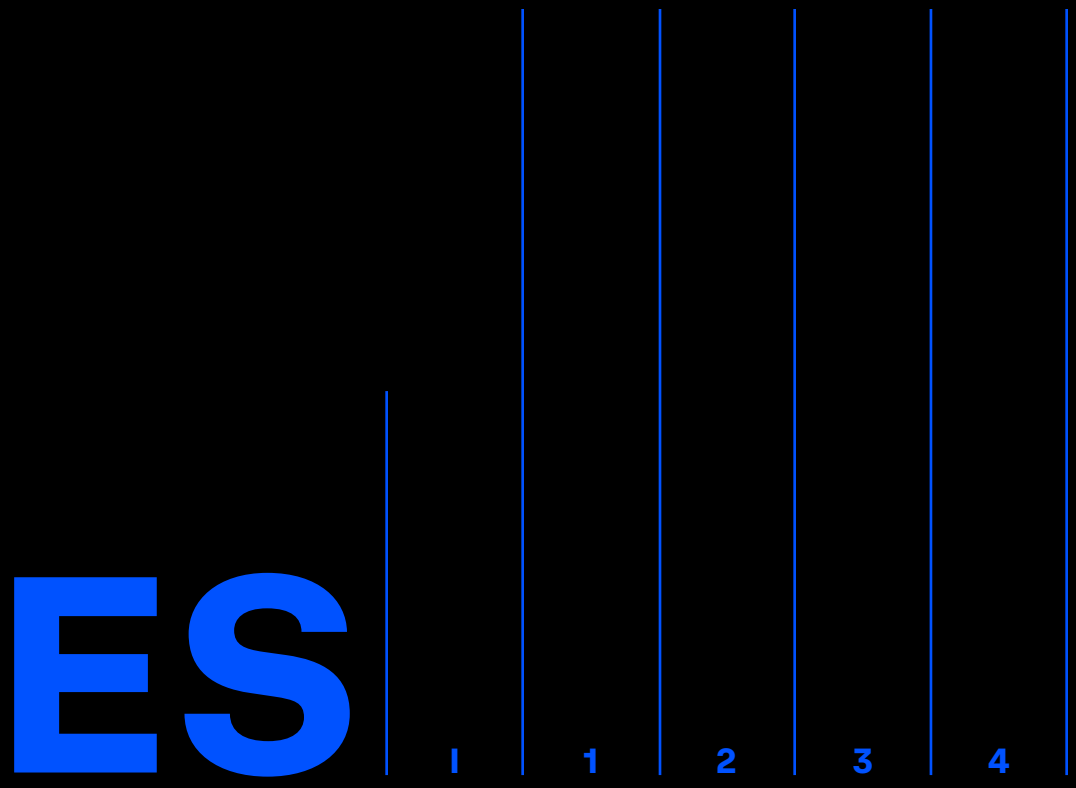
DIGITAL ASSET POLICY PROPOSAL

Safeguarding America's Financial Leadership

coinbase

ES

Executive Summary



ES

Executive Summary

Digital assets like Bitcoin, Ether, stablecoins, and other cryptocurrencies are now a mainstream part of the financial market ecosystem. In 2013, the market cap for the entire cryptocurrency market was around $1.5 billion. In 2021, that market cap has grown to $2 trillion. Adoption rates have seen a similarly astounding rate of growth with an estimated 1 million crypto users in 2013 to an estimated 330 million users worldwide today,[1] with tens of millions in the United States alone.

But as with the early days of the internet, the use cases for crypto are still in a nascent stage of development and adoption, but the emergent use cases are societally powerful. Blockchain and distributed ledger technologies have accelerated the democratization of finance that began with the emergence of money payments using mobile technologies. Using cryptography to break down component concepts of traditional finance, and turning those concepts into secure, transparent protocols, financial services that are out of reach can be unlocked with further development and adoption. Whether factors such as lack of wealth, inaccessible infrastructure, or a range of societal factors have historically contributed to the 1.7 billion adults who remain unbanked today, the evolution of decentralized protocols and peer-to-peer marketplaces aim to resolve that disparity.

Marketplaces for digital assets have emerged to offer a platform that facilitates the demand from Americans to access certain innovations in the way financial assets are transferred and traded. Retail and institutional traders have direct access to platforms that execute transactions 24 hours a day, seven days a week. Transactions settle in real time. A multitude of intermediaries is no longer needed as the digital asset market infrastructure has developed so that exchange and trading services, clearing, settlement, and custody can be provided effectively and more efficiently by the same entity.

We are seeing the beginning of more efficient, transparent, and cost-effective processes compared to those in traditional financial markets. These developments, in turn, will empower market participants with greater and more direct control over their trading decisions, increasing accessibility to financial services, reducing excess costs of the current system — costs too often borne by retail customers, and creating more transparency for regulators, who are already benefiting from new ways to engage in market surveillance and combat illicit finance.[2]

These changes are contributing to one of the most dynamic and broad based periods of American financial innovation. Crypto, including advances in distributed ledger technology and use of smart contracts, are being built and discussed across the country — at our universities, on social media, and in the homes of entrepreneurs. The result is greater transparency, decentralization, and ultimately, democratization of financial markets.

Laws drafted in the 1930s to facilitate effective oversight of our financial markets could not contemplate this technological revolution. At that time, in a paper-based financial system, multiple physical steps were necessary to move a financial asset from one person to another. The lack of an automatic, efficient, and trusted infrastructure that verified and transferred assets led to the need of separate intermediaries, such as brokers, custodians, exchanges, market makers, and settlement and clearing agencies, often with conflicting interests and incentives. The only way to create trust in the system was to require and then regulate these intermediaries. Ensuing regulations treated each step as a distinct service with many requiring an intermediary, thereby enshrining their role in these processes as being required under law. Elements of those laws do not have room for the transformational potential that digital assets and crypto innovation make possible. They do not accommodate the efficiency, seamlessness, and transparency of digital asset markets, and thus risk serving as an unintended barrier to current innovations in the digital asset economy.

Forcing the full spectrum of digital assets into supervisory categories codified before the use of computers risks stifling the development of this transformational technology, thus pushing offshore the innovative center of gravity that currently sits in the United States. Doing this will have profoundly harmful economic

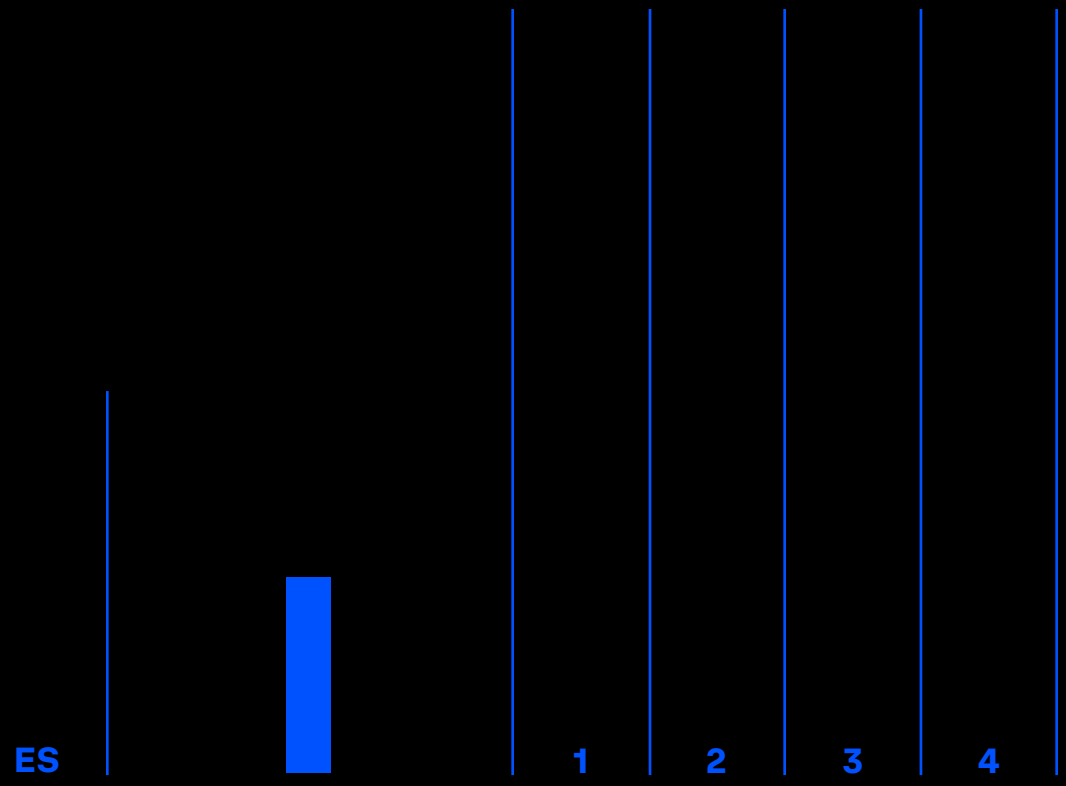
implications and undermine the United States' leadership at a time when technology is so critical to this country's geopolitical strengths.

Fostering this innovation is also critical because there are too many people in our society who do not see a place for themselves in our current financial system. According to the Federal Reserve, up to 22% of American households could be unbanked or underbanked.[3] This could mean up to 55 million adult Americans don't have access to key functions of our critical financial and societal architecture. Furthermore, even those with a bank account and recognizing the dramatic advances in financial technologies, payments remain slow and cumbersome. Millions continue to pay too much and wait too long to transfer funds to loved ones overseas or to invest their money directly in projects and ideas they care about.

This exclusion of millions from the financial system is occurring as more and more Americans look for alternatives to traditional finance. According to the University of Chicago, surveys show that a diverse group of Americans are availing of the unique and empowering financial opportunities that crypto affords.[4] This use case is more diverse and more inclusive than almost all other asset classes. Naturally, they see the opportunities of digital assets and the financial agency and empowerment they provide. To help the public and the businesses that will provide the services for this new, thriving financial ecosystem, regulatory certainty for everyone is required.

I

Approach to a New Framework



I Approach to a New Framework

Regulatory Pillars

Regulate Digital Assets Under a Separate Framework

Designate One Regulator for Digital Asset Markets

Protect and Empower Holders of Digital Assets

Promote Interoperability and Fair Competition

It is time for a clear and comprehensive approach to regulating digital assets, and for regulation that is fit for purpose. Underpinning this new regulatory framework must be a recognition of the benefits of how technological innovations can better empower and protect the public. This requires establishing new laws and oversight structures for digital asset trading and disclosure — which draw upon some of the lessons of existing regulation — to enable more efficient practices, promote customer protection, and build and maintain stability and confidence in our financial system.

The United States is behind other major jurisdictions, including the European Union, the United Kingdom, Singapore, and other key jurisdictions in developing a unified approach to the treatment of digital assets. Absent taking similar steps, the United States is at risk of becoming a "taker" of regulation as opposed to the primary "shaper" of modern financial services — a position the United States has long occupied.

It is in this context that we at Coinbase have undertaken an effort to contribute to the emerging consensus — a consensus that recognizes that policymakers need to act to ensure that the American people can access the full benefits of this innovation. There have been a number of important proposals already offered, and a great deal of helpful thought and commentary. We have reviewed these ideas carefully and listened to many thoughtful policymakers and ecosystem participants. Our conclusion has been that we are at an important inflection point in this technological revolution. We can best contribute to the policy debate by offering our thoughts on a framework for a re-imagined regulatory system that is truly technology neutral and open to innovation.

From our work, we feel that there are four important pillars that

should inform the debate on what a new regulatory framework should consist of. Our hope is that these pillars will help shape the debate, highlight key elements to accomplish important objectives, and accommodate innovation for the benefit of American society. These pillars would address confusion over the definition and regulatory treatment of digital assets, preserve the benefits of end-to-end services within a single entity, and promote low cost, efficient, and safe access to digital assets for consumers.

Regulatory Pillars

Pillar One:
Regulate Digital Assets Under a Separate Framework

The cryptoeconomy is defined by two concurrent innovations, both of which have manifold impacts on our financial system:

1. The blockchain-driven and decentralized evolution of the internet
2. The emergence of a distinctive asset class that is digitally native and empowers unique economic use cases

The changes made possible by these two innovations are transformational, but do not easily fit within the existing financial system, which assumes that the structure of our financial markets will remain largely as they have been in the past. Our financial regulatory system is predicated on the ongoing existence of a series of separate financial market intermediaries — exchanges, transfer agents, clearing houses, custodians, and traditional brokers — because it never contemplated that distributed ledger and blockchain technology could exist. A new framework for how we regulate digital assets will ensure that innovation can occur in ways that are not hampered by the difficulty of transitioning from our legacy market structure.

Pillar Two:
Designate One Regulator for Digital Asset Markets

To avoid fragmented and inconsistent regulatory oversight of these unique and concurrent innovations, responsibility over digital assets markets should be assigned to a single federal regulator. Its authority would include a new registration process established for marketplaces for digital assets (MDAs) and appropriate disclosures to inform purchasers of digital assets.

Additionally, in the tradition of other markets, a dedicated self-regulatory organization (SRO) should be established to strengthen the oversight regime and provide more granular oversight of MDAs. Together, they should formulate new rules that permit the full range of digital asset services within a single entity: digital asset trading, transfer, custody, clearing, settlement, money payment, staking, borrowing and lending, and related incidental services. This two-tier regulatory structure will ensure efficient and streamlined regulation and oversight, and evolve elements of the existing frameworks to meet the requirements of our new technologically-driven financial system.

Pillar Three:
Protect and Empower Holders of Digital Assets

This new framework should have three goals to ensure holders of digital assets are empowered and protected:

1. Enhance transparency through appropriate disclosure requirements,
2. Protect against fraud and market manipulation, and
3. Promote efficiency and strengthen market resiliency.

Each of the goals should be accomplished in recognition of the unique characteristics and risks of the underlying functionalities of digital assets.

Pillar Four:
Promote Interoperability and Fair Competition

Innovation in decentralized protocol development and the peer-to-peer marketplace continues to produce novel approaches that allow greater financial access across all facets of society. To realize the full potential of digital assets, MDAs must be interoperable with products and services across the cryptoeconomy. If fully realized, this can enshrine fair competition, responsible innovation, and promote a thriving consumer and developer ecosystem.

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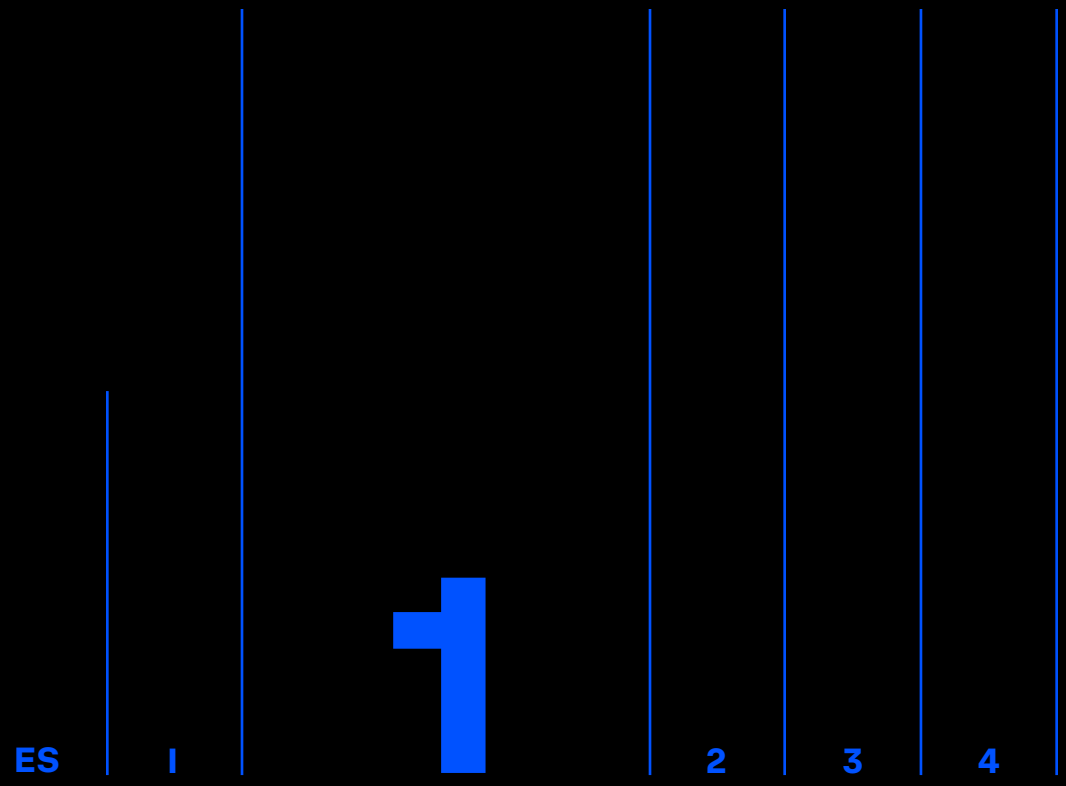
Regulate Digital Assets Under a Separate Framework



1 Regulate Digital Assets Under a Separate Framework

Unintended complexities of applying existing federal laws to digital assets: an example

Securities laws implemented in the 1930s were designed primarily to provide investors with information about the issuers of securities so that investors could weigh the risks of their investments. As a result, securities laws focus on disclosure about the company, its management, and its financial results. However, the decentralized and open-source nature of blockchain-based digital assets makes it a poor fit for the current regulatory structure. Digital assets often function on decentralized protocols with many contributors, with no central organization or "company," and with no financial results to report on to the holders of the digital assets. Every holder of a digital asset can examine for themselves the functionality and governance structure of the asset. Applying the disclosure requirements of public companies would likely mislead the public about what is actually material information about a digital asset.

Exacerbating these problems is that it is unclear where digital assets may fall under existing securities laws. The regulatory treatment of digital assets as securities currently depends on interpretations of legal tests developed long before digital assets existed. This includes the long standing *Howey* test from 1946 where the Supreme Court reviewed whether citrus groves were an "investment contract,"

Today there is no comprehensive regulatory framework for digital assets. Regulators have instead applied existing statutory authority and regulations to these assets, in a piecemeal fashion. This dynamic exists because there is no overarching consensus about how the United States should promote — or even allow — innovation in our financial architecture.

A challenge faced by regulators is that digital assets have characteristics that can make them different from traditional financial instruments in both their operation and the way we interact with them. As a result, regulators have not been able to define and classify many digital assets based on their existing statutory frameworks. Neither the public nor market participants can be certain of how any particular regulator might decide to regulate a digital asset in any given situation, or whom to go to for answers about its potential treatment.

Depending on its features and circumstances of use, a digital asset may be viewed as a payment instrument, with services supervised through state-issued money transfer licenses,[5] specialized state regimes (like the NYDFS Bitlicense[6]), and subject to the CFPB's enforcement authority.[7] It may be a commodity subject to the antifraud enforcement authority of the CFTC[8] or a security subject to regulation by the SEC.[9] Or perhaps some combination of all of the above and all at the same time. This list of possible regulators is far from exhaustive. Some states have developed specialized bank charters that permit digital asset custody and transaction services,[10] and the OCC has granted limited purpose bank charters to several digital asset custodians.[11] But none of these regulatory frameworks address all the activities and permutations of digital assets, and not even the regulators are certain of where their authority starts or ends.

Moreover, digital asset markets operate differently from

and therefore a security. While the *Howey* test has an important role in defining what is a security, applying it to digital assets has even led the SEC to be unclear and inconsistent.

The purpose of the *Howey* test was to determine whether an instrument was a security and, therefore, subject to regulation. Digital assets should be subject to a clear and predictable regulatory framework, rather than subject to the unpredictable application of the *Howey* test as a substitute. Even if a digital asset is a security, it cannot today be listed or traded on securities exchanges and it cannot be held or transferred through traditional broker-dealers. Therefore, were a digital asset to succeed in meeting the rigorous, but often inapplicable, registration requirements for a securities public offering, as a practical matter, it still could not be traded like other securities. No one could have intended this untenable outcome.

Alternatives to a Unified Framework For Digital Assets

Others have made important contributions to clarify this legal morass. For example, the *Digital Asset Market Structure and Investor Protection Act*[13] attempts to do this by defining a digital asset security as a digital asset that gives the holder the specific rights to equity or debt in an issuer; to profits, interest, or dividend payments from the issuer; in the major corporate actions of the issuer; and to liquidation rights in the event of issuer liquidation. Other types of digital assets would not be regulated as securities.

The *Digital Commodity Exchange Act*[14] would address the confusion on what is a security by broadly defining a new "digital commodity," bringing a range of tokens into the scope of regulation by the CFTC. A "digital commodity"

traditional financial markets. The convergence of the decentralized evolution of the internet with the emergence of digitally-native assets has created digital assets whose underlying technology mitigates risks inherent to those traditional markets. For example, controllable electronic records like blockchains reduce the need for intermediaries. This removes many of the conduct issues that plague the traditional markets today because customers do not have direct access to products and services. It may also engender new risks that current laws never contemplated.

The result is a fragmented and incomplete regulatory framework that was never crafted to contemplate the risks and benefits of digital asset technology. Market participants, the public, and even regulators are left confused. For example, uncertainty over whether a digital asset may also be a security is stifling innovation and development of digital asset marketplaces. The lack of clear statutory authority and an absence of regulations to oversee this new industry, combined with the inconsistent threat of enforcement actions, leaves market participants vulnerable to sanctions and discipline as reward for good faith effort to bring new products to market that benefit the public.

Legislation is needed to create an effective and coherent regulatory framework for digital assets. The first important and necessary step is to create a statutory definition of a digital asset — one that can be used to define the scope of the new regulatory framework. A digital asset subject to the framework should be defined to mean:

A financial asset issued and transferred using distributed ledger or blockchain technology. "Financial asset" would include an asset whose primary use is as a payment instrument, medium of exchange, means of storing value, or otherwise as a financial interest.[12]

In creating a new regulatory framework for digital assets, Congress should recognize in law that all digital assets, including digitally native versions of traditional financial assets, should be subject to a new regulatory regime for digital assets. This would ensure that regulation relevant to the underlying technology is consistent across all digital assets. For example, regulations governing the trading, clearing, and settlement of digital assets should apply to all digital assets, ensuring they reflect the more efficient methods of value transfer and

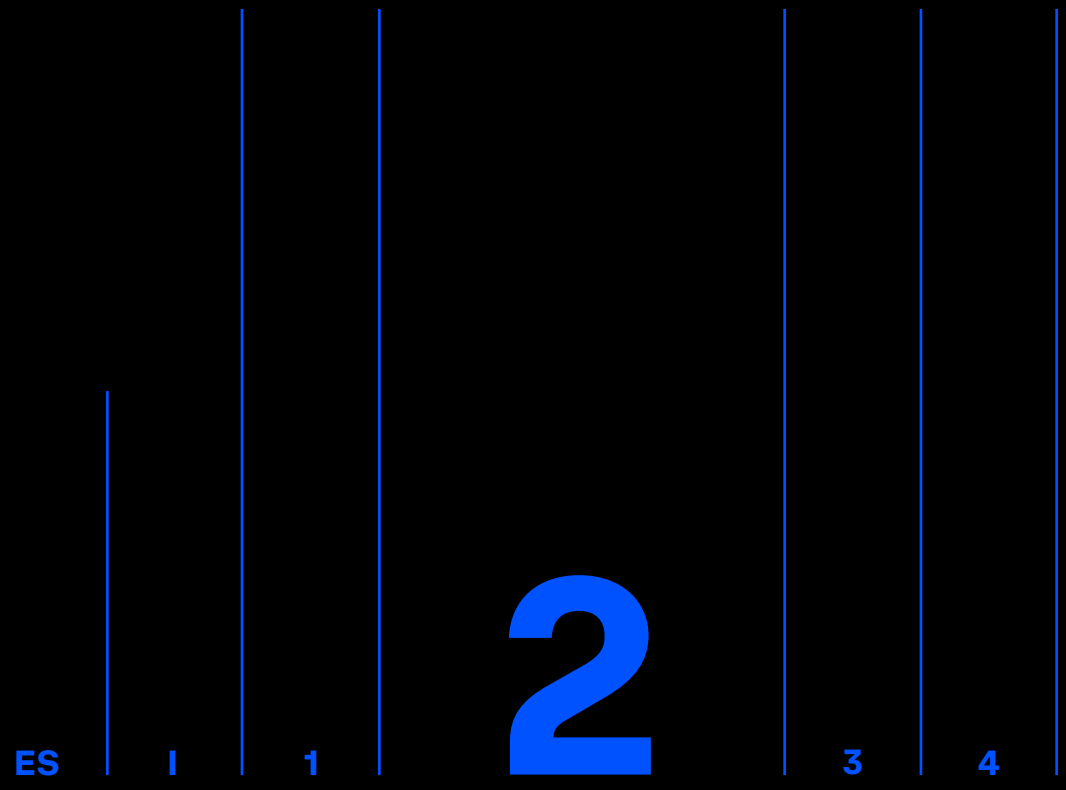
is defined as any form of fungible intangible personal property that can be exclusively possessed and transferred person to person without necessary reliance on an intermediary. It would exclude a digital asset that does not represent a financial interest in a company, partnership, or investment vehicle, which would be treated as securities under existing law.

While we recognize the merits of these approaches, we believe the most durable solution would be to establish a new unified regulatory framework for all digital assets and associated activities. The attendant regulations, registrations, and disclosures are tailored to the characteristics, risks, and types of activity involved, without the encumbrances of reconciling legacy market structures to the new technology and asset class.

exchange that blockchains make possible.

In creating the new regulatory regime, the framework should incorporate the principles and best practices from regulations that govern traditional financial assets where the characteristics of particular digital assets merit doing so.

2 Designate One Regulator for Marketplaces of Digital Assets



2 Designate One Regulator for Marketplaces of Digital Assets

Alternatives to a single supervisor approach

Establishing one federal regulator for all digital asset marketplaces would itself be an important innovation in financial services regulation. Generally, regulation of financial activities by the U.S. government is divided among a multitude of regulators, including the SEC, CFTC, Federal Reserve, OCC, FDIC, and CFPB based upon a wide variety of factors, from the type of entity involved to the products or services provided. Similarly, states have played an important part in financial services regulation, and state regulators serve as primary regulators for banks, money transmitters, and non-bank lenders. Some states have adopted digital asset specific regulatory frameworks such as the specialized Wyoming SPDI bank charter or the NYDFS Bitlicense.

Policymakers may seek to follow a more traditional approach, as has been contemplated by other proposals for digital assets. For example, the *Digital Asset Market Structure and Investor Protection Act* contemplates joint rulemaking between the SEC and CFTC to classify digital assets securities separate from digital assets and assign supervisory responsibility between the SEC and CFTC based upon these classifications.

Fragmentation and overlap in the regulation, and supervision, of financial markets have created inefficient and inconsistent oversight of digital asset marketplaces and their activities. The combination of a registration path for these marketplaces, a single federal regulator, and a complementary SRO are all necessary components to the solution.

Marketplaces today perform the full lifecycle of digital asset transactions within a single entity. They are designed to seamlessly host and directly serve tens of millions of people, and access does not depend on broker-dealer gatekeepers as is required by securities exchanges. Recordkeeping is native to blockchain transactions and settlement for digital assets takes place in minutes, compared to two days for equity securities. This eliminates the need to manage settlement risk by separating central counterparties from depositories, transfer agents, and custody services.

The efficiency gains from straight-through-processing — by housing all digital asset activities under a regulated MDA — can also serve to reduce risks in the system. Quicker settlement reduces reliance on capital and margin to facilitate trading and can avoid suspension of customer access to markets. While the outdated and costly role of the broker-dealer as gatekeeper is eliminated, these types of traditional intermediaries can still engage in critical market-making activities that provide valuable liquidity benefits to all participants.

Ensuring consistent regulation and application of the laws requires a single regulator. Where new policy questions or challenges arise, the ability of a single dedicated regulatory body to respond in an efficient and timely manner benefits everyone: the public, the government, the marketplaces, and the holders. For the government in particular, oversight by a single

regulator would improve supervisory efficiencies, streamline policy implementation and enforcement processes, and generally avoid wasting taxpayer resources.

To support market integrity, the framework should establish a new digital asset SRO to provide further oversight of MDAs. SROs are an important and historic part of the regulatory fabric of U.S. financial markets and already provide critical support for federal regulators in the securities and derivatives markets. The digital asset SRO would have delegated authority under the statute to provide interpretive guidance to members on a range of MDA regulatory and supervisory matters.

The framework would preempt state-by-state registration and related regulatory requirements. This would include preemption of state money transmitter regulations, consistent with current exemptions for federally regulated entities such as broker-dealers, futures commission merchants, and banks. This would bring uniformity to the implementation of rules and lower the compliance and examination burdens of MDA supervision.

The treatment of platforms and services that do not custody or otherwise control the assets of a customer would need to be inherently different from an MDA that holds and controls customer assets, and is therefore not addressed by this framework.

2.1

MDA regulation should support the efficiency benefits of straight-through-processing and authorize MDAs to perform the full range of digital asset transactions, including digital asset trading, transfer (e.g., wallet services), custody, clearing, money payment, staking, borrowing and lending, and related incidental services.

Full lifecycle of digital asset services with MDA registration

Today's innovations in digital asset markets improve the experience and welfare of participants. MDAs provide direct access to end-to-end services and straight-through-processing for digital asset transactions. These marketplaces currently perform custody, trading services, settlement, and clearing under the same roof, and are capable of offering staking as well as borrowing and lending services involving digital assets. The defining feature that differentiates MDAs from other market participants is that they provide custody and trading services on behalf of their customer. Direct access gives participants greater control over where and how they buy, sell, use, and hold digital assets relative to traditional markets. The result is an ecosystem that has the promise of increased efficiency, greater transparency, and ultimately a better experience for customers.

To support the benefits from straight-through-processing innovations in market structure and services, an MDA should be permitted to provide its customers full digital asset lifecycle services and related activities, including:

- Trading of all digital assets.
- Services directly to retail and institutional customers. Customers should not be required to access MDAs through intermediaries (as is generally true for securities and derivatives exchanges).
- Where appropriate, margin trading and other prime brokerage-type services such as lending and borrowing, subject to the oversight and regulations of a new self-regulatory organization that will address the risks associated with these activities.
- Custody of customer assets in a segregated manner and subject to blockchain audit procedures regularly used by MDAs that would satisfy examination requirements.
- Post-trade settlement services, including netting and the movement of client ownership of digital assets on and off blockchain.
- Money transmission of digital assets and fiat currencies, including transfers of fiat and digital assets among users of an MDA as well as transfers away from the MDA to other intermediaries or to self-hosted wallets.

An MDA that facilitates trading in digital assets should be subject to regulations specific to those activities. The regulator should also be authorized to offer different registration paths for different kinds of MDAs depending on the scope of activities they provide. Regulations should focus on equal and open access to digital asset trading for all market participants — retail and institutional.

2.2 Create a New Self-Regulatory Organization

Self regulatory organizations are a well-established feature of U.S. financial markets. SROs have created effective public-private partnerships leading to better supervision of market participants and their activities.[15] The nimbleness, knowledge, and resources of SRO members are critical attributes in ensuring the fairness and efficiency of industry practices. Incorporating an SRO into the regulatory supervision of MDAs will speed the development and enforcement of an appropriately-tailored digital asset industry rulebook. In doing so, the SRO would shift some of the burdens and costs of regulating MDAs to industry

participants and away from taxpayer funded agencies.

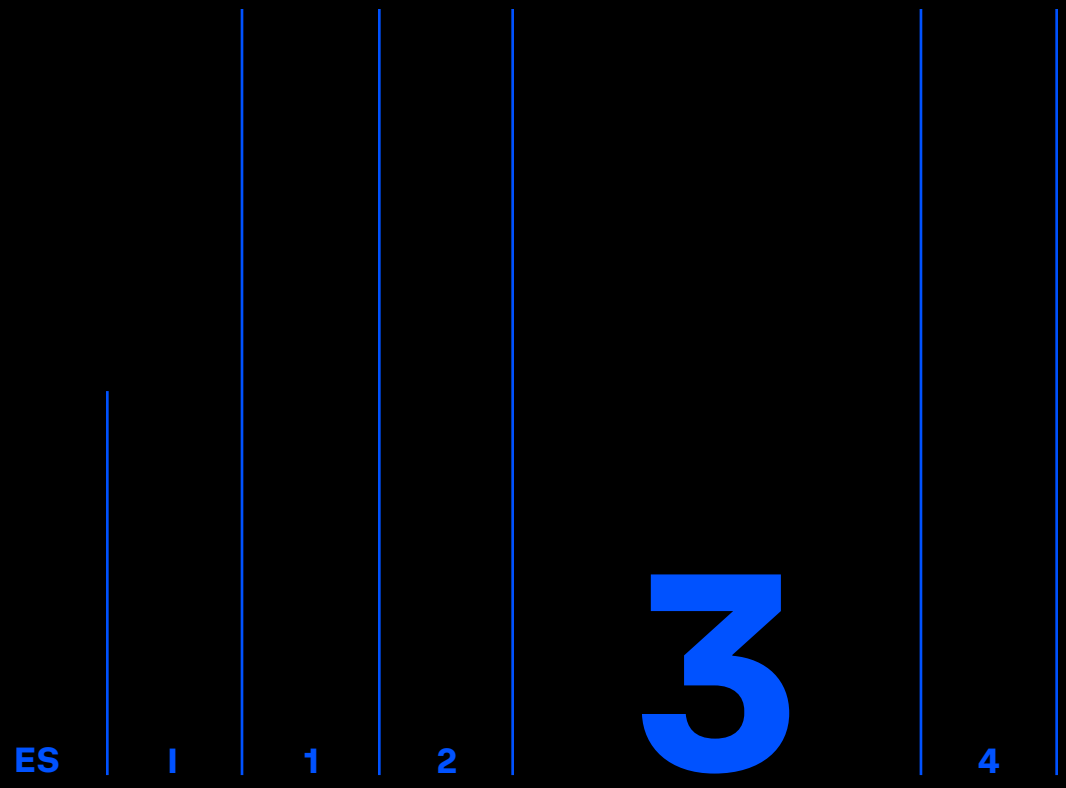
All registered MDAs should be required to be members of the SRO. The SRO would provide granular oversight for the full range of MDA activities, lead regulatory and compliance examinations of MDAs, and impose fines and other sanctions. The new SRO would be accountable to, and under the supervision of, the designated single federal market regulator for MDAs.

The SRO should establish the self-certification process that an MDA would use to make a digital asset available for trading on its platform. This process, similar to the futures markets, provides an efficient way for new digital assets to be offered subject to meeting regulatory standards. The SRO would also have authority to provide interpretive guidance to its members regarding the application of its rules.

The SRO approach for digital assets should not mirror the approach found in the securities and derivatives markets, where multiple SROs across exchanges, clearing agencies and others often face coordination challenges and competing incentives in their supervisory responsibilities. These problems are avoided by having a single SRO, under the supervision of a single federal regulator, dedicated to developing the more granular rules for the industry, rules that would likely go beyond the authority of a federal regulator.[16]

3

Protect and Empower Holders of Digital Assets



3 Protect and Empower Holders of Digital Assets

The immense potential of digital asset technology provides the opportunity to democratize the financial system through greater direct participation by all Americans. To instill consumer confidence and provide robust customer protection, the regulatory framework must (1) enhance transparency through appropriate disclosure requirements, (2) address fraud and market manipulation, and (3) promote efficiency and resiliency. Each goal should be implemented with recognition of the unique characteristics and risks of the underlying functionalities of digital assets.

3.1 Enhanced Transparency

A high quality and transparent information environment for digital assets will empower customers to make well-informed decisions about the transactions in which they enter. A robust disclosure regime tailored to the specific characteristics, risks, and benefits of different digital assets is necessary.

For digital assets that are debt or equity securities, many of the current securities disclosure requirements may be appropriate. In contrast, for digital assets that are well established and decentralized, like Bitcoin and Ether, there is no information asymmetry with the market that needs to be resolved, and no ongoing disclosure required.

Different disclosures are more appropriate for other types of digital assets, particularly those that represent a use case or rights relating to a single project or endeavor. Their values do not depend on an issuer or the business of an issuer, such as the mix of unrelated projects or the types of complicated ownership structures that commonly define public companies. The operational and governance aspects of digital assets are also fundamentally different. For example, self-executing smart

Appropriate information environment for digital assets

Digital assets that are well-established, broadly understood, and decentralized, like Bitcoin and Ether, should not require ongoing disclosure. The material information about their features and risks are transparent to the public. With no central management team, there is no information asymmetry that could be addressed by additional disclosure.

Digital tokens that are earlier in the life cycle, and not yet decentralized, should have a minimum set of disclosures. For example, those could be based on key features of the white papers that are already widely used by the industry. The *Clarity for Digital Tokens Act*,[17] which is based on the token safe harbor proposal advanced by SEC Commissioner Hester Peirce,[18] is an example of what

such disclosure could look like. It focuses on features such as information about significant holders of the tokens, number of tokens, governance provisions, information about the underlying technology, the method of distribution, and functionality of the underlying network and tokens.

Asset-backed tokens, like stablecoins and other digital assets that are pegged to a particular value or fiat currency and maintain a reserve of assets designed to ensure they maintain the peg, require a different type of disclosure. The reserves are often held in high-quality, short-term assets to avoid run risks. They can resemble the composition of a traditional money market fund — cash and cash equivalents — but are designed as stable-value payment instruments, not investments. The disclosures should be appropriate to how they are being used, which is inherently different from money market funds.

contracts of digital asset protocols are open and available for all to see. The risks related to computer operated protocols are entirely different from those related to human discretion over projects. Disclosure requirements for these digital assets should focus on material aspects of the digital asset rather than simply importing legacy requirements that are not helpful to market participants or the public. Notably, importing legacy requirements that are not tailored for the digital asset may actually harm holders by misdirecting them from the risks of the underlying protocol.

The information environment for digital assets should focus on the material characteristics and risks of the asset itself. An asset-centric approach would include information about the features of underlying projects that investors are likely to find most relevant in their purchase or use decisions. This includes, for example, the type of blockchain on which digital assets are recorded and transferred, as well as their technological and economic properties. Other information features should include the level of decentralization, whether capital is being raised as part of the distribution, operational and governance rules, and functionality and characteristics of the underlying network and tokens.

Importantly, disclosure requirements must be flexible, so they can be readily applied to a wide range of digital assets and so they are resilient in the face of future innovation. The assigned federal regulator – together with the new SRO – must also take a flexible and nimble approach with the disclosure requirements rules that the information environment applied in practice. This includes offering frequent interpretive guidance that will allow for market participants to reasonably and easily determine the requirements that will apply. Where additional guidance is needed, there should be a straightforward process for obtaining timely, case-specific, interpretive, or exemptive relief.

3.2 Address Fraud and Market Manipulation

There is currently no federal, consumer protection-focused regulatory regime for all digital assets that protects against market abuses. Enhanced transparency and preventing market abuse are the foundation of a vibrant, efficient, and resilient market that promotes public trust and confidence.

The digital asset regulator and SRO should develop requirements

for MDA trading facilities for digital assets. As with securities and derivatives markets, the new SRO would monitor and perform cross-market surveillance across regulated MDAs to provide integrity and public confidence in market participant adherence to the new regulatory structure.

An MDA would need to make available required disclosures about the digital assets it supports. It should establish requirements and mechanisms for executing transactions on MDA platforms, including for order book matching. The MDA should have the ability to monitor trading activity on its platforms and to enforce its trading requirements. MDAs should provide clear information about their operations to the public.

These requirements should incorporate key principles and best practices from existing registration categories, such as with Alternative Trading Systems (ATSs) for securities, SEFs for swaps, and futures exchanges for futures contracts, while reflecting the unique characteristics of digital assets.

3.3 Promote Efficiency and Strengthen Market Resiliency

MDAs that provide end-to-end financial services offer a significant potential for increased efficiency. This includes facilitating real-time transactions with straight-through-processing and ease of user interactions through a single platform.

Regulations for MDAs should preserve this efficiency while promoting the resiliency of MDAs and customer protection. Rules for MDAs should account for market participants having direct access to exchange services, and not through broker-dealers as gatekeepers. This approach stands in contrast to the exchange membership model that requires intermediated access to trading, which is standard in securities and derivatives markets.

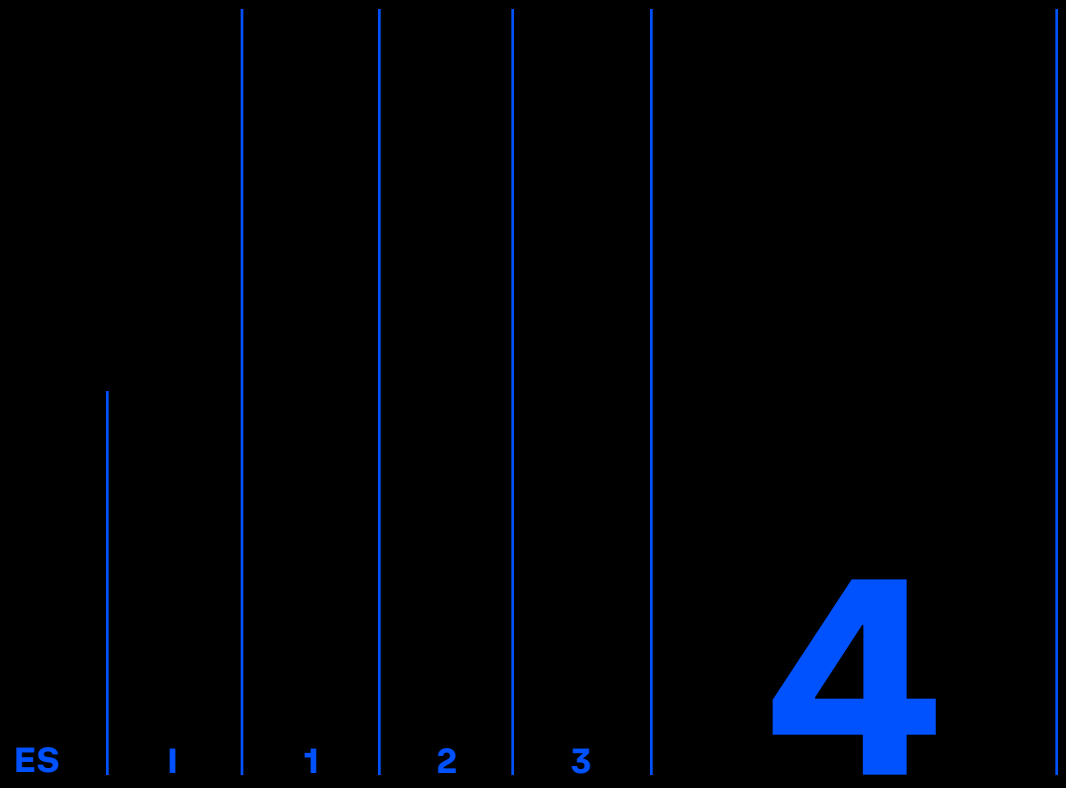
The regulations should prescribe baseline requirements around cyber and operational integrity and resiliency. They should include requirements for post-trade transparency of material terms of digital asset transactions conducted on the platform. Rules should include requirements for asset safekeeping and use, to address financial stability by requiring MDAs to maintain adequate capital and liquidity, to facilitate customer portability, to promote interoperability, and provide clear disclosures regarding the services provided and associated fees. MDAs

should be required to mitigate and disclose potential conflicts of interest.

MDAs must also consider and address risks arising from the role played by market-makers and other liquidity providers on their trading venues. MDAs would be required to implement a compliance program, including coverage of BSA AML requirements. Appropriately tailored customer identification, transaction monitoring, SAR filing requirements, and OFAC and sanctions screening obligations should all remain as available resources.

4

Promote Interoperability and Fair Competitio n



4 Promote Interoperability and Fair Competition

To ensure the continued development of new and innovative digital asset products and services, government's role in effectively overseeing the financial system, and United States' leadership in financial innovation, the digital asset regulatory framework should affirmatively promote interoperability across the crypto ecosystem, as it exists today and in the future.

The crypto ecosystem offers an unprecedented opportunity for developers to build products and services that contribute to the lives of Americans. Preserving and enhancing interoperability would allow the continued development of decentralized protocols, including solutions that allow free and open exchange of information between networks rather than closed and permissioned walled gardens. Interoperability also permits wider and more seamless peer-to-peer marketplace access for holders of digital assets, reducing transactional inefficiencies, and advancing the democratization of financial systems. It would also nurture emerging innovations in a growing number of financial services, such as remittances, small loans, insurance, savings accounts and new protocols that provide even more financial empowerment.

Interoperability becomes more important as the crypto ecosystem continues to develop use cases in the non-financial sector, where consumers seek new ways to access and use their digital property across the digital economy. Healthcare, real estate, and management of intellectual property, to name a few use cases, are experiencing a transformation through the application of blockchain technology.

To support the continued development of new innovations the new regulatory framework should encourage communication, competition and cross-pollination among protocols, applications, and MDAs. Adhering to this principle avoids the

risk of the regulation unintentionally picking winners and losers and actively works against the entrenchment of current market participants.

Benefits from promoting interoperability and fair competition include:

- Giving people greater choice in how to interact with their digital assets. For example, interoperability can facilitate users' ability to easily transfer digital assets across different platforms and tools, allowing them to explore new and innovative use cases and experiences in the emerging decentralized financial ecosystem. Incumbent financial market intermediaries often make this difficult, imposing manual and inefficient processes that charge customers fees for the simple act of moving their own property.
- Permitting digital asset holders to stake their assets through an MDA or by directly interacting with digital asset protocols. Staking serves as a primary means of establishing a secure foundation for crypto technology. Participants should be allowed to choose and move among MDAs and alternative methods and platforms for staking activities, and balance the perceived tradeoffs between the two.
- Allowing holders of digital assets to choose among MDAs and self-custodied wallets. This provides for easier access, use, and transfer of digital assets and digital property in new and innovative ways.
- Providing fair access to decentralized protocol services. These services can compete with MDAs to provide simple, secure and convenient financial transactions and user experiences, with reduced costs. These benefits are enhanced by compatibility with centralized digital asset platforms and traditional banking services, and the willingness of market participants to share information and exchange data.

This list is undoubtedly incomplete because current innovations and their underlying elements are still in development. The potential future is not yet widely understood. Maintaining technology neutrality in the regulatory framework is critical to ensure that we support the development of emerging digital assets and services. This will help ensure a competitive and vibrant digital asset market that secures continued American financial leadership.

Notes

[1] https://www.yahoo.com/now/countries-using-cryptocurrency-most-210011742.html

[2] An Analysis of Bitcoin's Use in Illicit Finance; Michael Morell, Josh Kirshner and Thomas Schoenberger (Apr. 6, 2021).

[3] Board of Governors of the Federal Reserve System, Report on the Economic Well-Being of U.S. Households in 2018 - May 2019, available at https://www.federalreserve.gov/publications/2019-economic-well-being-of-us-households-in-2018-banking-and-credit.htm.

[4] Associated Press-NORC Center for Public Affairs Research at the University of Chicago, More Than One in Ten Americans Surveyed Invest in Cryptocurrencies, July 22, 2021, available at https://www.norc.org/NewsEventsPublications/PressReleases/Pages/more-than-one-in-ten-americans-surveyed-invest-in-cryptocurrencies.aspx.

[5] See Congressional Research Service, Telegraphs, Steamships, and Virtual Currency: An Analysis of Money Transmitter Regulation (Aug. 20, 2020) available at https://sgp.fas.org/crs/misc/R46486.pdf

[6] 23 NYCRR Part 200.

[7] The CFPB has asserted the ability to bring actions against cryptocurrency firms under its Unfair, Deceptive, or Abusive Acts or Practices (UDAAP) authority. Dodd-Frank Act, Title X, Subtitle C, Sec. 1036; PL 111-203 (July 21, 2010).

[8] The Commodity Exchange Act provides the Commodity Futures Trading Commission with anti-fraud enforcement authority over spot market transactions in commodities, which the agency has viewed as including many types of digital assets. Section 6(c)(1) of the Commodity Exchange Act, 7 U.S.C. §9. This authority does not extend to regulation and supervision of these markets. For a summary of this topic, see CFTC Commissioner Stump, Digital Assets: Clarifying CFTC Regulatory Authority & the Fallacy of the Question, "Is it a Commodity or a Security?," (Aug. 23, 2021, available at https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement082321.

[9] Framework for "Investment Contract" Analysis of Digital Assets, U.S. Securities and Exchange Commission. https://www.sec.gov/files/dlt-framework.pdf; see also Securities and Exchange Commission v. Ripple Labs, complaint, U.S. District Court for the Southern District of New York, 20 Civ. 10832 (December 22, 2020). https://www.sec.gov/litigation/complaints/2020/comp-pr2020-338.pdf.

[10] E.g.,Wyoming Division of Banking, Special Purpose Depository Institutions, https://wyomingbankingdivision.wyo.gov/banks-and-trust-companies/special-purpose-depository-institutions.

[11] E.g., OCC Begins Accepting National Bank Charter Applications From Financial Technology Companies, Office of the Comptroller of the Currency, July 31, 2018. https://www.occ.gov/news-issuances/news-releases/2018/nr-occ-2018-74.htm.

[12] This definition excludes non-financial tokenized assets, for example, representations of physical assets such as non-financial commodities, blockchain-based records of trade financing documents, and title to real estate, art and other collectibles. This definition also excludes Non-Fungible Tokens (NFTs) that are non-financial assets. These non-financial tokenized assets would not be subject to regulation under the new digital asset framework, just as they are not subject to any market regulator's jurisdiction today. This approach is consistent with industry comments to the Basel Committee consultation focused on a new regulatory framework for the treatment of crypto-asset exposures within the global banking system.

[13] Digital Asset Market Structure and Investor Protection Act, available at https://beyer.house.gov/UploadedFiles/BEYER_028_xml.pdf.

[14] Digital Commodity Exchange Act of 2020, available at https://republicans-agriculture.house.gov/uploadedfiles/final_-_digitalcea_xml.pdf?utm_campaign=2604-396.

[15] 17 CFR 240, Release No. 34-50700, "Concept Release Concerning Self-Regulation," U.S. Securities and Exchange Commission, March 8, 2005. https://www.sec.gov/rules/concept/34-50700.htm#II. ("A key reason [for SROs] was that the cost of effectively regulating the inner-workings of the securities industry at the federal level was viewed as cost prohibitive and inefficient. In addition, the complexity of securities trading practices made it desirable for SRO regulatory staff to be intimately involved with SRO rulemaking and enforcement. Moreover, the SROs could set standards that exceeded those imposed by the Commission, such as just and equitable principles of trade and detailed proscriptive business conduct standards.")

[16] See 17 CFR 240, Release No. 34-50700, "Concept Release Concerning Self-Regulation" ("Moreover, the SROs could set standards that exceeded those imposed by the Commission, such as just and equitable principles of trade and detailed proscriptive business conduct standards.); see also Senate Document No. 93-13 (page 2), Securities Industry Study (page 2) ("The concept of industry self-regulation, subject to SEC oversight, is well-adapted to dealing with problems of conduct and ethics . . . ").

[17] Clarity for Digital Tokens Act of 2021, available at https://republicans-financialservices.house.gov/uploadedfiles/tsh_xml_signed.pdf.

[18] Commissioner Hester M. Peirce, Public Statement, Token Safe Harbor Proposal 2.0 (April 13, 2021). https://www.sec.gov/news/public-statement/peirce-statement-token-safe-harbor-proposal-2.0.

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