwide and that is largely due to their faith in ***<u>those markets being well-regulated</u>***. Will FIT 21 threaten to create new market structures that are not well-regulated if regulated at all? Will it result in weak, loophole-ridden regulation rather than genuine regulation that prioritizes the public interest? The golden goose (our markets) that laid the golden egg (a vibrant, growing economy funded by those markets) is at stake when thinking about laws that fundamentally change financial regulation. The laws enacted in the years leading up to the 2008 financial crash starkly reveal the consequences of getting financial regulation wrong. The American people are still suffering from those disastrous choices. That's what people should consider when thinking about FIT 21.

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Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

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