

Buyers' Remorse? Key Questions to Consider in Crypto Legislation

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This week, Congress will consider legislation that would enact a new light-touch trading framework at the behest of crypto trading firms. Anyone evaluating the merits of the bill should ask the below key questions to determine if legislation is up to the task of protecting investors, facilitating capital formation and ensuring fair and orderly markets.

Do crypto investors really deserve fewer protections than investors in the stock market?

No! Both stock market and crypto investors should enjoy robust regulatory protections. Investors today can go to an app like Robinhood and buy either stock (shares of public companies like Apple, NVIDIA, IBM, etc.) or buy crypto (Bitcoin, Ethereum, etc.) in a single interface. Both today and under pending congressional legislation, those investors would receive far different protections when trading stock than when trading crypto. That is unfair. Here are just a few examples of investor protections that customers enjoy in the stock market but would be deprived of in the crypto market:

- **Best execution:** In the stock market, there is a requirement for brokers to execute client orders on the most favorable terms reasonably available. This means seeking to obtain the best price, but also considering other factors like speed, likelihood of execution and settlement, size, and nature of the order. This requirement will not exist for crypto under this legislation.
- **Best interest or fiduciary duty:** In the stock market, there is a requirement for brokers and investment advisers to put their clients' interests ahead of their own when making recommendations to buy or sell. In other words, brokers and investment advisers can't promote investments that yield them bigger fees but might be worse for the client given their individual investment goals. This requirement will not exist for crypto under this legislation.
- **Insurance protection:** In the stock market, brokers must pay fees to the Securities Investor Protection Corporation. That insurance fund covers investor losses if the broker

goes bust due to circumstances such as fraud or a hack. That insurance protection will not exist for crypto investors.

- **Customer notifications of cyber breaches:** In the stock market, there are strict rules for when and how broker-dealers and investment advisers must alert customers when there's been a breach of customer data. These requirements will not exist for crypto under this legislation.
- **Dispute resolution:** In the stock market, there are guardrails around the arbitration process to govern investors' timely access to dispute resolution if they have a disagreement with their broker. These requirements will not exist for crypto under this legislation.
- **Legal recourse to sue:** In the stock market, there is 90-years of legal precedent allowing defrauded investors to sue companies issuing the stock or the brokers selling it. Under this legislation, crypto investors will not benefit from similar legal recourse or precedent.

There is no technological reason why crypto trading platforms can't offer these protections to investors. The choice to provide fewer protections than in the stock market is a choice by policymakers that puts investors at risk to juice crypto firms' profits. This is not hypothetical: the Robinhood CEO [said](#) in a TV interview that it costs 10x as much to run his stock trading business than his crypto business. It is much cheaper for firms to forgo offering investor protections.

Are customer assets really going to be safeguarded?

No! It is unclear in the legislation if a crypto broker or exchange needs to maintain an actual crypto asset for every crypto asset put into custody by the customer. For example, if I buy one Bitcoin for the price of \$100,000, does the exchange need to keep on-hand one Bitcoin or \$100,000? What happens if the price of Bitcoin surges and investors run to withdraw their Bitcoin? Likewise, the bill not only allows intermediaries to invest customer assets into a range of "safe" investments but also includes a provision allowing the CFTC to expand permitted investment to any other assets they deem approved. That means the cash you think is sitting in something akin to a deposit account could be used by the crypto broker or trading platform for investment in the market.

The proposed legislation also gives the CFTC authority to waive the requirement that digital commodity exchanges keep customer assets in a qualified digital commodity custodian, notwithstanding that a wide range of entities are already conditionally eligible to meet that qualification in the bill under existing licenses (i.e., all state-chartered trust companies, regardless of the robustness of the state regime). Not all state regimes are created equal. For example, one Nevada state trust recently [went bankrupt](#) after losing over \$80 million of customers' crypto.

Will anti-competitive conflicts at crypto firms be prohibited?

No! This legislation blesses the existing conflicted business model of crypto companies. In fact, crypto trading platforms can even own venture capital arms that invest in tokens and then give those tokens preferential listing on their trading app, favoring those assets over competitors. Crypto exchanges can also act as crypto brokers – creating perverse conflicts. For example, when you go to a stock broker today, they must look across stock exchanges to find you the best price. Under this legislation, a crypto exchange can act as both a broker and an exchange and send the order just to themselves to execute, regardless whether it's the best price.

Are the rule changes contemplated in this bill limited to crypto?

No! There are a number of provisions in this bill that will allow the risks of crypto to import into the traditional securities markets.


First, SEC-registered entities will be allowed to trade in crypto, but the SEC has no authority over digital commodities in the bill. That is tantamount to setting loose the Wild West inside the four corners of a well-regulated market. What's worse, the bill directs the SEC to wholesale exempt from “burdensome” regulations any entities dually registered with the SEC and CFTC. The legislation does not limit the exemptions to just the crypto business, opening the door to widespread traditional securities market deregulation with complete cover and authorization from Congress. There is similar language calling for “burden reduction” in supervision and examination.

Second, the bill provides that assets offered under the securities laws can migrate out of compliance with those laws so long as (1) the assets happen to trade on a blockchain; and (2) modest steps are taken to “mature” the blockchain. This provision will let market participants restructure their assets onto the blockchain using clever lawyering to avail themselves of the exemption under the bill and therefore sidestep 90-years of laws, rules and court precedent. We have already seen crypto firms [announce](#) that they're doing this overseas and [other crypto platforms](#) have their sights on doing it, too. In fact, the hype around “tokenizing” traditional stocks and migrating to the light-touch regime has gotten so frenzied that even the SEC's “Crypto Mom” Hester Peirce had to issue a [warning](#) to the market.

Will national security risks of crypto be appropriately addressed?

No! Crypto crime jumped 66% last year according to the [FBI](#). Massive hacks seem to happen every month, with North Korea [stealing \\$1.5 billion this year](#) from a crypto exchange. Given the severe and unique risks of this market, this legislation does not rise to the challenge of preventing crypto crime. In fact, the legislation simply restates anti-money laundering and sanctions laws already flouted by the industry. Worse, the Department of Justice released a [memo](#) saying that it would no longer investigate or bring illicit finance cases against crypto firms like trading platforms, digital wallets or online money laundering services known as “mixers” and “tumblers.”

Crypto supporters argue “but criminals use cash for money laundering, too!” But crypto is uniquely suited for money laundering given the ease with which criminals can transmit large sums of value. Cash, art, and cases of wine are all physically bulky and require huge networks of people to



transport, whereas crypto is borderless lines of code requiring just a few skilled hackers to move value. In the words of [one report](#) citing a Treasury Department study, “cryptocurrency remains the payment method of choice for criminal ransomware actors.” A [reported](#) 98% of ransomware payments demanded by criminals was in the form of Bitcoin and not, say, cash, Rolex watches or Picasso paintings, for this very reason.

Is the CFTC given the appropriate tools to regulate crypto with this bill?

No! Soon, the CFTC will only have one Commissioner, with no further Commissioner nominations on the horizon. This decimates the longstanding bipartisanship of the agency at a critical time.

Also, the President in February signed an [Executive Order](#) placing the CFTC and other formerly independent financial regulatory agencies under the control of the White House, requiring review by Office of Information and Regulatory Affairs before rulemakings can be proposed for public comment or adopted. This severely upends the integrity of the rulemaking process.

Finally, the CFTC is chronically understaffed and that will not be helped even with the provisions in this bill. The legislation appears to limit the CFTC’s ability to collect fees only to provisionally-registered entities, not permanently registered ones, and the funding provisions expire after four years.

Will constituents have confidence in the integrity of elected officials’ investments in crypto?

No! The legislation restates existing conflicts of interest law that do not even apply to the President or Vice President, nor does the bill do anything about the fact that the White House is brazenly flouting other existing applicable ethics requirements.



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