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4 Things to Know About Crypto Legislation As Congress Comes Back In Session This Week

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Congress comes back in session after the Labor Day weekend with a final push before the November elections. Over 20 bills regarding digital assets have been introduced to Congress, addressing a wide variety of areas including taxation and taxonomy of digital assets, consumer protection, systemic risk and regulatory oversight allocation and other matters. These bills are unlikely to become law during the current session of Congress but may shape the direction of future legislation or regulation. Congress continues to hold hearings with industry leaders and the financial services regulatory agencies continue to issue statements and enforcement actions. Many in the industry are searching for concrete guidance to operate their business in a compliant way. The various proposals are wide-ranging, but here are a few fundamental takeaways to know this week:

1. Will the CFTC get more power?

Weighing in on the debate between whether the SEC or CFTC should have more regulatory authority, two of the most recent bipartisan bills give the CFTC more express power over digital asset regulation. The *Lummis-Gillibrand Responsible Financial Innovation Act*, introduced by Senators Cynthia Lummis (R-WY) and Kirsten Gillibrand (D-NY) in June 2022.

The *Digital Commodities Consumer Protection Act of 2022*, introduced by Senate Agriculture Committee Chair Debbie Stabenow (D-MI) and Ranking Member John Boozman (R-AR) with support from Senators John Thune (R-SD) and Cory Booker (D-NJ) in August 2022.

- Many industry members prefer CFTC regulation, because among other considerations, the securities laws contain significant registration, disclosure and other requirements, not well tailored to the functionality, implementation, and use of digital assets.
- CFTC Chairman Rostin Behnam and crypto industry leaders will testify at the Senate Committee on Agriculture, Nutrition and Forestry hearing to review the Digital Commodities Consumer Protection Act on September 14, 2022.
- SEC Chair Gary Gensler will appear before the Senate Committee on Banking, Housing, and Urban Affairs on a hearing regarding oversight of the SEC on September 15, 2022.
- Any ultimate allocation of authority between the SEC, CFTC, and other regulators will be a product of the views of the regulatory authorities and input from consumer and industry groups. Additionally, the House Committee on Financial Services and the Senate Committee

on Banking, Housing, and Urban Affairs, which oversee most of the financial services sector, and the House Committee on Agriculture and the Senate Committee on Agriculture, Nutrition, and Forestry, which oversee the CFTC, will likely have significant input.

2. Application of the definition of "securities" to digital assets remains unclear.

Regulatory classification of digital assets drives regulatory requirements and regulatory oversight. Uncertainty around the application of the definition of security and the so-called "*Howey* test" continues to create uncertainty and has been argued to stifle US-based innovation and drive blockchain-based projects offshore. Legislative proposals seek to clarify what may be outside of the definition of a "security" but still ultimately rely on *Howey* concepts in application.

- The *Lummis-Gillibrand* bill attempts to distinguish an investment contract through which a digital asset may be sold from the asset itself by introducing the concept of an "ancillary asset." Ancillary assets are defined as intangible, fungible assets that do not provide certain economic rights associated with an "entity." Ancillary assets would be subject to CFTC regulation, but SEC reporting obligations would still arise, subject to certain exceptions including whether certain persons engage in any ongoing entrepreneurial or managerial efforts, a core prong of the *Howey* test.
- The *Digital Commodities* bill gives the CFTC exclusive jurisdiction over "digital commodities," which include all cryptocurrency or virtual currency "such as Bitcoin and Ether." However, the definition of "digital commodities" excludes "a security."
- These bills do not prevent the SEC from continuing to broadly use the *Howey* test to argue that a particular digital asset is a security. Crypto companies must continue to analyze the securities laws implications of the products and services they hope to offer because the reach of the securities laws is broad. If a digital asset is a security, an issuer of a digital asset must register with the SEC and publicly-disclose material information, unless an exemption applies.

3. Will the industry be allowed to self-regulate?

These two bipartisan bills consider the use of self-regulatory organizations (SROs).

- The *Lummis-Gillibrand* bill states that the CFTC and SEC should conduct a study to establish principles for self-regulation of the digital asset markets and a proposal to establish registered digital asset associations. This report would include standard rulemaking for the digital asset market, regular consultation with the CFTC and SEC regarding rulemaking and governance of these associations, membership of registered digital asset association members in other SROs and mutual recognition and acceptance of rules amongst SROs.
- Additionally, the *Digital Commodities* bill provides that a digital commodity broker, dealer, or custodian must be a member of a registered futures association, and that the CFTC may authorize those associations to perform any portion of the registration functions.

4. Stablecoin legislation is a top priority for Congress.

The recent instability of some stablecoins have pushed policymakers to speed up regulation. Both the House and Senate are working on passing legislation. New laws could require stablecoin issuers to have proper reserves and disclose their holdings.

- In November 2021, the President's Working Group issued a stablecoin report, stating that legislation should require stablecoin issuers to be insured depository institutions. A stablecoin could be a security, commodity, and/or derivative, regulated by the SEC or CFTC depending on the facts.
- In April 2022, Senate Banking Committee Ranking Member Pat Toomey (R-PA) released a discussion draft of the *Stablecoin TRUST Act of 2022*, which unlike the President's Working Group recommendations, would allow "payment stablecoin" issuers the option, but not requirement, to be regulated as banks. "Payment stablecoins" would include virtual currencies issued by a centralized entity that are designed to maintain a stable value relative to fiat currencies and meet other requirements. To issue a payment stablecoin the issuer could: (1) obtain a new federal license for stablecoin issuers, (2) utilize their state-registered money transmitter status; or (3) become an insured depository institution.
- The *Lummis-Gillibrand* bill would impose requirements on the ability of depository institutions to issue, redeem and conduct other activities for "payment stablecoins," defined generally to be digital assets redeemable one-for-one with US dollars.
- House Financial Services Committee Chair Maxine Waters (D-CA) and Ranking Member Patrick McHenry (R-NC) are working on a bill that would regulate stablecoins and require the Federal Reserve to research and develop a central bank digital currency (CBDC).
- The stablecoin proposals are a positive step toward legitimizing private stablecoins but successful stablecoin legislation will need the support of Senate Banking Committee Chair Sherrod Brown (D-OH) and Ranking Member Pat Toomey (R-PA).

The introduction of proposals with bipartisan support shows that members of Congress are thinking about crypto regulation and pushing it forward. Even if the bills are unlikely to become law during the current session of Congress and any eventual legislation may look significantly different, the concepts and language from these bills may be seen in future legislation or influence regulation. Ultimate legislation may be further shaped by developments in the digital asset market including the upcoming merge of Ethereum, macroeconomic and electoral developments, and efforts by the crypto industry and financial institutions and others to shape responsible legislation.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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