October 11, 2022

The Honorable Sherrod Brown
Chairman
Senate Banking Committee
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Patrick Toomey
Ranking Member
Senate Banking Committee
534 Dirksen Senate Office Building
Washington, D.C. 20510

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

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

The Honorable Maxine Waters
Chairwoman
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Patrick McHenry
Ranking Member
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable David Scott
Chairman
House Agriculture Committee
1301 Longworth House Office Building
Washington, DC 20515

The Honorable Glenn "GT" Thompson
Ranking Member
House Agriculture Committee
1010 Longworth House Office Building
Washington, DC 20515

Re: Prioritizing Investor Protection and Existing Regulatory Frameworks in Digital Assets Legislation

Dear Chairs and Ranking Members:

The Securities Industry and Financial Markets Association ("SIFMA") commends the Senate Banking Committee, Senate Agriculture Committee, House Financial Services Committee, and House Agriculture Committee (collectively, "Committees") for their leadership in seeking to address the important issues raised by various digital asset product types. As the Biden Administration pursues a whole-of-government approach to digital asset regulation, it is clear that Congress has an important role to play in

leading the effort to provide structure and legal certainty for this developing market.[1] As you continue this work within the Committees and across Congress, SIFMA encourages you to prioritize investor protection, apply a technology neutral approach, and follow the principle of "same activity, same risk, same regulatory outcome." This principle importantly recognizes the need for similar regulatory requirements when different entities' activities pose similar risks. However, the principle also embraces the reality that different actors can conduct the same activity and produce very different risks, depending on a host of factors including scale, scope of services, and other regulated functions, meriting a different regulatory approach. As we discuss below, digital asset activities could be subject to either bank or non-bank and either federal or state regulatory frameworks depending on a range of factors, so long as they yield comparable regulatory outcomes. We encourage Congress to utilize existing regulatory frameworks that have helped make U.S. financial markets the strongest and most resilient in the world, recognizing that key innovations will be necessary to reflect blockchain technology's unique characteristics.[2]

The growth of blockchain technology and Web 3.0 gives investors access to an increasingly broad range of digital assets, including stablecoins, non-fungible tokens ("NFTs"), crypto-assets such as Bitcoin and Ethereum, and many different configurations of security tokens. This diversity of products raises a fundamental question: what regulatory framework should govern such digital assets? The strength of our existing regulatory regimes is due in large part to their focus on investor protection. SIFMA believes that investor protection must be placed at the forefront in any digital asset policy framework. Recent events implicating elements of the digital asset ecosystem underscore the importance of prioritizing investor protection in digital asset markets.

It is crucial to delineate between digital assets and the use of blockchain technology to support "traditional" assets (i.e., those not issued natively on a blockchain network). There are a range of

[1] *See, e.g.,* Exec. Order No. 14067, 87 Fed. Reg. 40881 (July 8, 2022); White House, Fact Sheet: White House Releases First-Ever Comprehensive Framework for Responsible Development of Digital Assets (2022); Press Release, Brian Deese, Nat'l. Econ. Council Dir., and Jake Sullivan, Nat'l. Sec. Advisor, on Digital Assets Framework (Sept. 16, 2022); U.S. Dep't of Treasury, Report on The Future of Money and Payments (2022); U.S. Dep't of Treasury, Report Crypto-Assets: Implications for Consumers, Investors, and Businesses (2022); U.S. Dep't of Treasury, Action Plan to Address Illicit Financing Risks of Digital Assets (2022); Press Release, Janet Yellen, Sec'y, U.S. Dep't of Treasury, on the Release of Reports on Digital Assets (Sept. 16, 2022); U.S. Dep't of Justice, Office of the Att'y Gen., The Role Of Law Enforcement In Detecting, Investigating, and Prosecuting Criminal Activity Related To Digital Assets (2022); Press Release, U.S. Dep't of Justice, Justice Department Announces Report on Digital Assets and Launches Nationwide Network (Sept. 16, 2022); U.S. Dep't of Commerce, Responsible Advancement of U.S. Competitiveness in Digital Assets (2022); Press Release, Statement from Gina M. Raimondo, Sec'y, U.S. Dep't of Commerce, Responsible Advancement of U.S. Competitiveness in Digital Assets Report Release (Sept. 16, 2022).

[2] The recently released report by the Financial Stability Oversight Council (FSOC) endorses many of the same regulatory principles, such as the importance of "same activity, same risk, same regulatory outcome," "technology neutrality," and "leveraging existing authorities where appropriate". *See* FSOC, Report on Digital Asset Financial Stability Risks and Regulation (Oct. 3, 2022). Note that the meanings of these terms in the FSOC report may differ from the way they are defined in this letter.

opportunities for financial institutions to use blockchain technology to improve the processes supporting "traditional" assets, from clearance and settlement to asset servicing to information management, that can enhance efficiency and reduce risk. These blockchain driven enhancements of industry infrastructure and processes for "traditional" securities must be distinguished from any regulation governing digital assets. For example, using blockchain technology for internal transfers or to record information as part of a financial institution's books and records functions should be clearly differentiated from digital assets and should not be subject to additional regulation as such books and records functions are already subject to existing supervisory approval, review, and oversight by the financial institution's regulators.

In evaluating how best to regulate digital assets, Congress and regulators should take into account that this is still a developing asset class and that any regulatory regime will need to be sufficiently accommodative of a variety of novel products while still promoting investor protection, financial stability, and market quality. Consider stablecoins, for example. Stablecoins have a range of different attributes, including whether they pay interest, the mechanisms used to maintain stable value (*i.e.,* whether fiat currency-backed, crypto-backed, or algorithmically-backed), and how they are offered, sold, and used within the crypto ecosystem. Such attributes should inform how stablecoins ought to be regulated. This variety of technologies and attributes within a single category of digital assets illustrates the need to consider the facts and circumstances of a product, not its label, to determine whether it is a security, or some other instrument, and thereby identify the appropriate agency to regulate it.

As we understand, draft stablecoin legislation reportedly under consideration by the House Committee on Financial Services appears to focus on "payment stablecoins" that are backed by cash or cash-like investments. The treatment of stablecoins should be informed by the specifics of the relevant business model, including, among other things, the mix of assets that back the stablecoin. For example, a stablecoin that is backed by cash and cash-like instruments may in appropriate circumstances[3] be treated like a bank deposit, that is, subject to banking laws and regulations and oversight by bank regulators. Alternatively, a stablecoin that meets the definition of a "security" as defined by the federal securities laws and interpreted by Supreme Court precedent[4] should be subject to the federal securities laws and regulation and oversight by the Securities and Exchange Commission ("SEC"). As a result, the treatment of particular types of stablecoins may, depending on their attributes, be analogous to the way that bank sweep programs operate today, where cash may be swept into either a deposit account at a bank

[3] For example, where the stablecoin does not promise or provide exposure to the investment return on the underlying instruments in the reserve.

[4] *See* Section 2(a)(1) of the Securities Act of 1933 and Section 3(a)(10) of the Securities Exchange Act of 1934. *See also SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) and *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

(subject to bank regulation and oversight) or invested in a money market mutual fund (a security) at a financial services firm (subject to SEC regulation and oversight).[5]

As policymakers continue to consider legislation, they should also bear in mind the range of non-bank regulatory frameworks that currently oversee certain aspects of the digital asset marketplace. While still nascent, many digital asset brokerage and derivatives activities should be regulated at the federal level given existing frameworks. Other developing activities, such as issuing a reserve-backed "payment stablecoin," could be governed under a variety of regulatory regimes provided that they offer have fundamentally comparable regulatory requirements. While remaining cognizant of the differences between activities and regulation across a range of criteria, such as their coverage of different entity types, products, and activities, SIFMA recognizes the ongoing policy debate over how novel and still developing digital assets products align with the jurisdictional perimeters of regulators. It is critical that any federal regulatory approach follows the principles outlined above and that any state regulation in this area should be no less stringent than federal regulation of like activities, consistent with current regulatory approaches.

SIFMA believes that digital asset products, including stablecoins, can be accommodated within existing regulatory frameworks, such as the federal securities laws (if applicable), with possible modifications as necessary to reflect the unique ways in which blockchain technology functions. Similarly, accommodating digital assets within existing regulatory frameworks should not result in all digital assets and the entities working with them necessarily being subject to bank regulation, consistent with the current functional regulation framework. SIFMA encourages Congress to frame any legislation in this area as technology neutral with a focus on the asset or activity conducted rather than on the technology used to deliver it. In particular, SIFMA encourages Congress to build upon the protections provided to investors under existing regulatory frameworks.

For example, certain types of digital assets should be viewed as securities. U.S. securities regulation places investor protection forefront across the securities lifecycle. From securities issuance to trading to clearance and settlement, a robust investor protection framework guides the activities of participants in the U.S. securities markets. Investors are protected by a mature and tested disclosure-based regulatory regime that includes as its centerpiece investor access to timely and updated information on issuers and other market participants. In addition, investors are protected by a broad net of safeguards that require market participants to, among other things, "know their customers,"[6] protect vulnerable individuals from

[5] *See* Investor Bulletin: Bank Sweep Programs (June 5, 2014), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_banksweep.

[6] FINRA Rule 2090.

financial exploitation,[7] protect investor privacy and data, put their investors' best interests first when recommending a transaction,[8] comply with robust regulatory requirements regarding custody and segregation of customer assets,[9] and abide by a range of rules governing markups, commissions, and fees.[10] Moreover, investors are protected by a robust regulatory oversight regime that continually reviews for compliance with these investor protection rules.

As policymakers think about the role of regulation in supporting the development of the digital asset marketplace in the U.S., SIFMA stresses that the strengths of our regulatory system, and in particular its focus on investor protection, has been a primary factor behind the leadership of the U.S. in traditional financial markets. We should be leaning into and building upon the foremost financial regulatory regime in the world so that the U.S. can retain leadership in the digital assets and infrastructure space.

SIFMA applauds the Committees for their continued work on this important investor protection issue. SIFMA encourages the Committees to apply a technology neutral approach that focuses on the asset or activity conducted rather than on the technology used to deliver it. SIFMA believes taking such an approach will leverage existing regulatory regimes, such as the federal securities laws, that are mature, tested, and center on investor protection.

Sincerely,

Kenneth E. Bentsen, Jr.
President and CEO
Securities Industry and Financial Markets Association

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[7] FINRA Rule 2165.

[8] SEC Regulation BI. *See also* FINRA suitability rule (FINRA Rule 2111).

[9] SEC Rule 15c3-3 (securities broker-dealer customer protection rule) and SEC Rule 206(4)-2 (securities investment adviser custody rule). The SEC's net capital rule (15c3-1) and customer protection rule (15c3-3), for example, form the foundation of the securities industry's broker-dealer financial responsibility framework. The net capital rule focuses on liquidity and is designed to protect securities customers, counterparties, and creditors by requiring that broker-dealers have sufficient liquid resources on hand at all times to satisfy claims promptly. SEC Rule 15c3-3, or the customer protection rule, which complements rule 15c3-1, is designed to ensure that customer property (securities and funds) in the custody of broker-dealers is adequately safeguarded and segregated.

[10] FINRA Rules 2121 and 2122.