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S. HRG. 119–367

EXPLORING BIPARTISAN LEGISLATIVE FRAMEWORKS FOR DIGITAL ASSETS

HEARING

BEFORE THE

SUBCOMMITTEE ON
DIGITAL ASSETS

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED NINETEENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE FRAMEWORKS FOR DIGITAL ASSETS

FEBRUARY 26, 2025

Printed for the use of the Committee on Banking, Housing, and Urban Affairs



Available at: https://www.govinfo.gov/

U.S. GOVERNMENT PUBLISHING OFFICE
63–448 PDF WASHINGTON : 2026

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C O N T E N T S

WEDNESDAY, FEBRUARY 26, 2025

	Page
Opening statement of Chairman Lummis	1
Opening statements, comments, or prepared statements of:	
Ranking Member Gallego	2

WITNESSES

Lewis Cohen, Partner, Cahill Gordon & Reindel LLP	4
Prepared statement	32
Jonathan Jachym, Deputy General Counsel and Global Head of Policy and Government Relations, Kraken Digital Asset Exchange	6
Prepared statement	45
Jai Massari, Chief Legal Officer, Lightspark	7
Prepared statement	50
Timothy Massad, Research Fellow and Director of Digital Assets Policy Project, Kennedy School of Government, Harvard University	9
Prepared statement	57

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Letters and statements submitted to the Committee	81

EXPLORING BIPARTISAN LEGISLATIVE FRAMEWORKS FOR DIGITAL ASSETS

WEDNESDAY, FEBRUARY 26, 2025

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON DIGITAL ASSETS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:30 p.m., via Webex and in room 538, Dirksen Senate Office Building, Hon. Cynthia M. Lummis, Chairman of the Subcommittee, presiding.

Present: Senators Lummis, Tillis, Hagerty, Moreno, McCormick, Gallego, Warner, Van Hollen, and Smith.

OPENING STATEMENT OF CHAIRMAN CYNTHIA M. LUMMIS

Chairman LUMMIS. I would like to call this first meeting of the Digital Assets Subcommittee to order.

And Mr. Gallego, welcome as the Ranking Member. I'm looking forward to working with you and the other Members of the Subcommittee. This has been a long time coming. So I'm delighted to get started. I'll make an opening statement and then the floor will be yours to make an opening statement. And then we'll introduce our witnesses.

So the hearing now being in order, thank you, everyone, for being here at the inaugural Subcommittee on Digital Assets hearing. I'm really grateful to Senator Scott for creating this Subcommittee. And as I said, Senator Gallego, looking forward to working with you to pass bipartisan legislation on Bitcoin, on stablecoin, and digital assets.

We want to promote responsible innovation and protect consumers. We sure have come a long way since I first arrived in the Senate. Many Members of the Senate, we're still trying to wrap their heads around what is a bitcoin, what is a digital asset, what is a stablecoin, what is a Howey test.

And so now we've arrived at the point where we can move forward. We're on the precipice of finally creating a bipartisan legislative framework for both stablecoin's market structure. I hope we can get both pieces of legislation to President Trump for his signature this year, including the Lummis-Gillibrand Responsible Financial Innovation Act which is the more market structure-oriented bill that would sort of dovetail with what the House passed last year which was FIT21.

But we're going to start with stablecoin and on stablecoin. So I'm optimistic the Senate Banking Committee will soon markup Sen-

ator Hagerty's legislation. It is called the GENIUS Act. Chairman Scott and Senators Gillibrand and I are all cosponsors.

The act makes the U.S. dollar fit for the digital age, creates additional demand for U.S. debt, and makes payments both faster and cheaper. I'm also pleased that the legislation fully protects the dual banking system and creates parity between both States and Federal stablecoin charters.

Turning to market structure, I'm excited to work with Chairman Scott, our Subcommittee Members, Chairman Boozman, Chairman French Hill over in the House, and Chairman G.T. Thompson who are respectively chairs of Financial Services and Agriculture to clearly draw the line between a security and a noninvestment contract commodity and to create a path for digital asset exchanges to register with the Commodity Futures Trading Commission. This industry needs clear rules of the road that it can follow while simultaneously promoting both responsible innovation and protecting consumers.

So each of our witnesses today are committed to these goals. And I'm really grateful to all four of you to be here and share your expertise on these topics.

First, we have Lewis Cohen, partner at Cahill Gordon & Reindel. Did I get that right? Thank you. Mr. Cohen is a learned lawyer and an expert with respect to differentiating between a security and a commodity. Can't wait to hear from you about that. We have been wrestling with that for months.

Second is Jonathan Jachym, Global Head of Policy at Kraken. I am proud that Kraken calls Wyoming home today. And Jonathan, thank you for being here and sharing your expertise.

Third, Jai Massari, Chief Legal Officer at Lightspark. Ms. Massari is one of the original thought leaders on stablecoin policy and understands how stablecoins operate. And then finally, we are honored to have Tim Massad as a witness. He was Chair of the Commodity Futures Trading Commission from 2014 to '17 and is a research fellow at the Harvard Kennedy School of Government.

I'm personally thankful to each of you for working with me and my staff over the years and providing great feedback on legislation and providing it over and over as we've tried to move the subject forward. We're thrilled to have you here today and look forward to having an in-depth policy conversation about the intricacies of stablecoin and market structure policy.

Ranking Member Gallego, you are recognized for an opening statement.

OPENING STATEMENT OF RANKING MEMBER RUBEN GALLEGO

Senator GALLEGO. Gracias, Chair Lummis, for hosting this hearing and for starting off our work on this Committee with a bipartisan focus. I look forward to our continued work together on these issues.

Thank you also to our witnesses for joining us today to discuss an issue of growing importance, how Congress can deliver bipartisan legislative solutions for digital assets that promote innovation and U.S. competitiveness while protecting consumers and ensuring the integrity of our financial system.

The rapid development of digital assets, blockchain technology, and the broader crypto economy presents both extraordinary opportunities and, of course, significant challenges. These innovations have the potential to enhance financial inclusion, streamline transactions, and spur economic growth. At the same time, they raise concerns and questions about consumer protection, financial stability, and the proper role of Government in overseeing these emerging technologies.

We, in Congress, have the responsibility to strike the right balance which we sometimes do, fostering safe and responsible innovation and establishing clear guardrails to prevent abuse, fraud, and systematic risk. So this is not about us picking winners and losers among technologies or industries. It's about creating a stable and predictable regulatory environment that allows legitimate enterprises to thrive and grow while protecting the interest of the American people and consumer.

First, let's talk about safe and responsible innovation. Digital assets are a fast, evolving sector and the United States must lead in this space. Innovation should be encouraged and it must be safe, transparent, and accountable.

Without robust oversight, bad actors can exploit loopholes, undermining trust in the system and causing harm to consumers and investors. We must ensure that digital assets are not used to circumvent existing laws on money laundering, tax evasion, or illicit financing.

At the same time, we must ensure that we are encouraging innovation as productive and useful to everyday Americans. The growth of things like memecoins on everything from Trump to Doge to Peanut the squirrel about flashy headlines and trending on social media. And they are not about helping traditionally un- and underbanked communities, gaining access to the financial system. I hope to hear from our witnesses on how we can incentivize good behavior and mitigate risk while still allowing digital assets and the economy to develop.

Second, we need to have clear rules of the road. Today's regulatory framework for digital assets is insufficient in my opinion. Bipartisan legislation should provide clarity and consistency well into the future enabling innovators to operate with confidence and ensuring regulators have the tools they need to address risks effectively.

Third, we must ensure that the rise of digital assets does not come at the expense of safety and the soundness of our traditional banking system. Stablecoins and other digital assets with links to the broader financial sector could pose risk if not properly managed. We must ensure that the use of digital assets does not lead to risk to depositors or the Government backstops for the banking system.

Finally, consumer protection must remain at the heart of our efforts. I became interested in crypto because I heard from many of my constituents, especially young Black and Latino men, that are excited about what this new technology can offer to them in terms of access and investment opportunities that largely they have been shut out of. What they don't want, though, is to be the victims of fraud or dangerous financial loss.

Consumers need transparency, safeguards, and recourse if things go wrong. Digital assets can and should be a place for bipartisan collaboration. Both parties share an interest in fostering innovation, protecting consumers, and maintain the strength of our financial system.

By working together, we can craft legislation that meets these goals and cement America's leadership in the new digital economy. Thank you and thank you, Chair. I look forward to working together and look forward to hearing from our witnesses.

Chairman LUMMIS. Thank you, Mr. Gallego.

We will hear now from our witnesses starting with Lewis Cohen. We're looking forward to hearing what you have to say and sharing your expertise in why there are gaps in existing securities laws with respect to digital assets, love to hear your views on the Howey test, and how Congress should appropriately draw the line between securities, commodities, and anything else you care to share with us, Mr. Cohen.

The floor is yours.

OPENING STATEMENT OF LEWIS COHEN, PARTNER, CAHILL GORDON & REINDEL LLP

Mr. COHEN. Thank you, Chair Lummis, Ranking Member Gallego, and distinguished Members of the Subcommittee. My name is Lewis Cohen, and I'm a partner at the Wall Street law firm of Cahill Gordon & Reindel and the cohead of the firm's CahillNXT emerging technologies practice. As a practitioner, I have over 20 years of experience working in both traditional finance and the blockchain sector. This experience has allowed me to witness firsthand both the tremendous promise as well as the regulatory challenges of this technology.

Today, I offer testimony in support of a legislative framework for activity involving the use of digital assets. Over the past several years, innovation in the digital asset sector has raced ahead of the legal and policy frameworks designed decades ago for traditional finance, resulting in divergent regulatory approaches, inconsistent agency pronouncements, and a fragmented legal landscape, throttling American competitiveness.

Perhaps most critically, this uncertain regulatory environment has left consumers and users of digital assets at risk. A clear, practical, and flexible Federal statutory regime is urgently needed to address activity involving digital assets in both the primary and the secondary markets. The U.S. securities laws formed in the wake of the Great Depression rely on the bedrock concept that every security has an identifiable issuer such as a corporation that can be held accountable for ongoing disclosures to investors.

And for virtually all of the digital assets that are widely traded in the U.S. today, almost none create a legal relationship with an identifiable business entity that may be considered the asset's issuer. Unlike securities which cease to exist if the securities issuer has been dissolved, digital assets, once created, continue to exist and circulate in perpetuity on global decentralized networks.

However, without an issuer that can be required to register and disclose information, current law struggles to address secondary trading of these assets. This creates unnecessary confusion as to

the lines between securities transactions which are the appropriate subject of SEC oversight and more conventional commodity-like activity.

Nevertheless, our securities laws were thoughtfully designed to address what the Supreme Court has referred to as novel, uncommon, or irregular devices. And the Howey test you mentioned, Chair, recognized that fundraising schemes in which a person invests money to purchase an item, expecting profits from the efforts of the promotor, are securities transactions, even where the item sold is not itself a security.

Over the years, these investment contract transactions have involved all sorts of items purchased not for use but rather for the resale and a hope for gain. These ancillary assets have included beavers, chinchillas, earthworms, and even postage equipment. I discuss these cases in my 19—excuse me, in 2022 paper entitled the Ineluctable Modality of Securities Law.

Many digital assets have similarly been sold as ancillary assets to raise capital to develop a blockchain-based project. With an understanding of the distinction between fundraising activity that results in a securities transaction and a nonsecurity ancillary asset sold in that transaction, the basis of a sensible regulatory framework is inherent. Where the Howey test applies, fundraising transactions involving digital assets would continue to need to be registered with the SEC or exempt from registration, for example, as a private placement.

However, a change in law is needed to require sellers of ancillary assets, that is the issuers of these securities transactions to provide ongoing disclosures. These disclosures would be subject to SEC oversight and securities law antifraud rules once the related ancillary assets initially sold or come widely traded. These required disclosures would cease when the entrepreneurial efforts of the fundraising team are no longer essential to maintaining the value of the digital asset.

This framework set out in the Lummis-Gillibrand Responsible Financial Innovation Act would recognize the critical role that the SEC plays in capital formation and fundraising. It would also provide for a new ongoing securities law-based disclosures from fundraising parties that would eliminate the potential for asymmetries while implementing a clear dividing line to end the is it or isn't it debate about when securities themselves—excuse me, when digital assets themselves are securities.

Thank you again for the opportunity to share these perspectives, and I look forward to your questions.

Chairman LUMMIS. Thank you, Mr. Cohen.

Next, Jonathan Jachym who is Deputy General Counsel and Global Head of Policy for Kraken Digital Asset Exchange. We look forward to hearing from you on how the lack of legal clarity is impacting businesses, digital asset trading practices, and how digital asset exchanges should be regulated.

Mr. Jachym, the floor is yours.

OPENING STATEMENT OF JONATHAN JACHYM, DEPUTY GENERAL COUNSEL AND GLOBAL HEAD OF POLICY AND GOVERNMENT RELATIONS, KRAKEN DIGITAL ASSET EXCHANGE

Mr. JACHYM. Chairwoman Lummis, Ranking Member Gallego, and distinguished Members of the Subcommittee, thank you for the opportunity to testify today.

My name is Jonathan Jachym, and I serve as Global Head of Policy and Government Relations at Kraken. Part of my past 3 years in this role, I spent over a decade in traditional markets based in the U.S. and Europe.

Kraken was founded in San Francisco over 13 years ago and has grown into the world's largest—one of the world's largest and most trusted digital asset exchanges. Today, we serve over 15 million customers around the globe. We custody over 40 billion in assets on our platform. We executed over 600 billion in transactions last year, and we have a team of over 2,000 professionals across 60 countries.

Kraken plays a diverse role across three main areas of the markets. First, we operate as a centralized exchange for spot crypto markets along with other intermediary services.

Second, we support traditional market investment into digital assets. This includes the world's leading benchmark provider, CF Benchmarks, and our novel State-chartered bank, Kraken Financial, which offers institutional custody under an innovative and robust Wyoming legal framework.

Third, our on-chain business includes our wallet and our Layer 2 blockchain, called Ink, which serves as our platform for decentralized innovators.

I would like to commend and thank Senate Banking Chairman Scott for establishing this important Subcommittee and Subcommittee Chairwoman Lummis for her many years of leadership in advancing bipartisan legislation and discussion on digital asset policy. The first drafts of comprehensive market structure legislation were introduced in the Senate over 3 years ago. A lot has happened since then. We've seen fraud, poor risk management, and business failures.

We've experienced misguided attempts to regulate our markets through enforcement actions rather than sound policy development. This has pushed innovation, investment, and market activity offshore.

But through these challenges, we also saw bipartisan work in Congress continue. Last June, the House passed the market structure bill with strong bipartisan support. Ranking Member Gallego, we thank you and your former colleagues from the 118th House for advancing that historic effort.

This collaboration across parties and across chambers has built a strong foundation to finalize and deliver market structure legislation to the President's desk for signature this year. Bipartisan support for good crypto policy is no longer a distant goal on the horizon. Congress should act decisively this year to establish the essential foundation for market regulation.

Today, nearly 90 percent of activity in the digital assets market is executed via centralized intermediaries like Kraken. Market structure legislation is the critical foundation to set a level playing

field in areas of consumer protection, security, and market integrity. Many other markets have already taken this important first step.

Innovation in our industry evolves rapidly. Emerging areas in our markets will require further study, inputs, deliberation before arriving at policy conclusions. But solving every single policy issue should not delay building a basic regulatory foundation for centralized markets here in the United States.

This critical first step must happen here in Congress. Effective market regulation should include spot market authority for the CFTC to register and oversee centralized intermediaries and secondary market transactions, effective disclosure rules, and clear jurisdictional cooperation between the CFTC and the FCC. Jurisdictional lines in statute should not be overly complex. They should be clear, effective, and durable.

We commend this Administration for embracing innovation and establishing the President's Working Group on Digital Assets. And we also commend the new leadership at the SEC and CFTC for quickly moving forward to engage in real policymaking. We look forward to supporting this important work on our new journey ahead.

The crypto industry is diverse and includes developers, decentralized protocols, centralized intermediaries, institutional and retail customers, and many others, each playing a very important role in expanding this new area of innovation. Our industry will continue to work hard to forge consensus and support bipartisan passage of a market structure bill this year.

Thank you again for the opportunity to testify. I look forward to your questions and our discussion.

Chairman LUMMIS. Thank you, Mr. Jachym.

And now, Jai Massari, Chief Legal Officer of Lightspark, is going to share her thoughts with us. I'm so delighted you're here. Your knowledgeable about both stablecoins and market structure which we're starting with in this Committee.

And all of us get questions about the use case for these assets, people who don't work with them on a regular basis. And I know you have expertise in what makes stablecoins valuable to the economy, the manner in which stablecoins operate, and all of the legislative approaches to stablecoin legislation and regulation. So we're very much looking forward to your testimony.

And thank you very much for being here. The floor is yours.

OPENING STATEMENT OF JAI MASSARI, CHIEF LEGAL OFFICER, LIGHTSPARK

Ms. MASSARI. Thank you, Chair Lummis, for that very kind introduction. Thank you, Ranking Member Gallego and Members of the Subcommittee. I'm really happy to be here speaking on this topic today.

I'm cofounder and Chief Legal Officer of Lightspark, a company that is building modern payments on the Bitcoin Lightning Network. Before Lightspark, I was a partner in the Financial Institutions Group of Davis Polk where I advised a wide range of banks, stablecoin issuers, and crypto firms on regulatory matters.

There should be strong bipartisan support for new laws to regulate stablecoins in crypto markets. They will provide clarity, protect American consumers in markets, and help bring the United States back to the cutting edge of innovation in financial services. These new laws must be based on strong fundamentals that reflect our best views about the benefits and risks of stablecoins in crypto markets as they should exist, not only based on the industry as it exists today.

Today, we can email, text, or call each other instantly and for low cost, no matter what brand of phone or computer we're using. Payments can and should work the same way. Stablecoins can help make this a reality. Among other uses, they enable the 24/7 transfer of dollar value to anyone online. They are uniquely suited for online commerce when they are properly regulated.

My comments today will focus on three fundamental aspects of stablecoins with recommendations for legislation. Some of these points are already well addressed in bills being considered by the Subcommittee and should be kept at the forefront as these bills move through Congress.

The first fundamental is that the true innovation of stablecoins is in their potential to be digital cash, always on noncredit money. Unlike bank deposits, the money value of a stablecoin is supported by full reserves, not FDIC insurance or the creditworthiness of the issuer. This means that someone using a stablecoin to pay or accepting a stablecoin for payment should not care which stablecoins are being used. This is not true today, with users in markets correctly distinguishing between USDC, USDP, USDT, and so on.

Stablecoins as digital cash can be achieved through the following mechanisms. Stablecoins must be backed one-to-one with reserves of high-quality liquid assets, with carefully calibrated capital buffers and liquidity requirements. Issuers must be available to redeem the stablecoin at face value, for example, a dollar.

And in resolution or bankruptcy of the issuer, reserve assets should be segregated and beneficially owned by stablecoin holders. These assets should be quickly liquidated and paid out to these holders in an orderly manner.

The second fundamental is that stablecoin issuers should compete based on innovative payment use cases, not on reserve design. Of course, this requires getting reserve design right. Reserve requirements that are too permissible, reduce incentives for stablecoin issuers to innovate or compete based on the usefulness of their stablecoin.

At the same time, overly conservative reserve requirements make stablecoin issuance attractive only to the largest market participants or for those that can subsidize stablecoin issuance with other business. In addition to striking the right balance on reserves, stablecoin legislation should promote a diverse and competitive stablecoin issue or landscape.

It should allow for issuers of different types, banks, bank affiliates, as well as nonbanks with different kinds of business models to establish minimum operational and compliance requirements for all issuer types. It should address potential conflicts of interest or other concerns about affiliates through limits on affiliate transactions and should impose common enhanced standards for all

issuers for access to Federal reserve payment systems and master accounts. This approach will create a more competitive multi-issuer world and incentivize issuers to compete on payment solutions and utility rather than on reserve size and returns.

Third, we should use stablecoin legislation as a way to level up our approach to financial compliance and privacy. The industry has built new compliance tools, including chain analytics and technology to freeze or block stablecoin transactions to meet BSA requirements that have long applied to stablecoin issuers and those providing money transmission services using stablecoins.

Similarly, the industry is developing new tools to address privacy considerations raised by on-chain transactions which can reveal sensitive information about consumer and business payments and can put user privacy at risk. These tools are a critical way to advance new and better technologies for better, more efficient, more informative, and less costly financial crimes and privacy compliance. While these technologies are designed to benefit stablecoin use, they can also be leveraged more broadly in crypto and even in traditional financial services.

Stablecoin legislation should set strong and clear standards for illicit finance and sanctions requirements. It should also provide for time, flexibility, and incentives to develop new and better ways to address these requirements.

Thank you again to the Subcommittee, Chair Lummis, Ranking Member Gallego, and the hardworking staff who are dedicated to getting stablecoin and crypto markets regulation right. I'll be happy to answer questions.

Chairman LUMMIS. Thank you, Ms. Massari.

And our last witness is Tim Massad, a research fellow at Harvard Kennedy School, and very helpfully to this discussion, a former Chair of the Commodity Futures Trading Commission under President Obama. We're very much looking forward to your view on potential approaches to stablecoin and market structure legislation and your emphasis on consumer protection. And we'd love to hear your thoughts about the GENIUS Act, Lummis-Gillibrand, and FIT21.

Mr. Massad, the floor is yours.

OPENING STATEMENT OF TIMOTHY MASSAD, RESEARCH FELLOW AND DIRECTOR OF DIGITAL ASSETS POLICY PROJECT, KENNEDY SCHOOL OF GOVERNMENT, HARVARD UNIVERSITY

Mr. MASSAD. Thank you very much. Subcommittee Chairman Lummis, Subcommittee Ranking Member Gallego, Members of the Subcommittee and staff, I'm honored to be here today. The views I express are my own and do not represent the views of Harvard Kennedy School.

It was in 2014 that the CFTC under my leadership declared bitcoin a commodity. And ever since then for over 10 years now, I've been writing about the need to strengthen regulation in this area and bring clarity. Everyone wants clarity. We can all agree on that.

But you can have clarity with bad rules. We need to create a regulatory framework that encourages responsible development of this

technology as the Ranking Member said and not one that just leads to more of the speculative activity and abuses that we've seen far too much of today.

I'm happy to focus on stablecoins, the most useful application of the technology to date. And I applaud the Subcommittee for prioritizing this.

The GENIUS Act has many features I support such as full reserves for tokens, conservatively invested, and limitations on the activities of an issuer. But there are many areas where it is deficient. It is substantially weaker in many respects than the McHenry-Waters proposal that was negotiated between House Republican and Democratic members last fall, and it's substantially weaker than what Europe and other jurisdictions have put into place.

First, the basic prudential requirements need to be strengthened. This includes how the reserves are held and invested and whether regulators have sufficient authority to establish rules regarding reserves, capital, liquidity, and other risk management standards.

In addition, the proposal limits State's authority for licensing and supervision to situations where there is a substantially similar State framework and an issuer below 10 billion in market cap. That's a good concept. But I would lower the threshold and explicitly require States to still follow some minimal Federal standards.

Second, the legislation does not address the bankruptcy of a stablecoin issuer. This means that the standard corporate bankruptcy process would likely apply which would likely take a long time. The fact that the proposal gives holder a priority claim is good, but it does not assure them a full recovery, even at the end of that process. Ideally, the legislation should create a dedicated resolution process that returns money to holders quickly and minimizes collateral damage.

Third, the GENIUS Act does not do enough to address the risks of financial crime and evasion of sanctions. It's good that it says stablecoin issuers are subject to the Bank Secrecy Act or BSA. But the BSA focuses on obligations on centralized intermediaries.

Stablecoins can be transferred and traded without going through a centralized intermediary, whether that's on a self-hosted wallet or on an automated decentralized platform. And they can be transferred through centralized platforms in jurisdictions that don't comply with BSA type rules. We need to extend the regulatory perimeter and be more creative in tackling the AML and CFT challenges as I discuss in my testimony.

Fourth, the GENIUS Act does not have strong enough enforcement provisions. Three of the five largest dollar denominated stablecoin issuers are offshore, including Tether. The legislation should have a clear enforcement mechanism, strong criminal and civil penalties, and an explicit extraterritoriality provision.

Fifth, the proposal does not address questions of competition and concentration of power, including limits on affiliate relationships and transactions and how to ensure a level playing field among competing platforms, including potentially by giving them access to essential bank payment infrastructure.

Finally, I urge the Subcommittee and the Congress to get stablecoin legislation in place first and defer for now consideration

of market structure legislation for several years. For 4 years, the crypto industry has called on the SEC and CFTC to develop rules and guidance and to stop regulating by enforcement. That is now happening.

The SEC has dropped enforcement cases and launched a crypto task force to tackle these issues. We should let these regulatory initiatives make progress before rushing to rewrite the securities laws. Many of the market structure proposals made to date in my mind would create more confusion than clarity regarding when a digital asset is a security, a commodity, or neither. And they have the potential to undermine our securities laws.

That is particularly true of proposals that focus on decentralization. That term and DeFi are used to describe a lot of things that aren't decentralized. There are almost always some vectors of control. And even if a process is decentralized or automated, that does not mean it should be exempt from regulation. As I discuss in my testimony, I think there are other ways for Congress to advance the goals of clarity and market structure without substantially rewriting our securities laws at this time.

Finally, with all due respect to the Subcommittee Chair, I join the many voices from across the ideological spectrum expressing opposition to a bitcoin strategic reserve for reasons that I've discussed in my written testimony.

Thank you, and I'm happy to take your questions.

Chairman LUMMIS. Thank you to our panel. And we'll begin with questions. The Chair recognizes herself for 5 minutes.

Mr. Cohen, I'm going to begin with you. From a legal perspective, why are most digital assets not properly classified as securities today?

Mr. COHEN. Thank you, Chair. This is a really important question, and it's flummoxed many in the space, lawyers, judges, and regulators alike. What characterizes as a security is a legal relationship between an issuer and the investor.

So when you think about, for example, a share of stock, there's a legal relationship, not necessarily a contractual relationship but a legal relationship that identifies who the issuer is. A security is not the piece of paper it's printed on the digital asset or any other representation. It is a relationship that the law recognizes, whether that is debt or equity.

The vast majority of digital assets that are traded right now simply do not evince that relationship with any other person. The reason this becomes so important, Chair, from a securities law perspective is that there is no one that actually can take permanent responsibility for that asset. This is why this has been so challenging, whether we think of, for example, the Ether token, there is an Ether foundation. But if that foundation wound itself up, the token would continue to exist. This is unlike any security that's out there.

Chairman LUMMIS. So to constitute a security, has the Howey test historically required some kind of written or verbal legal relationship after the sale of an asset?

Mr. COHEN. Senator, the Howey test has focused historically prior to the advent of digital assets on transactions that purported to be commercial in nature. I'm selling you something, chinchilla,

what have you. And it turns out that the actual activity going on, the courts have recognized, is really more of an investment.

I didn't want those chinchillas. What I really wanted was to make a return based on your managerial or entrepreneurial efforts. Many digital assets are sold in the same way.

However, in none of those cases, zero exactly, has any court stated that that kind of relationship makes some asset that is not itself a security. It's sort of an embodiment of a securities transaction. So the law has not recognized or placed on nonsecurity assets some characteristic of being a security simply because they were sold in digital assets.

And in the paper I mentioned, the Ineluctable Modality of Securities Law, we reviewed each and every appellate case on Howey from the Howey case onward. And you can see our appendices analysis that reaches that conclusion.

Chairman LUMMIS. Thank you. Mr. Jachym, where in the United States is a relationship to other countries in setting up a framework for digital asset exchanges to register? How do we stand?

Mr. JACHYM. Thank you for the question, Chairwoman. Behind but in a strong position to catch up quickly. We've seen progress. Kraken is a global company. We've seen other jurisdictions, major jurisdictions, G10 markets move forward with legislation, move through the regulatory phase to finalize rules. And we've worked with policymakers in those jurisdictions to put those in place which is why it is so critical after many, many years of hard work in Congress that we move forward with this foundational step to pass a market structure bill.

Chairman LUMMIS. Thank you. And Ms. Massari, why do stablecoins make payments faster and cheaper? Here again, the use case issue.

Ms. MASSARI. Such a good question. It's always the first and most important question when talking about crypto. The way I think about stablecoins is they are a new fast money, right?

So they are inherently on-chain. They can be transacted online, on-chain transactions 24/7 with anyone that can access a crypto wallet. They also can be transacted only on-chain.

No complicated clearing mechanism needs to happen to make sure that transactions are settled behind the scenes as is the case for bank deposits and other forms of electronic money that we have today. So this is really a new form factor for money that can work as digital case. And it can be transacted instantly, 24/7, around the world. That's something that doesn't exist today.

Chairman LUMMIS. And how does the GENIUS Act put in place commonsense prudential standards for stablecoins?

Ms. MASSARI. I think the GENIUS Act goes a long way to providing the kind of foundational elements that will make stablecoins good money. So prudential standards for reserves are probably the most important point. Another is requirements for redemption of stablecoins by the issuers.

That's what makes stablecoins good money, capital liquidity requirements against reserve assets or a third aspect that are really important. And then I think the GENIUS Act goes a long way in trying to define different types of stablecoin issuers, how they must be regulated, how they must be chartered, and how they must be

registered. And I think those are really fundamental aspects of the bill.

Chairman LUMMIS. Thank you, Panel. I recognize Mr. Gallego for 5 minutes.

Senator GALLEGO. Thank you, Madam Chair. One of the main reasons I think Congress needs to act on digital asset legislation is to ensure the U.S. remains competitive in this given space, especially the rapid pace of digital asset regulation internationally. Particularly, we avoid regulatory arbitrage.

So Mr. Jachym, and sorry if I said that incorrectly, Kraken operates globally in jurisdictions with established digital asset regulations. What elements from these international frameworks should Congress consider incorporating into legislation to ensure U.S. competitiveness and innovation?

Mr. JACHYM. Thank you for the question, Ranking Member. I think there's two fundamental components here. One is regulation of centralized intermediaries, including exchanges.

This is the most fundamental basic step. I've been involved in market regulation most of my career. There are very common components to how you regulate centralized markets.

There are unique risks and opportunities that digital asset markets prevent. But when you talk about registration, disclosures, rules around market integrity, rules around operational resilience, those are all fundamental components of market regulation. We've seen these jurisdictions put that basic first step in place.

The other component has been simplicity. So rather than attempt to bluntly apply traditional rulebooks to the digital asset markets, jurisdictions have simply called this market and this new asset class crypto asset in many markets. And I think that's fundamental to this discussion today when we talk about the path forward here in the United States. The jurisdictional lines, the tests, the oversight needs to be simple in order to be durable and to be on par with what the rest of the world has moved forward with.

Senator GALLEGO. Ms. Massari and Mr. Massad, what other lessons can we learn from other countries to shape our approach to digital asset legislation?

Ms. MASSARI. Thank you for the question. I think it's really informative to look at jurisdictions that have gone before us. As I mention in my comments, we need to think about what the industry should look like, not only what it looks like today.

And I think perhaps some other jurisdictions who have gone very, very quickly with digital asset legislation, whether it's unstable coins in markets, may have moved too soon and have been slightly backward looking in how they regulate. And I think as we think about—particularly as I focused on stablecoins, we should think about the real opportunities that present and what makes them different and unique and important for better modern payments and aim legislation in that way to be forward looking. And I'm not sure that's happened in other jurisdictions.

Senator GALLEGO. Mr. Massad.

Mr. MASSAD. Thank you. I think there's also a lot we can learn, starting with stablecoins. I think some of the jurisdictions that have gone ahead of us have put in some very good measures.

Europe, I think, has overall a much stronger prudential and customer protection framework than is in the GENIUS Act or the STABLE Act. The authorities have greater discretion to specify necessary rules on a variety of requirements. There's stress testing, diversification requirements. And Europe has said stablecoins don't pay interest—can't pay interest which is also something we should be thinking about.

Senator GALLEGO. Can't or can? I'm sorry.

Mr. MASSAD. Cannot.

Senator GALLEGO. Cannot? OK.

Mr. MASSAD. Cannot, because that turns them into more of an investment vehicle. And that raises a lot of issues. So you don't want to allow the payment of interest and at the same time exempt them from being securities.

And the market structure area, one thing I would point out that's often not noted is under the MiCA framework, yes, they created this framework for crypto assets. But they made it very clear that crypto asset does not include a financial instrument. And their financial instrument definition is very similar to our securities definition.

So they're facing these difficult jurisdictional questions as we are too. They're just inherently hard. So I think maybe we can learn from where they are on that.

Senator GALLEGO. Some bills have also proposed using a bankruptcy process to resolve user claims if a stablecoin issuer fails. But bankruptcy can take years. And Ms. Massari, you actually talked a little bit about this in your opening statements.

What other mechanisms should we consider so that if a stablecoin issuer fails users can still get their money back quickly while other creditors go through the bankruptcy process? So essentially, for that person that is holding a lot of this, they don't have the bandwidth nor the reserves to basically wait until the bankruptcy process finishes.

Ms. MASSARI. This is a really, really important question. Thank you for asking it. And I think Mr. Massad also touched on it in his remarks.

This point is not only important out of a matter of fairness for stablecoin holders when or if something goes wrong with their stablecoin issuer. But instead, it's fundamental sort of ex ante to make the money good money because——

Senator GALLEGO. And could build confidence.

Ms. MASSARI. Exactly, build confidence that if something bad happens, they will be able to get their money out just like we do for bank resolutions by the FDIC. The priority, right, is to make sure the depositors can have access to their deposits as quickly as possible. The concept is the same and really important.

I think priority over reserve assets for stablecoin issuers is part of it, and it's an important part of it. But exactly as you've said, the result of that could still be an extended process in bankruptcy. I think a stablecoin bill should provide for clear rules under which stablecoin holders own assets from the reserve at the time of a bankruptcy or resolution of the issuer so that it's not part of the bankruptcy estate and then can be paid out very quickly. I think a mechanism like that will serve better, both from a confidence in

the value of the money up front as well as be fair to issuers on the way out.

Senator GALLEGO. Thank you. I'm out of time. Thank you, Madam Chair.

Chairman LUMMIS. Thank you. The Chair recognizes Mr. Hagerty for 5 minutes.

Senator HAGERTY. Thank you, Senator Lummis. I appreciate your leadership on this Subcommittee and for holding this hearing today. And welcome to all of our witnesses here.

I'm just going to provide a broad set of statements here. So everybody can relax for a moment. Let me touch on my view in terms of the need for providing a legislative framework for digital assets.

To me, it's overwhelming clear. The lack of clear rules is stifled innovation and set businesses offshore to date. It's also weakened consumer protections by forcing activities into foreign jurisdictions that don't have the kind of standards that Americans would expect.

Solution, and this is sure to be a bipartisan solution, is to provide what innovators, consumer production advocates, and our financial markets crave and that's legislative clarity. My colleagues and I have already taken concrete steps toward developing constructive policies that advance this mission. I'm proud to sponsor the GENIUS Act alongside Senator Lummis, Chairman Scott, Senator Gillibrand, and Senator Alsobrooks, all of this to establish a commonsense framework for stablecoin issuance in the United States.

The United States can and should be a leader in payment stablecoins. They improve transaction efficiency, expand financial inclusion, and strengthen the dollar status as a world reserve currency, all while driving demand for U.S. treasuries. I'm optimistic that we'll advance this legislation and demonstrate that a commonsense framework for digital assets is a bipartisan priority.

This progress will build momentum in other crucial areas such as market structure for digital assets. The status quo of having no regulation does nothing to stymie bad actors and is pushing innovation beyond our shores. We need regulatory clarity for digital assets to both protect consumers and to be a leader in the industry.

Thank you, Madam Chair.

Chairman LUMMIS. The Chair recognizes Ms. Smith.

Senator SMITH. Well, thank you, Madam Chair and Ranking Member Gallego. And thanks to all our panelists for being here today. I appreciate this very much and having an opportunity to learn about—hear your thoughts about what we need to do to provide a robust and reasonable regulatory framework, especially for stablecoin. And I want to focus my questions on kind of better understanding how consumer protections should work for stablecoin and how they might work under the GENIUS Act in particular.

So Mr. Massad, let me ask you. So under current law, financial institutions are subject to the Bank Secrecy Act. So that means the financial institutions are required to actively work to detect and prevent money laundering and terrorism financing and other illicit uses of our financial system. So I want to understand how this would work under the GENIUS Act.

So as I understand it, the GENIUS Act would extend these obligations under the Bank Secrecy Act to issuers of payment stablecoins. Is that how you understand it?

Mr. MASSAD. That is correct, yes.

Senator SMITH. OK. And so then under this legislation, what would happen once a payment stablecoin is issued on the public blockchain? What happens to those Bank Secrecy Act obligations once the stablecoin is issued?

Mr. MASSAD. Thank you for the question, Senator. The challenge is that those stablecoins can then be transferred without going through a centralized intermediary. Our entire BSA/AML/CFT framework relies on centralized intermediaries.

All transactions run through those centralized intermediaries in some way. And so we've imposed obligations on those intermediaries, banks and others, to do the compliance checks that we want. Stablecoins are very different in that once they've been issued, they can be transferred, exchanged for other crypto assets without going through a centralized intermediary.

So we have to sort of creatively rethink how we achieve these goals. And I think that includes extending the regulatory perimeter, if you will, but also looking at a lot of other creative measures requiring stablecoin issuers to aggressively monitor transactions, fees, stablecoins, looking at ways to design the smart code of a contract so that a transaction doesn't go through unless someone has effectively been cleared by an appropriate authority. And there are other measures as well that I talk about in my testimony.

Senator SMITH. And so as the bill is written right now, network participants comes along after to facilitate transactions. They wouldn't be required as the bill is written right now in your understanding to meet the obligations of the Bank Secrecy Act?

Mr. MASSAD. Unless they're a money service business registered with Treasury, it would not be.

Senator SMITH. OK, OK. So let me ask you another question. When bank regulators review applications for charters or for deposit insurance, they consider a bunch of factors, including the character and the fitness of management. And that seems reasonable to me.

You want to make sure that if you're opening up a bank or you're safeguarding somebody's money that management is up to the task. And the boards follow basic risk management and so forth. So my question—my next question is this.

Stablecoin issues, they serve a—perform a similar function, I would argue. Consumers give them their money. And in exchange, they get a stablecoin and a promise that they can always come back and redeem that stablecoin for a fixed price. Would the GENIUS Act or should the GENIUS Act or should our regulatory framework require stablecoin issues to be vetted for character and fitness as we do for other financial institutions?

Mr. MASSAD. Excellent question, Senator. My reading of the GENIUS Act is it does not require that. I think it should require that. It should include that as a part of the application review process that was contained in the McHenry-Waters proposal that was negotiated in the House.

Senator SMITH. Right.

Mr. MASSAD. Similar standards are in the European legislation and in other countries' legislation.

Senator SMITH. The concern would be—I mean, literally, somebody like Sam Bankman Fried could issue a payment of stablecoin and regulators wouldn't have any legal grounds to deny his application based on his history just as a sort of maybe an extreme example. But let me just——

Mr. MASSAD. Cor——

Senator SMITH. ——get at one more thing in the short time I have left. There's this risk of—there's a need to protect from theft and fraud. If somebody falls victim to a hack or a scam, their assets could be gone for good, and there's no reversing that transaction.

And we've seen this, of course, happen with digital assets. So if a consumer's bank account is hacked or their debit card, for example, is stolen, people are protected, right? Their liability is limited.

Mr. MASSAD. Correct.

Senator SMITH. And what laws——

Mr. MASSAD. That's the Electronic Funds Transfer Act which does——

Senator SMITH. Right.

Mr. MASSAD. ——apply in those cases. It's very murky with respect to stable coins. It's not clear whether stablecoins would be treated as funds, whether the accounts would be covered. The CFPB put out a proposal——

Senator SMITH. Right.

Mr. MASSAD. ——a couple of weeks ago. But obviously, that's not moving anywhere given the effective——

Senator SMITH. Mothballing.

Mr. MASSAD. ——closing of the CFPB. But those are very challenging issues, particularly again because these are bare instruments that can travel on a decentralized blockchain. Certainly, though, with respect to entities that are providing accounts or entities that are interacting intermediaries, we should have similar protections as we have under the EFTA with banks.

Senator SMITH. It seems to me that there is no specific—there's no mention——

Mr. MASSAD. Correct.

Senator SMITH. ——anywhere of the Electronic Funds Transfer Act or CFPB. It seems to me that that would strengthen this bill——

Mr. MASSAD. I agree with you, Senator.

Senator SMITH. ——if it was clarifying that. I thank you for your lenience, Madam Chair. I appreciate this hearing very much. And I want to say that I think establishing a robust framework for stablecoins is extremely important. And I look forward to the ongoing work that we can do to make sure that these consumer protections are addressed in the bill.

Chairman LUMMIS. Thank you very much. The Chair recognizes Mr. Tillis for 5 minutes.

Senator TILLIS. Thank you, Madam Chair. Welcome, all of you. I've had the belief that we do need a regulatory regimen, but it has to be Goldilocks just right for us to really reemerge.

I think, Mr. Jachym, you said that we're behind but poised to catch up and maybe surpass. I think that we have to figure out the way the markets and activities are properly regulated. But we also

have to make sure that we don't have flight to foreign jurisdictions if we get this wrong.

So I guess one question I'll have for you, Mr. Jachym, is, what country is the best practice? Fill in this blank if you agree with it. If we would only implement a regulatory regimen like, blank, we would be the head of the pack. Is there an answer to that question, anybody here on the panel? I'll start with you.

Mr. JACHYM. Thank you for the question, Senator. Look, I think the U.S. needs to design rules and policy that are fit for the U.S. markets. I think we can look to other jurisdictions for examples.

Senator TILLIS. In doing so, how do we develop competitive advantage jurisdictionally speaking with what you consider to be a best practice today? What country is that and why are they a best practice today?

Mr. JACHYM. I think if you look to the European Union, for example, and the United Kingdon and again other G20 markets, they've kept it simple. And they've said, look, these are a diverse group of asset class. We've listed over 300 assets on our platform.

There's bitcoin, there's stablecoins, and many others. And they have very diverse characteristics. But if you start drawing complex lines and complex text and bifurcate markets, that becomes problematic. So I think we can look to simplicity as an example.

Senator TILLIS. Ms. Massari, do you have anything to say to that?

Ms. MASSARI. I think this is a great question. I think maybe I'll focus a little bit on the stablecoin front.

Senator TILLIS. Yeah.

Ms. MASSARI. I think proposals in the EU might make some mistakes. Proposals in the U.K. might make some mistakes, either in getting the reserve requirements too restrictive. Very few are too permissive. My concern with overly restrictive reserve requirements is it really makes it difficult for new entrants to come into the market. And instead——

Senator TILLIS. Have you looked at any of the proof of reserves proposals up here in Congress?

Ms. MASSARI. I haven't actually on the proof of reserves point. But I think if we get to your point, the Goldilocks positioning just right, we can have better competitive markets for stablecoin issuance which I think is what's really needed. I don't think we have that today with our duopoly.

Senator TILLIS. Mr. Cohen, where do you think the biggest gaps are for the—if you were instructing us on prioritizing tranches of regulations, what must come in the first tranche?

Mr. COHEN. Thank you, Senator. One point you asked about regarding other jurisdictions and the U.S. and what we can take away, it's important to bear in mind the U.S. is a bifurcated market regulatory structure with the CFTC and the SEC. So right off the bat, one of the first things that needs to be done is have a clear policy around how market participants can determine, am I engaged in a securities transaction, am I not?

That's caused immense consternation for everyone in this space, be they centralized exchanges, people who act as broker-dealers, issuers, and others. So as a priority matter, the Lummis-Gillibrand Responsible Financial Innovation Act would provide such a clear

and bright line test. Is the asset one that's been issued by someone who's a legal issuer?

Where that's not the case, the transaction which those assets are sold may attract a securities treatment. But secondary trading between Bob and Alice are not securities transactions. Once we put a line in the sand, the market can respond by creating appropriate frameworks for each of these two categories, those that appropriately require disclosures of issuers and those that are more commodities—like and are treated in a similar way to Bitcoin and Ether.

Senator TILLIS. Mr. Massad, I'm really worried. I got a briefing from DEA, a classified briefing a couple years ago. And just look at the—any of the things that transnational criminal organizations are carrying along suitcases of money now.

I haven't paid attention to how illicit money laundering is occurring today. And it's mainly on these various platforms, particularly crypto platforms. How do we—you're absolutely right.

Architecturally, we're not—AML/BSA architecturally dealing with a centralized sort of process. Is there any jurisdiction out there that's found the secret sauce on how to, on the one hand, make the participants of payments and settlements responsible and the other hand really be able to identify any of the kinds of patterns that we use for SARs and AML activities?

Mr. MASSAD. It's an excellent question, Senator. I don't think any jurisdiction has found the secret sauce yet.

I think everybody is focused on this. I think it's going to be a combination of things. One is extending the kind of current framework to jurisdictions, to intermediaries who aren't complying. That's a big part of the problem.

A second, though, is looking at this technology and trying to think about ways that we can sort of reach the same goals. And these ideas of essentially being able to program smart contracts so that transactions can't go through unless someone has been properly vetted is one that at least I hear a lot of conversation about.

You can also put more obligations on the stablecoin issuers than I think the current proposals do. We've seen Japan do that. We've seen other countries do that where they require more aggressive monitoring and freezing of stablecoins.

Senator TILLIS. It's easy for some class of stablecoin issuers. If you happen to be a bank, it's not so easy with some of the other ones. So we look forward to the continued discussion. Thank you.

Mr. MASSAD. Thank you.

Chairman LUMMIS. We're pleased to welcome Senator Warner. Do you need a minute?

Senator WARNER. I'm always willing to pontificate. But could you give me a minute more?

Chairman LUMMIS. Absolutely. I'll ask one question. Would you like another question, Mr. Gallego?

Senator GALLEGO. Yeah, whatever you want to do.

Chairman LUMMIS. OK, great. Mr. Cohen, the SEC has tried to advance a legal argument that digital assets embody an underlying investment contract. So is this supported in case law? And what would be the effect of using that legal argument as a statutory requirement or definition?

Mr. COHEN. Senator, that is a very important question. The reality is that the SEC has developed a novel theory when they failed at other approaches in this regard. Initially, the SEC characterized all digital assets as crypto asset securities and they very plainly said this in their complaints and court filings.

After that approach was rejected by courts, the SEC under the prior administration attempted to adopt a new theory, that a digital asset may not itself be a security but that it embodies in some way some sort of scheme. The problem with that theory, Senator, is that how do you know? Just because one says so?

There's nothing about a digital asset that suggests that a third party examining that asset could make any determination, does it or does it not embody something? I can say this bottle of water here embodies my plan to do something. But you can't examine the bottom of water and reach that conclusion.

Several courts have very clearly rejected that theory by the SEC. Obviously, we're now in a period where some of this litigation has ceased. And I think we can all be thankful for that. But I do believe, Senator, that if the legislation continued, that theory would've been rejected by Federal courts.

Chairman LUMMIS. Thank you, Mr. Cohen. Mr. Gallego.

Senator GALLEGO. Thank you. The bills under consideration do have a variety of penalties for violating the provisions. Some will be civil penalties while others have additional criminal penalties. Mr. Cohen and Mr. Massad, given that bankers face criminal penalties for failing to comply certain banking laws, shouldn't we also apply somewhat of the same standard when it comes to digital assets?

Mr. COHEN. I guess I'll go first, Senator. Thank you. Yes, I would agree. Those criminal or civil penalties should be in line with equal activity when done in other markets. So for example, issuers can face both civil and criminal penalties if they sell securities on the basis of misleading statements. If they're deliberate and intentional fraudulent activity, they can face criminal as well as civil penalties. That should not be differentiated when the securities transaction involves digital assets. However, we shouldn't create new penalties that are specific simply to the technological means by which those securities transactions occur.

Senator GALLEGO. Mr. Massad.

Mr. MASSAD. Excuse me. I would agree with that. We do need to incorporate criminal and civil penalties and have a very clear enforcement mechanism. The GENIUS Act to my mind doesn't have that. The STABLE Act doesn't have that. And I think that's not just important for the substance. I think it sends a strong signal too. It sends a signal that we won't tolerate violations of the law.

Chairman LUMMIS. Mr. Warner, you are recognized for 5 minutes.

Senator WARNER. Thank you, Madam Chairman. And I appreciate you and Senator Gallego. I'm still in the catchup with these guys in terms of learning this stuff.

About 4 or 5 years ago, I had some of it in my head, but I think it's long gone. I come to this with the notion from my role on the Intel Committee. So I think we've got to make sure we get national security right.

I agree with my colleagues. We've got to get consumer protection right. And I think at the end of the day, we've got to make sure we've maintained the resiliency of the Treasury market which frankly is the backbone. And there are huge opportunities here. But I think there are challenges.

One of the things as we think about AML and Senator Tillis' comment, AML and BSA, I do know a number of the stablecoin operators, issuers who are actually doing KYC. I think, Mr. Massad, you've mentioned that. But I'm still trying to understand that there are—even if they do KYC from their time as an issuer, do they convert back to a fiat currency?

In that transition, there's some potential challenges. I think you and your comments have addressed that. Could you all address that? I'll start with you, kind of like the enhanced monitoring of the blockchain during that transition.

Mr. MASSAD. Sure. It's a bare instrument, Senator. So a stablecoin issuer issues the stablecoin, although in some cases, it licenses a third party to do that. It can do KYC. But once that stable coin has been issued, it can be transferred——

Senator WARNER. Many, many times so that there's no requirement to follow that customer.

Mr. MASSAD. That's correct.

Senator WARNER. Because again, as you said, it was bare demand.

Mr. MASSAD. Yeah, and I can transfer it from a self-hosted wallet to another self-hosted wallet. And that can happen several times. And that's why we've seen these things be used to evade sanctions and for money laundering by Russian smugglers, by Hamas, and by others.

Senator WARNER. Were others—because listen, I want to get to a regulatory framework that works. But I have seen echoing what others have said from the classified side. Oh, my gosh, a whole bunch of bad stuff. So help me figure out—and I recognize some people, the anonymity and the intermediation role that blockchain plays. But how do we put some minimum protections from issuer all the way back to conversion to fiat?

Ms. MASSARI. I'm happy to jump in, Senator, for a moment. I agree with you. I think the risks to stablecoin markets, issuers, and to be honest, the use of stablecoins at all as a true means of payment is dependent on our ability to get it right when it comes to combating illicit finance and enforcing sanctions. I think everyone must agree with that.

I think as Chair Massad was saying, when a stablecoin issuer sells stablecoins into the market, they are KYC'ing everybody that they're directly transacting with. That's one place KYC happens. You're exactly right that when transactions happen between self-custody wallets, there isn't KYC obligations on those.

And so those can happen without KYC. But there is an immutable on-chain record of those transactions that can be monitored not only by the issuer but third parties, including law enforcement. And I think that happens quite a bit today. And then——

Senator WARNER. But isn't there that process, the mixtures where you can—following it through that path, you may still have

the blockchain to follow the entity. But you may not know who really that entity is without a KYC next to it, right?

Ms. MASSARI. Absolutely right. I think people can use a variety of different technologies on purposes to obfuscate their financial transactions. I think that's true on blockchain. That's true in traditional financial payment services as well.

I think it's a really important issue, and I agree that we need to continue as the industry has done to continue to develop new tools to address these issues. I think one other piece is when KYC happens is when a user transfers a stablecoin to a custodial wallet. So an exchange, another wallet service, that's another point of KYC, right?

So the gap, I think, is largest when you're talking about unhosted wallet transfers. And in some sense, it's, like, slightly better than digital—or slightly better than paper cash in this sense, right, because there is the on-chain history.

Senator WARNER. Right, right.

Ms. MASSARI. Is it sufficient? Should we be satisfied?

Senator WARNER. But I think Senator Tillis said people are not walking around with bags of cash.

Ms. MASSARI. It's heavy. Yeah, it's heavy to carry cash, right? It's not heavy to carry stablecoins. And I think that is a difference that matters, and we have to always seek to do——

Senator WARNER. Madam Chair, could I go ahead and get the other two to make a comment? Gentlemen.

Mr. JACHYM. Senator, I think it's important to distinguish in the stablecoin context between primary issuance and transacting on secondary markets. So Kraken's role in the market is as a centralized intermediary. And we have a platform where we know who's coming in, who's coming out.

We track not only KYC. So we know everyone coming into our platform, anything that leaves our platform, if there's any risk of it hitting a sanctions address, it's blocked. There's enhanced monitoring tools.

So I think again back to the role centralized intermediaries play, this is why we believe it's so essential for the United States to move forward with market structure legislation that would put that basic market regulation, create a level playing field for all centralized intermediaries. Ninety percent of transactions today, almost up to 90 percent, are conducted through centralized intermediaries. And my colleague, Mr. Massad, is absolutely correct.

There is an ecosystem out there that is outside of centralized intermediaries. But the surveillance, the traceability that is available because of blockchain technology is unparalleled. And we've seen this with hacks, right. The ability to quickly find, track, trace financial crime is unparalleled to any technology we've seen in history.

Senator WARNER. All right. Mr. Cohen, can you——

Mr. COHEN. I'll just quickly comment to say again, I agree with my colleagues here. You're right. These are difficult questions.

But there are tradeoffs involved in any new technology. I think we briefly alluded to the ability with crypto assets to freeze and seize. That's different from tracking. But it can mean that if a stablecoin issuer identifies that a particular amount of stablecoin

is at an address controlled by an illicit actor, they can functionally turn that off at that time.

That's not a feature that we have today with paper money that once achieved or other assets. It's important to remember illicit finance occurs through many ways through valuable, moveable assets. And stablecoin in many ways are a step change better than a lot of other assets.

Senator WARNER. Right. But if we're saying this is better than bags of cash, I would agree. I grant you that. Whether this is something that we ought to fully embrace and I want to get the S.

So I want to be clear. I want to get the S. But in our whole financial system and trying to measure the risks, I think back about the Colonial Pipeline hack where we were able to recover about a third.

And I need to get from the classified side why we couldn't get the other two-thirds. But I need further—and I get the intermediary role, going in, going out. But you obviously lived through a lot.

I can still remember when the Meta boys came up with their initial plan a number of years back. But you got to help those of us who want to get there and how we can not get rid of the innovation and bring this back to America. Clearly having it onshore is better than offshore. Entities like Tether, it'd be great to bring them back. But you got to help us fill this out, and I'll keep listening, Madam Chair. Thank you.

Chairman LUMMIS. Thank you. Before I recognize Mr. Moreno—oh, we have another Committee Member here. So I will recognize Mr. Moreno for 5 minutes.

Senator MORENO. Thank you, Madam Chairman, for putting this Committee together. And I'll take off right where Senator Warner ended. So let me see if I can help you get the yes. And maybe the four of you can chime in for me.

So let's always start with the things that we agree on. So you don't have to chime in necessarily unless you disagree. There should be certainty, correct? No disagreements? OK. Look at that. See, progress. We should make certain that the——

Senator WARNER. How are you defining certainty?

Senator MORENO. Well, certainty means, like, you know what the rules are? Like, you know what the rules of the road are. Does that make sense? There's also transparent. In other words, you don't find out through an enforcement action.

You don't find out—like, for example, I guess I would use a car analogy. You're driving down 95. You don't know what the speed limit is until a cop pulls you over and tells you. That's stupid. We can agree on that, right? There's signs. Tell you what the speed limit is.

So we agree on that. We agree it should be fair, right? We shouldn't have unfair agreements. And then most importantly, and this is where I think we're having problems here.

And I honestly understand it a little bit and don't understand it because coming from the private sector, this place is decently perplexing to me because I look at this and go, OK, well, Government has this total complete desire to control things. And if feels like if someone is not perfect, the Government's role is to make something

perfect. There could never be a problem because if there's ever a problem, the Government is going to stop it.

So let's go back to some other technology. So none of you are this old. So I'm going to ask you, like, if you were the regulator with this kind of mindset in 1900, would cars be allowed?

I mean, cars have caused hundreds if not millions of deaths. So you say, my God, how do we have millions of deaths over the last hundred years? We should've never allowed the car to exist. That obviously today would seem like an idiotic comment.

Now Ohio, probably not Pennsylvania because we always know Ohio is better, has invented the airplane. But airplanes crash. Lots and lots of people have died in airplanes and, by the way, have empowered foreign countries to be able to fly over our airspace and the airspace of our allies and cause all kinds of damage. But we wouldn't ban airplane because that, again, would be idiotic.

Personal computers, a pretty good invention. I remember sitting in my dorm room in college in 1985. I'll confess to that. And my roommate saying, what the hell is that thing? I said, it lets me send a message to somebody anywhere on earth. He goes, what a dumb idea. He's currently a roofer.

All right. So then you look at the internet. The internet we can look at and say is amazing opportunities that it's unlocked but now a lot of problems. I mean, human trafficking and sex trafficking and child trafficking existed for as long as civilization has existed. The internet didn't create that, but we don't ban the internet.

If you look at social media, my God, social medial is a total and complete disaster in a lot of ways. But to a lot of people, it's connected people that otherwise wouldn't be connected. And so here we are with smartphones. They've caused a lot of havoc too.

The point I'm trying to make is why all of a sudden when we got to digital currencies did we decide here in Washington, D.C., no, no, no, we are going to decide the pace of innovation, the way technology should work? So this isn't so much of a question as I would like each of you to quickly comment. Make the case to why we shouldn't create the lightest touch possible petri dish for innovation to grow and thrive because there's no way any of us know today what's going to roll out in the next 4 or 5 years.

So should it be the mandate that says, hey, look, Committee, a bunch of smart people up here. I know you have this impulse for control. But light tough is going to create innovation, and things will go wrong and being able to know that happens. I'll start with you, Mr. Cohen. What are your thoughts? Am I crazy? Should we ban the automobile?

Mr. COHEN. Not at all. I think we need to recognize, though, what is the automobile doing? So for example, in 1900, the potted roads may have required automobiles to go at 20 miles an hour. Now that we have smooth highways, you don't have automobiles still going at 20 miles an hour.

You change the rules to adapt to the situation. And I think with digital assets, we do the same thing. We don't need to ban them, but we need to be thoughtful about how we apply the rules to them.

When people engage in fundraising activity with digital assets, when people entrust their capital to others, it is appropriate to

think of those as investment activities. When two people exchange digital assets for whatever reason, I'd like to use some bitcoin today to send money via Lightspark, that's not a securities transaction. There are many things that are not. So we should have—I wouldn't say a light touch or a heavy touch but a right touch set of litigation based on the actual use cases involved.

Senator MORENO. Jonathan.

Mr. JACHYM. Senator, I think it's important to understand what we know today and where innovation is still developing. So I think what we know today is we have centralized actors, centralized intermediaries that process most of the transactions of these markets, regulators, lawmakers that know how to apply rules to centralized intermediaries, market integrity rules, operational resilience rules, customer protection rules, disclosures. Let's get that first step done.

I think there's other areas of this market and it is a very diverse ecosystem. When you look at decentralized protocols, you cannot take centralized rulebooks and bluntly apply them to these centralized protocols. And decentralization is a broad term, absolutely.

But we've seen other jurisdictions grapple with this topic, take pause, study, evaluate, and learn. And I think let's do what we know what we can do first which is put market structure rules in place. Continue to look at the decentralized ecosystem. It's not to say protection should not be in place. But we can't take old rulebooks and apply it to new innovation.

Senator MORENO. So don't let perfect get in the way of good and progress?

Mr. JACHYM. Precisely.

Senator MORENO. Ms. Massari.

Ms. MASSARI. I agree with you. I think we are dealing in financial services here obviously. And so I think there are some baselines that we must meet, right? Users need to trust the products they're working with.

They need to have disclosure about them. They need to know that their regulatory frameworks for stablecoins, for instance, that make stablecoin good money and create competition. I think that's an appropriate role for regulation.

I think to your point which I think you've stated really nicely, we have a tendency in financial services to try to take the new thing and cram it into the old because we understand the old. And the risk there is that we kill any innovation, right? And I think that could do more harm than good because it's happening anyway. It's happening outside of the United States if it doesn't happen here.

Senator MORENO. Perfect. Chairman, I'll venture back to you. Oh, sorry. Ohio State, we always worry about Harvard guys. But the——

Mr. MASSAD. Can I speak?

Senator MORENO. Go ahead.

Mr. MASSAD. Thank you.

Senator MORENO. It's up to the chair. We're way over time, but it's up to you.

Chairman LUMMIS. You certainly may.

Mr. MASSAD. Thank you very much. Senator, the devil is always in the details. But when I think of light touch, I think that's what weak countries do that are trying to pull business away from the strong countries.

That's what I saw happen with swaps. We created basically a very good framework. Smaller jurisdictions tried to undercut us by having weaker rules. And we basically had to work very hard to harmonize rules which we did. And now the swap market, I think, works pretty well.

In the case of stablecoins, look, right now, Europe and Japan are ahead of us. They've implemented some very good frameworks. Most of the things I'm suggesting today are in those frameworks. There may be a few things as Ms. Massari pointed out that we don't want to emulate in what they've done. But I think we can do a lot better than the bills currently before that have been introduced, the GENIUS Act and the STABLE Act.

Chairman LUMMIS. Thank you. The Chair recognizes Mr. McCormick for 5 minutes.

Senator MCCORMICK. Thank you, Madam Chairwoman. Thank you all for being here. Innovation is the driver of economic growth, and we've all lived through waves of innovation in the United States with everything from the internet to 5G to artificial intelligence.

Digital assets and blockchain are the next big wave. It creates enormous opportunity for all of us and particularly in Pennsylvania. And it's our job as policymakers to create an environment where that innovation can thrive while at the same time protecting consumers along the way. And I saw this firsthand as the CEO of a software company in the late '90s in Pittsburgh where there was—it was sort of a go-go world. And we didn't have that certainty.

So it's critical that Congress must pass meaningful legislation, and I appreciate the Chairwoman and Chairman Scott's commitment to this task. I want to talk about international competitiveness because in the absence of U.S. leadership, other major jurisdictions are rushing ahead as you've said in your testimony. We risk having our entrepreneurs moving overseas because of those existing frameworks.

So Mr. Jachym, I'd like to start with you. Could you discuss how innovators in the United States in specific terms are disadvantaged due to the development of regulatory regimes in other jurisdictions?

Mr. JACHYM. Thank you for the question, Senator. The lack of regulatory certainty in the U.S. is absolutely impeded investment and growth. And that's businesses like ours who operate as centralized intermediaries. That's businesses like developers, project teams, protocols that have operated without clear guidelines as to the legal status of what they're building.

You cannot run a business like that. I think what we've seen primarily in Europe but in other major G10, G20 markets is efforts to put step one in place, basic foundations that provide regulatory clarity for secondary market transactions in centralized markets. There is no question that there are many other issues to explore and we'll have to continue to explore.

To my colleague, Mr. Massad's point, let's also learn lessons from our legislative past here with the swaps reforms. The toughest part about that was not domestic implementation. It was rationalizing the cross border market access framework. And we run a global business. If we want to get this right, the U.S. needs to move forward with this market structure bill, get a seat at the table, and work with their counterparts to develop a clear international framework.

Senator MCCORMICK. Thank you. Mr. Cohen, we talked about the threat of litigation and how that curtails investment. Could you say a little bit about that? How do innovators think about that threat of litigation and what are the implications?

Mr. COHEN. Thank you, Senator. As someone in private practice, that is one of the very first questions that our firm gets. If we endeavor to take this innovative technology forward, what is our litigation risk?

And it's a constant threat and concern. It was both on the civil litigation side and also from regulators, particularly those who took overly aggressive stances. It made it very difficult for entrepreneurs here in the United States to start businesses when they had the threat of overhang of litigation.

And I think Senator Moreno made the point. You're driving on a highway and nobody tells you what the speed limit is until after they pull you over. And that was the feeling that many of our clients had around the risk of litigation. They simply did not know when they were crossing a line. And as a lawyer in private practice, it's very frustrating for us not to be able to give that advice to our clients.

Senator MCCORMICK. Very good. Thank you. Ms. Massari, just one quick last question. One of the benefits of stablecoins is U.S. dollar dominance because stablecoins are largely denominated in the U.S. dollar. Can you talk about that in a little more specificity on how the evolution of stablecoins can be a real force for good in terms of dollar strength?

Ms. MASSARI. Thank you for the question, Senator. I think actually today—and we see this in how stablecoin issuers often talk about their products. I think they think of stablecoins as a way for those outside the United States who don't have U.S. bank accounts and so on and so forth to have access to the U.S. dollar in new ways.

And I think that's really one aspect of dollarization. I don't think it fundamentally changes how much demand outside the United States that are going to be for dollars. But certainly, stablecoins are an easy way for a lot of consumers outside the United States, whether it's businesses or individuals who want to make payments to hold and use dollar value. Senator McCormick. Very good. Thank you, Madam Chairman. I yield the remaining time.

Chairman LUMMIS. Thank you. The Chair recognizes Mr. Van Hollen for 5 minutes.

Senator VAN HOLLEN. Thank you, Madam Chair. Thank you and the Ranking Member. And good to be on the Subcommittee. I thank you all of you for your testimony. Sorry I'm running late. I was just on the Senate floor. There's a lot going on today as you and my colleagues know.

And coming to this with an open mind, we're all, over many years, been trying to really understand these currencies and stablecoins in particular. And I know the GENIUS Act has been proposed as one way forward on stablecoins.

Mr. Massad, just a couple questions. And you may have tread this territory a little bit. But if you could take a little deeper dive, both in terms of the vetting of stablecoin issuers under this proposal, whether it has the checks and safeguards that you think are necessary to protect consumers.

And the other issue would be if, for some reason, one of these issuers were to go belly up and you had to resolve claims, my understanding is it's a bankruptcy type procedure as opposed to some of the procedures we currently have for people who need to claim lost monies from a banking loss or something. Could you zero in on those and any other concerns you have as we approach this?

Mr. MASSAD. Certainly, Senator. Thank you for the question. On the vetting, I think the GENIUS Act has some of the provisions you'd want in there for vetting. But it's not comprehensive enough.

Senator Smith asked the question about the fitness of management. That's not in there. I think we just need a broader framework of criteria. The McHenry-Waters proposal, I think, has that in terms of vetting.

But the other aspect of vetting is who does it. Is it done at the Federal level or is it done at the State level? And that's where we are trying to strike a balance. I think the approach in the GENIUS Act tries to do that by saying the State framework has to be substantially similar to the Federal one, meaning the criteria and so forth. And the issuer can't have a market cap larger than $10 billion.

I think that notion of a trigger that puts you into the Federal bucket, if you will, doesn't allow a stablecoin issuer to go to the State is a good one. But I would strengthen it in a few ways. I would probably lower that threshold. Europe has a threshold for its significant e-money tokens of 5 billion Euros. And I would still insist on some minimal Federal standards that the States have to follow.

On the bankruptcy issue, you're right that today what would happen in the absence of any special provisions is a normal corporate bankruptcy would apply. You'd have the automatic stay which would mean token holders would not get their money until the conclusion of that process. They would also be pari passu with unsecured—other unsecured creditors.

The GENIUS Act at least says they have a priority claim. But it doesn't deal with that timing issue. And so I would prefer to see some sort of dedicated bankruptcy process or resolution process that's fast, both from the standpoint of the interest of holders but also to prevent any sort of collateral damage.

If you've got a situation with a large stablecoin issuer and you're going through a very lengthy process before the holders get their money, you could have consequential defaults too. We saw that even with the small Terra algorithmic stablecoin. So ideally, you'd have a dedicated process.

At minimum, you'd want to say you have segregation of those reserves. They're held in trust for the benefit of the holders. Ms.

Massari argued that they should be available to be given to the holders right away. Those sorts of concepts I think you could look at. But truthfully, a dedicated process could work and should be must simpler than a bank because the business model of these entities is going to be fairly simple.

Senator VAN HOLLEN. I appreciate that. Just to take us off track a little bit from stablecoins but to deal with digital assets, much has been said and written about memecoins. You have been somebody who supports responsible innovation among digital assets.

Of course, the President issued a memecoin which I understand has gotten about $100 million worth. Do you have concerns that creates all sorts of conflict of interest problems? And I'm interested in other people's thoughts on that as well in closing.

Mr. MASSAD. Absolutely, Senator. I've said publicly this was plainly wrong. I think it's a black eye for crypto. I think it's brazen corruption, and I'm disappointed that more people in the crypto industry as well as frankly Members of Congress have not said similar things.

Senator VAN HOLLEN. I appreciate that. I'd just ask each of the witnesses whether you share Mr. Massad's view on that.

Ms. MASSARI. Take a bigger step back and I say this in my written testimony as well, we've seen some of the worst scams and frauds and grifts using crypto. And that is, I agree, a black eye in the industry. It hurts those of us trying to build something that has real value and that has real utility.

I actually think legislation that clarifies the legal framework for crypto markets, for stablecoins will help fight against the sort of worst of the bad behavior because it will provide clear lines and will let law enforcement and regulators easily distinguish between the good and the bad. And that has to be the right answer.

Senator VAN HOLLEN. Worst of the bad behavior. Gentlemen.

Mr. JACHYM. Senator, with respect to the memecoin market, I think facts are important here. So take, for example, our platform at Kraken. We have over 300 assets listed. Less than 10 percent of those are memecoins. Memecoins are not a new phenomenon. Dogecoin, I think, is over 10 years old, maybe around there. So this is not a new thing. It's trending now.

I think part of the reason there's been a focus on memecoins is because there's been regulatory uncertainty in the United States to create much of anything else, right? We've had developers that are looking to build protocols and technology that have many different use cases. It's clear that memecoins are not securities and thus I think they're trending at the moment.

Our role as a marketplace, however, is to ensure whatever is traded on our market, right? We run these assets through rigorous due diligence tests, cybersecurity tests, legal tests and make sure everyone that is participating in our market is subject to KYC and sanctions. So I think, again, putting this in perspective, yes, it's trending now. But there's a much bigger ecosystem here that we need to focus on.

Senator VAN HOLLEN. Thank you. Mr. Cohen.

Mr. COHEN. Yeah, I would concur on that view. This is open technology, Senator, at the end of the day. And people around the world will do with it as they will. I think it's really important that

we focus on the use cases that drive adoptions around the world. And I strongly support that.

Senator VAN HOLLEN. Thank you, Madam Chair.

Chairman LUMMIS. Mr. Warner.

Senator WARNER. I'm sorry. Next time. It's unfair because I wanted to answer Senator Moreno and he left. You can convey I'm all for innovation. Thank God. When he was looking at that computer in the mid-'80s, I was already in the wireless business.

And because there was allowance to have competition in the wireless industry, I did pretty well. I started a company called Nextell. But I didn't agree with certain rules.

But I guess one of the things that I feel like here is one of our best assets, one of our most essential assets is the stability of the dollar, is our financial markets. And I candidly believe even while there's been this innovation abroad that if we do this right, every offshore is going to rush to America. That's where they want to be.

And I would just—what I would've asked my colleagues and Senator McCormick as well is I think back to the SVB crisis when I had some of my most libertarian friends say, we don't want the Government touching anything until the shit hit—excuse me, the stuff hit the fan. And everybody said, we need the Federal Government to step in and bail us out. If we're going to touch our Federal markets, if we're going to do while stablecoin is completely divorced from the rest of the financial system, maybe light touch would work.

But if we're going to ultimately intertwine this with the financial system which is why I think companies would want to come here to be connected to our overall financial system, we don't want to stifle innovation. But nudging our entities a little further along the line, that's the risk balance I'm trying to get to. And I think there is a spot here, and I really support you and the Ranking Member and particularly the Chairwoman who's worked so hard and so long on this.

I think reasonable people can get there. And I think we can get there in a way that maintains the integrity of our financial system, makes us far and away the most attractive place for the legitimate entities, finds a way to keep the bad guys out as much as possible and still preserves innovation. But that may not be light touch for the sake of light touch because I would love to get my colleagues—I wish they'd been on the line when some of the biggest funders in this industry were calling around the SVB crisis and saying, gosh, we need the fed to bail us out.

So I'll try to share that directly with Senator Moreno later. But just I really appreciate the chance and I didn't mean to cut you off.

Chairman LUMMIS. Thank you, Mr. Warner. I like to conclude hearings by asking our panel, is there anything that you wish you had been asked but were not? I would like you each to respond to that question but very briefly. And let us begin and go the opposite direction. Mr. Massad?

Mr. MASSAD. I don't believe there is, Senator. I think it's been a very full hearing. I'm happy to answer any questions that come to you afterward. I've given you a long, written testimony that addresses a lot of other issues.

Chairman LUMMIS. Ms. Massari.

Ms. MASSARI. First, thank you for having this hearing. Nothing in particular. I just really think it's important for us when we're thinking about stablecoins to really focus on the competitive landscape and think about a diverse, open, well regulated, but competitive ecosystem for stablecoin issuance. Stablecoin issuers are not as risky as deposit-taking banks. We should treat them accordingly and let there be open competition. I think we'll all benefit from that.

Chairman LUMMIS. Thank you. Mr. Jachym.

Mr. JACHYM. Chairwoman, I think Senator Tillis asked about examples abroad, who got it right. I think we can look here in the United States to certain State frameworks. And speaking on behalf of a special purpose depository institution, I think if you look at what Wyoming has done, they've taken old rulebooks and they've tailored them.

And they've created a bespoke product that creates and solves for unique risks in this system, especially respect to custody. You cannot run a safe custody business in the crypto ecosystem the same way you do in the traditional markets, right? And States have looked at two examples like that. So I think let's look internally what the States have done creatively to solve for the unique risks in the ecosystem.

Chairman LUMMIS. Thank you. Mr. Cohen.

Mr. COHEN. Thank you so much again, Senator, Ranking Member, for including me today and to all the great work that you and this Subcommittee are going to be doing. I would just quickly add, I guess, a question not directly asked. But we've alluded to the importance to the financial system in the U.S. of stablecoins and in particular Treasury backed stablecoins.

I recently saw a chart which plotted amount of Treasury bonds and debut held by China over the last 10 years. And it, of course, went down like this. And the amount of that same debt that's now held by stablecoin and similar issuers back in crypto assets, the reality of things is that one of the things this country does very well is create debt of our own Government.

And the question is if we now have one of our major off takers of that debt no longer taking up that slack, is this a way to achieve that goal? And I think that's something as we think about this that really is critical. That does not exist if we don't have the crypto rails to allow that activity to take place.

This is all very interconnected. And I also would just say quickly we didn't talk about real world assets. But it's a very important topic. Real world assets that can be tokenized, run on crypto rails. And so there are many reasons why we do need to get this right, Senators. And I'm excited to be part of that process.

Chairman LUMMIS. With special thanks to our panel and to this Committee for its first hearing, I want to thank you all for your thoughtful consideration of today's topic. We'll be consulting you again over time. We had consulted several of you prior to today, and that's why we recognize you as the expertise we wanted to hear from today. The Committee is adjourned with our thanks.

[Whereupon, at 4:11 p.m., the hearing was adjourned.]

[Prepared statements and additional material submitted for the record follow:]

PREPARED STATEMENT OF LEWIS COHEN

PARTNER, CAHILL GORDON & REINDEL LLP

FEBRUARY 26, 2025

Testimony of Lewis Rinaudo Cohen
Partner, Cahill Gordon & Reindel LLP
Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs
"Exploring Bipartisan Legislative Frameworks for Digital Assets"
February 26, 2025

Introduction

Chair Lummis, Ranking Member Gallego, and distinguished members of the subcommittee, thank you for the opportunity to testify today on a subject that will shape the future of American finance and technological innovation. I am Lewis Cohen, a partner at Cahill Gordon & Reindel and co-head of our CahillNXT emerging technologies practice. My career has included more than two decades as a capital markets specialist at major global law firms working in traditional finance, with nearly ten additional years focusing on the needs of clients working with digital assets and blockchain technology. This experience has allowed me to witness firsthand both the tremendous promise, as well as the regulatory challenges, of this transformative technology.

Today, I offer testimony in support of a bipartisan legislative framework for activity involving the use of digital assets on my own behalf and not on behalf of my firm or any client of the firm or other third party. Over the past several years, divergent regulatory approaches, inconsistent agency pronouncements, and a fragmented legal landscape have created uncertainty that stifles innovation and leaves American competitiveness at risk. My testimony will explain why a clear, coherent, and flexible statutory regime is necessary and will propose an approach that both harnesses the benefits of blockchain technology and protects consumers and investors.

I will discuss the historical context that shaped our current financial regulatory system, the unique characteristics of digital assets, and how the bifurcated U.S. regulatory structure—where the oversight of activity involving securities and commodities derivatives fall under different federal agencies—complicates the regulation of the digital asset sector. Finally, I will outline a legislative proposal based on an "ancillary asset" framework, as featured in the bipartisan Responsible Financial Innovation Act (RFIA) introduced by Senators Cynthia M. Lummis and Kirsten Gillibrand, that distinguishes between core "investment contract" activity appropriately characterized as securities transactions and overseen by the Securities and Exchange Commission (SEC), on the one hand, and the day-to-day transactions in digital assets not constituting securities activity, on the other.

I. Background

The U.S. financial system was reformed in the wake of the Great Depression through the enactment of the Securities Act of 1933 (the Securities Act) and the Securities Exchange Act of 1934 (the Exchange Act), among other federal legislation. These laws were designed to restore investor confidence in our financial markets through a variety of reforms, perhaps most critically by ensuring that issuers of securities provided full and fair disclosures about their businesses, both when capital raising and, in certain circumstances, on an ongoing basis. Over the decades,

these statutory frameworks evolved to incorporate new financial instruments and market practices. However, the advent of blockchain technology and digital assets has upended many of the foundational assumptions underlying our current regulatory framework.

When I first encountered blockchain technology in 2015, I immediately recognized its potential to bring unprecedented transparency and efficiency to financial markets, among many other uses. Unlike traditional securities, digital assets are often designed to be used as a means of exchange, to facilitate the governance and/or use of decentralized applications, or to provide utility and incentives for the maintenance of a blockchain network—functions that go far beyond the conventional role of an investment instrument. And yet, as we have seen over the past several years, the absence of clear Congressional direction has allowed disparate regulatory agencies to impose inconsistent and sometimes conflicting frameworks on the various uses of this developing technology.

For example, while the Commodity Futures Trading Commission (CFTC) oversees only those digital asset transactions deemed to involve the creation and transfer of commodity interests, like swaps and futures, the Securities and Exchange Commission (SEC) has historically viewed almost all activity involving digital assets through a framework of securities regulation—primarily through an overbroad application of the Supreme Court's "*Howey* test" (discussed below)—regardless of the digital asset's intrinsic characteristics. Further complicating matters, for digital assets currently acknowledged not to constitute securities, such as bitcoin and ether, operators of "spot" exchanges have no federal supervisory oversight and are overseen under state money transmission law. As has been frequently observed, the lines between these approaches are anything but clear.

This complex and uncertain approach inevitably creates legal ambiguity, hinders market innovation and may well put American consumers and investors at a disadvantage compared to their counterparts in jurisdictions, like the European Union, Switzerland and Singapore, that have enacted comprehensive regimes focusing on activity involving digital assets. It has also limited growth of the blockchain sector in the United States, driving high-tech jobs and investment overseas.

II. The Historical Context and Lessons Learned

It is instructive to reflect on how our current federal securities regulatory framework came into being. Following the market abuses exposed during the Great Depression, the Senate Banking committee investigated through what came to be called the Pecora Commission. The Pecora Commission uncovered rampant use of incomplete or affirmatively false information being provided to investors in securities which led to the creation of disclosure-based regulatory framework, ultimately embodied in the Securities Act and the Exchange Act, among other critical bi-partisan Congressional legislation. These reforms were rooted in the idea that transparency and accountability would restore trust in capital markets. For decades, the system worked effectively to protect investors in traditional markets. However, digital assets pose fundamentally different challenges.

Unlike the paper-based securities of the past, many digital assets are encoded on immutable public blockchains. Creating a thousand, a million, or even a billion fungible digital assets is as simple writing a few lines of code and uploading that code to a public blockchain network.[1] A development team may initially offer these assets for sale in fundraising transactions appropriately characterized as "investment contract" *transactions*—a type of securities activity. When acting as *sellers* of these digital assets, these development teams may appropriately be subject to our federal securities laws. However, unlike securities, the digital assets themselves generally lack a legal relationship with the development team or any other company that could be considered the "*issuer*"—an entity necessarily connected to the asset through a legal relationship, such as an issuer of shares of stock, or an obligor on a series of bonds.[2]

This necessary legal relationship with an issuer forms the bedrock of our federal securities law framework and allows the law to hold these issuers accountable for ongoing disclosures. As my colleagues and I demonstrated in our paper—*The Ineluctable Modality of Securities Law: Why Fungible Crypto Assets Are Not Securities*[3]—the application of the traditional federal securities framework to all activity involving digital assets without an "issuer" (regardless of the nature of transactions involved) is not supported by the federal case law on investment contracts and would be neither technologically nor economically sensible to implement in new legislation.

Moreover, the bifurcated financial markets regulatory structure in the United States—wherein the SEC regulates securities and securities activity and the CFTC oversees markets in commodity interests—has no natural analog in the digital asset sector. Most digital assets do not neatly conform to the characteristics of either category. The Supreme Court's *Howey* decision provided a test to determine what constitutes an "investment contract,"[4] yet that test was crafted in 1946, an era when the concept of something as fluid in nature as digital assets was unimaginable. As we have seen that in recent cases such as *SEC* v. *Coinbase* and *SEC* v. *Payward*, the attempted application of *Howey* to third-party activity involving digital assets in secondary markets has led to significant legal uncertainty. I was heartened by the recent

[1] In this testimony I use the broad term "digital assets" to refer specifically to fungible assets, the ownership of which is recorded on a cryptographically protected public blockchain ledger, like those maintained by the Ethereum network or the Solana network. There are many other types of digital assets, such as non-fungible tokens (NFTs) which may raise similar issues but which our out of scope of this testimony.

[2] Note that the "legal relationship" need not be contractual in nature, as courts interpreting the *Howey* precedent have repeatedly found in recent years.

[3] Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4282385.

[4] As defined by the Supreme Court, an "investment contract" is a contract, transaction or scheme involving (1) an investment of money (2) in a common enterprise (3) with an expectation of profits (4) to come solely from the efforts of the promoter or a third party, although the last prong is generally regarded as having been modified by subsequent case law to require an expectation of profits derived from the essential entrepreneurial or managerial efforts of others. See *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946) ("*Howey*"). Because Congress chose not to define the term "investment contract" in either the Securities Act or the Exchange Act, it was left to the courts to define the parameters of this term. In *Howey*, the Supreme Court first articulated the test used to determine whether an investment contact is present. Although this standard has been subject to considerable interpretation since 1946, its basic elements continue are applied to this day.

announcement made by Coinbase that the SEC has agreed to dismiss the case against them brought under the prior Administration based on these unfounded theories.

Other leading industry voices have decried this regulatory uncertainty, noting that enforcement-first approaches have pushed innovation offshore and exposed American market participants to unnecessary and unjustified litigation risk. It is time, therefore, for Congress to step in and create a clear, adaptable framework for digital assets that reflects the realities of modern technology and the needs of American consumers.

III. The Regulatory Challenge: Securities *Versus* Commodities

Given our bifurcated market regulatory structure, a critical issue at the heart of the digital asset debate is the question of classification. When should activity involving a particular digital asset be regulated as a securities transaction, subject to extensive disclosure and registration requirements, or as a non-securities transaction? This question is not merely academic—it has dramatic real-world consequences both for market participants and for the development of blockchain technology in general in the United States.

On the one hand, if virtually all activity involving digital assets is considered to be some type of securities transaction, then all of this activity becomes subject to the full gamut of federal securities regulation. This includes registration requirements applicable to companies deemed to be acting as "brokers", "dealers", "exchanges" or "clearing agencies" in connection with that activity. The question to be asked then is not whether these regulations are "too onerous" for participants in digital asset markets. Rather, the correct question is whether these regulations have *any relevance* to activity involving digital assets that are not themselves securities.

As seen in numerous enforcement actions, even platforms that operate with robust compliance programs can be caught in the crosshairs of litigation for facilitating transactions in assets that may not possess the traditional characteristics of a security. It is akin to asking why the federal securities laws should not also apply to all transactions in concert, sports and other event tickets (an area in which there is also a mix of speculative and consumptive use)—it is not that the securities laws are too onerous for a ticket trading platform—they simply do not apply to brokers, dealers, or marketplaces in the event ticket space.[5] Worse yet, suggesting that the federal securities law framework should apply to secondary transactions in digital assets has led to numerous civil actions for alleged registration violations. On the other hand, if digital assets are not viewed as securities, then no federal supervisory regulation would apply to marketplaces that facilitate "spot" exchanges of these assets.[6] Given the current and rapidly growing size of this market in the U.S. alone, creating an appropriate federal regulatory environment for this activity makes sense and, in my experience, is supported by many in the digital asset sector.

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[5] *See* The Ticket Reserve, SEC No-Action Letter dated September 11, 2003, available at https://www.sec.gov/divisions/corpfin/cf-noaction/ticketreserve091103.htm.

[6] Facilitating the spot exchange of digital assets (considered "convertible virtual currencies" by the Treasury Department's Financial Crime Enforcement Network (FinCEN)) is subject to licensure and varying levels of regulatory oversight in 49 of the 50 states.

Federal courts have consistently recognized that *certain* transactions involving digital assets are appropriately characterized as securities activity.[7] Specifically, courts have found most sales of existing or promised future digital assets by a company to raise funds to be used either to build or develop technologies used to support or grow the utility or functionality of the digital asset or, in some cases, to promote awareness of the benefits of the digital asset and its associated network or application, are appropriately considered "investment contract" transactions subject to the federal securities laws. Accordingly, it is critical that any regulatory scheme adopted by Congress take this dichotomy into account.

The RFIA, as introduced by Senators Lummis and Gillibrand, offers a technology-neutral way to reconcile these competing considerations. Under its approach, any intangible, commercially fungible asset (which may include an asset characterized under other law as a "digital commodity") that is offered and sold as part of an investment contract transaction would be considered an asset *ancillary* to the securities transaction (or an "ancillary asset") and be definitively recognized as not itself a security unless the asset provides the owner of the asset with equity, debt, liquidation, cash flow or another financial interest in a business entity, such as a corporation. In this framework, a fundraising scheme involving a digital asset offered to the general public in the U.S. would be required to be registered with the SEC (or benefit from a valid exemption from registration). However, a digital asset that is sold in an investment contract transaction would not itself be subject to separate SEC registration if it does not confer traditional investor rights (such as equity or debt claims).[8] Instead, such tokens would be treated more like commodities, with the regulatory oversight of secondary market activity given to the CFTC. This approach preserves the benefits of blockchain technology for everyday transactions while still imposing necessary disclosure obligations on primary market offerings.

IV. The Ancillary Asset Framework: A Legislative Proposal

At the core of my testimony today is the belief that the technology-neutral ancillary asset framework offers the best path forward for determining when transactions involving digital assets should be regulated as securities activity and when transactions involving digital assets

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[7] *See, e.g., SEC* v. *Ripple Labs, Inc. et al.* 682 F. Supp. 3d 308 (S.D.N.Y. 2023).

[8] As elaborated on in *Ineluctable Modality*:

> [T]he 70-plus year history of *Howey* jurisprudence ... reveals a long line of cases in which courts distinguish transactions involving the sale of real estate, oil drilling rights, animals and sundry other objects of a purported commercial arrangement from the business arrangements and other facts and circumstances that gave rise to a finding that there exists an investment contract. Indeed, in those transactions a sales agreement was almost always accompanied by an expectation of profit on the part of the purchaser, based on the seller or an affiliated entity performing post-purchase functions (such as picking, bundling and selling oranges, husbanding cattle and their embryos, or maturing whiskey in casks). And, in each of these cases, the investment package (*i.e.*, the set of formal or informal agreements or understandings between the seller and the purchaser) is clearly distinguishable from the object of the scheme itself. Moreover, there is no suggestion in any of the appellate cases that the transfer of the relevant object to another "investor" without an assignment or transfer of the benefit of the underlying promises, would result in another securities transaction.

Ineluctable Modality, *supra* note 3, at pp. 57-58.

should be regulated under other law (such as under a separate framework for digital commodities overseen by the CFTC).

A. The Implementation of Clear, Technology-Neutral Definitions

Under the ancillary asset framework, Congress would not need to attempt to reframe the Supreme Court's 1946 definition of the term "investment contract" in the *Howey* case, which has served to protect consumers from a wide range of investment swindles long pre-dating the advent of digital assets. While many observers would agree that this definition could use a refresh, the current definition serves many needs outside of the digital asset sector and I would not recommend delaying the process of passing critical legislation that provides clarity to the digital asset sector while a range of stakeholders debate alternative definitions for the term "investment contract".

In addition, the ancillary asset framework does not require Congress to make technology-specific amendments to the Securities Act or the Exchange Act (such as defining hard-to-pin-down concepts like "blockchain technology" and "digital asset"), which means that the work done by this Committee now will not need to be revisited each time new technological developments are adopted in the blockchain sector.

Most importantly, the ancillary asset framework provides a clear, bright-line test for when market participants using, trading or investing in digital assets in secondary transactions are engaging in securities activity—a test appropriately based on the nature of the assets themselves. This allows each market participant to readily determine for themselves whether they are dealing with a security or not without retaining a law firm to provide a lengthy and highly caveated analysis interpreting facts and circumstances that are *extrinsic* to the asset. Such extrinsic circumstances may be difficult or impossible as a practical matter for market participants to determine and may change from time to time. It is also a definition that is much less susceptible to being "gamed" by persons creating the relevant digital assets, since either a given asset confers traditional investor rights (such as equity or debt claims), or it does not.

B. Creation of an "Ancillary Asset" Category

The ancillary asset framework posits that in many transactions involving the use of digital assets (such as when an end user seeks to acquire a digital asset to pay "gas" to network validators or when a company seeks to accumulate a given digital asset anticipating greater demand for that asset in the future), the asset itself—although it may have initially been sold in a transaction appropriately characterized as an investment contract—should not be treated as a security solely as a result of that initial sale. In other words, while the transaction in which the asset is initially sold might be a securities transaction (and thus require comprehensive disclosure of material information concerning the transaction by the seller functioning as the "issuer" in the context of that transaction), the asset, once in the hands of secondary market participants, should be regarded as an ancillary asset.

Such assets would be treated similarly to more traditional commodities. This approach would shield third-party market participants, such as exchanges, wallet providers, development

companies, dealers, market makers, and custodians from the threat of liability for *inadvertent* unregistered securities activity, provided these entities do not otherwise engage in activity with respect to a digital asset that independently meets the four prongs of the *Howey* test. In my experience, the number one complaint of market participants when it comes to digital asset activity is the need to be able to clearly and efficiently determine when they are dealing with an asset that is itself a security without needing to consider information extrinsic to the asset; given the quantity of case law interpreting *Howey*, market participants are able to manage the potential risk that *their own activity* results in investment contract transactions.

C. Tailored Disclosure Requirements

While the ancillary asset framework would shift the regulatory burden on participants in secondary market transactions to a new framework to be implemented by the CFTC, it would not reduce investor protection with regard to actual securities activity. To the contrary, for primary offerings of digital assets sold as part of an investment contract, the framework would mandate tailored disclosure requirements where, post primary sale, the relevant digital asset achieves a minimum threshold of trading and distribution. Where this is the case, the party that engaged in the original fundraising would need to provide—under penalty of the anti-fraud provisions in the Exchange Act—comprehensive periodic information about the nature of the asset, the extent of the promoter's involvement, and any other information material to users of, and investors in, the asset.

These disclosures would be required to be made available to the public to reduce information asymmetries between the development team and users of, and investors in, the asset who may be buying, selling, and otherwise engaging with the digital assets (*e.g.*, staking the asset to secure a blockchain network or using the asset to pay network validators to add a proposed transaction to a "block" added to the relevant blockchain network). These disclosures should be designed to give both investors and day-to-day users of the digital assets sufficient insight into the risks and benefits of the assets and the related network or application, without imposing upon the fundraising development team the full-scale reporting burdens, such as GAAP-based audited financial statements, required of traditional public companies.

Although the version of the RFIA introduced in 2023 contains a thoughtful list of disclosure information that would need to be provided to the market, this Committee may wish to undertake further study to ensure that required disclosures appropriately balance the need for transparency to purchasers of digital assets without overburdening development companies seeking to innovate in a rapidly changing business environment.

Finally, although the ancillary asset framework does not create new mechanisms for development companies to raise funds through sales of new digital assets in circumstances that would be considered securities transactions under the *Howey* test, the current regulatory framework under the Securities Act that allows for both exemptions and registered offerings for this activity would not be altered by the adoption of this framework and thus would continue to be available to parties seeking to engage in this activity. Nevertheless, Congress may want to make clear to the SEC its support for flexibility in applying our existing disclosure frameworks for fundraising to take into account the unique additional informational requirements applicable

to investment contract-based sales of digital assets while at the same time making accommodations for the omission of information from the SEC's traditional disclosure forms where the information called for is not material to an investment decision in a purchase of the digital assets.

D. Bipartisan and Flexible Legislative Authority

Finally, the ancillary asset framework discussed above is designed to be flexible and garner bipartisan support. It respects longstanding legal principles established under the *Howey* test while adding new elements, such as ongoing disclosures, to account for the unique features of digital assets. By creating bright-line rules that allow market participants to differentiate between digital assets that are, or are not, securities, the framework would allow federal regulators to focus on eliminating fraud and protecting investors without stifling innovation. It would also harmonize the roles of the SEC and CFTC by drawing a clear line between transactions that require comprehensive securities regulation and those that can be efficiently overseen by a commodities regulator. This dual approach not only promotes investor protection but also ensures that the United States remains at the forefront of digital asset innovation.

V. The Impact of the Current Regulatory Chaos

The current regulatory uncertainty has far-reaching consequences. As demonstrated through a lengthy record of Congressional testimony of industry leaders[9] and observed in enforcement actions, American entrepreneurs face a constant threat of litigation arising from ambiguous applications of our federal securities laws. For instance, cases have been brought against major platforms for facilitating secondary market trading in tokens that some plaintiffs allege are unregistered securities—even when there is no "issuer" with which the asset holders

[9] *See, e.g.*, The Future of Digital Assets: Identifying the Regulatory Gaps in Digital Asset Market Structure, Hearing Before the Subcomm. on Digit. Assets, Fin. Tech., and Inclusion of the H. Comm. on Fin. Servs., 118th Cong. (2023), https://tinyurl.com/2yp22fwm; The Future of Digital Assets: Providing Clarity for the Digital Asset Ecosystem, Hearing Before the H. Comm. on Fin. Servs., 118th Cong. (2023), https://tinyurl.com/4ar5vxsj; Dazed and Confused: Breaking Down the SEC's Politicized Approach to Digital Assets, Hearing Before the Subcomm. On Digit. Assets, Fin. Tech., and Inclusion of the H. Comm. on Fin. Servs., 118th Cong. (2024), https://tinyurl.com/2jzsf3by; Crypto Crash: Why Financial System Safeguards are Needed for Digital Assets Before the S. Comm. on Banking, Hous., and Urb. Affs., 118th Cong. (2023), https://tinyurl.com/uphtw2nk; Crypto Crash: Why the FTX Bubble Burst and the Harm to Consumers Before the S. Comm. On Banking, Hous., and Urban Affs., 117th Cong. (2022), https://tinyurl.com/56hc2chw; Investigating the Collapse of FTX, Part I Before the H. Comm. on Fin. Servs., 117th Cong. (2022), https://tinyurl.com/56hc2chw; Protecting Investors and Savers: Understanding Scams and Risks in Crypto and Securities Markets Before the S. Comm. on Banking, Hous., and Urb. Affs., 117th Cong. (2022), https://tinyurl.com/3ku4b4y5; Putting the 'Stable' in 'Stablecoins:' How Legislation Will Help Stablecoins Achieve Their Promise Before the H. Subcomm. on Digit. Assets, Fin. Tech. and Inclusion of the H. Comm. on Fin. Serv., 118th Cong. (2023), https://tinyurl.com/cbhpnc62; The Future of Digital Assets: Measuring the Regulatory Gaps in the Digital Asset Markets Before the H. Comm. on Fin. Servs. & H. Comm. on Agric. Joint Subcomm., 118th Cong. (2023), https://tinyurl.com/3z482ech; The Future of Digital Assets: Identifying the Regulatory Gaps in Digital Asset Market Structure Before the H. Comm. on Financial Services & H. Comm. on Agric. Joint Subcomm., 118th Cong. (2023), https://tinyurl.com/muedwru9; Understanding Stablecoins' Role in Payments and the Need for Legislation Before the H. Subcomm. On Digit. Assets, Fin. Tech. and Inclusion of the H. Comm. on Fin. Servs., 118th Cong. (2023), https://tinyurl.com/59zwum75; Coincidence or Coordinated? The Administration's Attack on the Digital Asset Ecosystem Before the H. Subcomm. on Digit. Assets, Fin. Tech. and Inclusion of the H. Comm. on Fin. Serv., 118th Cong. (2023), https://tinyurl.com/mr2ea497.

have any legal relationship. This regulation-by-enforcement approach creates a chilling effect on innovation—I have observed this firsthand. Companies that might otherwise invest in developing robust digital asset products are currently forced to spend millions of dollars on vague and uncertain attempts at legal compliance or risk punitive litigation that drains resources and stifles growth.

VI. Policy Recommendations

To address these issues, I respectfully offer the following policy recommendations:

A. Adopt a Technology-Neutral Statutory Approach

Congress should enact legislation that implements the ancillary asset framework along the broad lines set out above. The RFIA provides an excellent starting point for this work. This technology-neutral approach would allow participants in secondary markets in digital assets to have certainty about the regulatory requirements applicable to their activity while ensuring high levels of investor protection when digital assets are used in connection with fundraising transactions. This clarity will help prevent divergent interpretations among regulators and courts.

B. Establish a Dual Regulatory Framework

Legislation should explicitly divide regulatory authority between securities and commodities regulators. Fundraising activity involving digital assets that would be considered investment contract transactions, generally involving a primary offering of the asset, should be subject to securities regulation overseen by the SEC, including ongoing reporting by the asset seller through a publicly accessible website if the digital assets achieve some minimum level of trading in markets open to the U.S. public. However, this reporting would continue only until the value of the relevant asset is no longer dependent on the entrepreneurial efforts of the fundraising party and its affiliates. This determination would be made by the fundraising development team—the entity in the best position to evaluate the level of dependency users of the network or application, or owners of the asset, have on that fundraising party and its affiliates at any given time.

At the same time, once sold to purchasers, digital assets that do not provide the asset owner with equity, debt or other rights in the fundraising party or any other business entity would be freely transferrable, including through spot markets overseen by the CFTC (created through other law) without risk that, at some unknowable point in the future, the assets either "morph" into, or out of, being treated as a security (or some other similar regulatory status by a different name) that would result in dramatic limits on the transferability (and thus liquidity) of these assets—a burden that would fall on third parties holding and using these assets who are unaffiliated with the original fundraising party.

One important matter to be addressed in such a framework would be mechanism to ensure that early funders, insiders or similarly situated others are not able to facilitate a "workaround" of our traditional securities law precepts by purchasing ancillary assets from an

initial seller in investment contract transactions that are exempt from registration as transactions not involving a public offering based on Section 4(a)(2) of the Securities Act and then subsequently acting as an effective distribution party (broadly akin to a "statutory underwriter" in a traditional securities law setting) by reselling the ancillary assets to the general public without satisfying a minimum holding or cooling off period.[10]

C. Implement a Tailored Disclosure Regime

Issuers of investment contract transactions involving sales of digital assets should be required to provide tailored disclosures that focus on the unique risks of the digital asset offered and the related blockchain network or application as and when those digital assets become widely available to the general public in the United States. These disclosures should include information on the network or application's governance, the role of the development team, any related foundation or similar entity, and the types and level of dependencies on centralized parties needed to support the usability of the network or application and the value of the digital asset. Regulators should work with industry stakeholders to develop disclosure standards that are both robust and practicable. This approach places the regulatory burden of achieving "sufficient decentralization" (*i.e.*, termination of the statutory requirement to provide ongoing disclosures about the relevant network or application) on the party best able to evaluate and control that process—that is, the burden of compliance is placed on the original fundraising entity.

D. Appropriate Oversight of Secondary Market Activities

To protect exchanges, custodians, dealers, market makers, wallet providers and other secondary market participants, this framework would effectively establish a safe harbor that shields these entities from inappropriate *securities law* liability for the sale or transfer of ancillary assets that are not themselves securities. Nevertheless, there already exist significant anti-fraud and anti-manipulation protections in current federal law (including the CFTC's Rule 180.1 as well as protections against unfair and deceptive acts and practices in consumer markets overseen by the Federal Trade Commission). These protections may be further enhanced by other market structure legislation which can provide for surveillance by companies operating secondary market platforms for non-security digital assets, along with federal oversight to address the potential for abuses in these markets.

E. Encourage Coordination with International Regulators

Finally, the key U.S. regulators for activity involving digital assets (*i.e.*, the SEC and the CFTC) should be encouraged to work with international regulatory bodies to promote consistency and interoperability in digital asset regulation. Global digital asset markets are as interconnected as the Internet itself, and divergent regulatory regimes only serve to create arbitrage opportunities and regulatory gaps. International coordination can help establish

[10] *See, e.g., SEC* v. *Telegram Group, Inc.*, 448 F.Supp. 3d 352 (S.D.N.Y. 2020).

common standards and promote best practices that benefit investors and market participants worldwide.

VII. Anticipated Benefits of a Bipartisan Legislative Framework

The adoption of a bipartisan legislative approach based on the ancillary asset framework would yield numerous benefits:

A. Enhanced Investor Protection

This framework would impose tailored disclosure requirements on fundraising parties applicable only when a given digital asset becomes widely available to the general public in the United States. These disclosures would be subject to the antifraud provisions of the Securities Act and the Exchange Act. As a result, the proposed framework ensures that investors in, and users of, digital assets receive the necessary information to make informed decisions without fundraising parties being overburdened by an unnecessary regulatory apparatus. At the same time, the framework would protect secondary market participants not affiliated or working in concert with the fundraising party through clarifications that ancillary assets they hold are not securities and are not subject to having the transferability of these assets otherwise limited at some point in the future as a result of events that extrinsic to the asset itself.

B. Reduced Litigation Risk

Clear statutory definitions and bright-line rules will reduce the incidence of extractive civil litigation based on ambiguous interpretations of what constitutes a security. This will lower compliance costs and free up resources for innovation rather than legal defense while leaving critical anti-fraud provisions in place.

C. Increased Market Liquidity

A framework that distinguishes between securities and ancillary assets will promote a vibrant secondary market in digital assets. With lower regulatory uncertainty, exchanges and other market participants will be more willing to facilitate trading, thereby enhancing liquidity and price discovery. Liquidity would also be enhanced through the implementation of a CFTC-led framework for oversight of secondary markets in digital assets that fall within the category of ancillary assets.

D. Promotion of U.S. Leadership in Innovation

By establishing a clear, stable and technology-neutral securities law framework, Congress can help ensure that American firms remain competitive in the global digital asset market. A predictable regulatory environment will attract capital, foster innovation, and prevent the offshoring of technology and talent.

E. Dynamic Adaptability

The proposed framework's focus on reduced dependency on fundraising teams as a trigger for winding down securities law reporting allows projects to adapt at their own pace over time. The approach avoids creating artificial deadline for decentralization and substitutes for this clear disclosures about dependencies on project teams as well as, potentially, other incentives that do not penalize third party users of the digital assets.

F. Bipartisan Consensus

It has been frequently remarked that technological innovation should not be a partisan matter. The framework is intended to be flexible enough to gain support from members on a bi-partisan basis. By balancing investor protections with the facilitation of innovation, the ancillary asset approach addresses the concerns of regulators, industry participants, and consumer advocates alike. Being able to achieve a bipartisan consensus is essential for passing durable legislation that can stand the test of time and technological change.

VIII. Addressing Potential Concerns and Criticism

I appreciate that any legislative proposal of this significance will be subject to scrutiny and debate. Some critics may argue that drawing a sharp distinction between securities and commodities in the digital asset space is overly simplistic. However, it is important to note that our existing regulatory framework for traditional assets is itself built on clear statutory definitions and judicial interpretations that distinguish between fundamentally different types of financial instruments and other assets. The ancillary asset framework does not abandon these principles—it extends them to a new and rapidly evolving asset class.

Although this approach does not adopt the idea of the potential for a "morphing" of assets into and out of "securities" status and instead focuses on the *inherent nature* of the assets themselves, through a requirement for robust disclosures, the framework does create significant incentives for fundraising parties to reduce the extent and degree of dependencies in the related network or application, thus strongly aligning with the digital asset community's concerns about avoiding so-called "decentralization theater" and the paradoxical result in the current environment in which projects seem to be gravitating more closely toward centralized structures, rather than in the opposite direction.

Finally, there is concern that increased regulatory clarity might inadvertently stifle innovation by imposing burdensome requirements on startups and early-stage projects. On the contrary, a well-calibrated framework that distinguishes between primary and secondary market activities involving digital assets and provides clarity for intermediaries will lower the cost of compliance and reduce the risk of litigation. By doing so, it will encourage innovation rather than deter it, allowing new projects to thrive under a predictable regulatory regime.

IX. Conclusion

In closing, the United States stands at a critical juncture in the evolution of blockchain technology and digital assets. The explosive growth of interest in digital assets and dependency minimized networks and applications has the potential to transform our financial system, expand economic opportunity, and solidify our nation's position as a global leader in innovation. However, this potential will remain unrealized if we continue to operate under a patchwork of conflicting regulatory approaches that impede market development and expose American businesses to unnecessary risks.

A bipartisan legislative framework for digital assets—built on the ancillary asset concept and grounded in the principles of transparency, accountability, and flexibility—is not only necessary, it is imperative. By clearly distinguishing between transactions that should be subject to securities regulation and those that do not involve investment contract or other securities characteristics under current law, Congress can provide the legal certainty that participants in the digital asset sector need. Such a framework would protect investors, reduce litigation risk, foster innovation, and ultimately enhance the competitiveness of the United States in the global digital asset market.

I urge you, as policymakers entrusted with shaping the future of our financial system, to act decisively. Let us build on the lessons of the past, learn from our international counterparts, and craft legislation that embraces the transformative potential of blockchain technology while safeguarding the interests of consumers and investors. The time for ambiguity is over; it is now time for clear, forward-thinking regulation that paves the way for a robust, innovative, and competitive digital asset ecosystem.

Thank you for your attention, and I look forward to answering your questions.

This testimony is intended to contribute to a constructive discussion on developing a bipartisan legislative framework for activity involving the use of digital assets. The views expressed herein are my own and are informed by extensive experience in both traditional securities law and emerging blockchain technologies.

PREPARED STATEMENT OF JONATHAN JACHYM

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FEBRUARY 26, 2025

Testimony By

Jonathan Jachym, Global Head of Policy and Government Relations, Kraken

Before the
United States Senate Committee on Banking, Housing and Urban Affairs
Subcommittee on Digital Assets

Exploring Bipartisan Legislative Frameworks for Digital Assets

Wednesday, February 26, 2025, 2:30 PM ET

Chairwoman Lummis, Ranking Member Gallego, and Members of the Subcommittee:

Thank you for the opportunity to testify today.

My name is Jonathan Jachym. I am the Global Head of Policy and Government Relations at Kraken. Founded in San Francisco in 2011, Kraken is one of the world's oldest and largest digital asset trading platforms. Since then, we have steadily grown into a diversified digital asset business serving over 15 million customers around the world.

Kraken actively supports policymakers in the United States and abroad in efforts to implement effective domestic rules and a coherent international regulatory framework for digital asset markets. As other major jurisdictions finalize and implement rules to regulate centralized intermediaries, we welcome efforts by this Subcommittee to advance bipartisan legislation that powers responsible growth of innovative digital asset technology in the United States.

We commend Senate Banking Chairman Scott for establishing the Digital Assets Subcommittee and Subcommittee Chairwoman Lummis for her many years of dedication to advancing bipartisan discussions and legislation on digital asset policy. The introduction of the Lummis-Gillibrand Responsible Financial Innovation Act in 2022 pioneered a meaningful foundation for policy development to advance legislation in the United States.[1]

Over the last several years, dozens of bills have been introduced on market structure, anti-money laundering, stablecoins, strategic reserves, and other key areas.[2] Notably, there was strong bipartisan passage of a market structure bill out of the House of Representatives in 2024.[3] Congress now has a crucial opportunity to build on this progress and finalize legislation this year.

Bipartisan cooperation will continue to drive progress. We commend the Administration and new leadership at our U.S. regulatory agencies for taking swift and meaningful steps towards advancing effective policymaking in the United States. This includes appointment of a Crypto and Artificial Intelligence Czar, establishment of the Crypto Council, and formation of the Securities and Exchange Commission's (SEC) Crypto Task Force.[4]

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[1] See, *"Lummis-Gillibrand Responsible Financial Innovation Act,"* https://www.congress.gov/bill/117th-congress/senate-bill/4356?s=4&r=3.
[2] For a list of digital asset related legislation introduced in Congress, see Congress.gov, http://bit.ly/3D4l9od.
[3] The Financial Innovation and Technology for the 21st Century Act passed out of the House of Representatives on May 22, 2024, with 208 Republican and 71 Democratic Members voting Aye. https://clerk.house.gov/Votes/2024226.
[4] See SEC, *"'The Journey Begins,' Statement by Commissioner Hester Peirce,"*

Following its early policy leadership in digital assets, the Commodity Futures Trading Commission (CFTC) continues to expand initiatives to establish effective regulation of spot crypto markets in addition to driving new policy thinking around the role of digital assets in derivatives markets.

Kraken plays a diverse role in supporting growth and innovation in digital asset markets.

Kraken operates with a team of over 2,000 professionals around the world. Today, we safeguard over $40 billion in assets. We executed over $600 billion in trading volume in 2024, primarily across our core markets in North America and Europe. Kraken is consistently named one of the most secure places to buy and sell digital assets due to our robust security for client assets.[5]

We advance our mission to expand the adoption of cryptocurrencies in three main areas:

1. **Centralized spot markets –** We operate as a centralized intermediary for spot crypto markets which includes our exchange, custody, staking program, and related products and services.

2. **Traditional markets –** We power traditional market investment allocation into digital assets. This includes:
   - Derivatives offerings in eligible jurisdictions;
   - CF Benchmarks, the world's leading benchmark provider for digital asset markets, which powers a majority of the exchange-traded products approved in the United States and other markets around the world;[6] and
   - A novel state-chartered bank, our Special Purpose Depository Institution (SPDI), which offers institutional custody under a robust and innovative WY legal framework tailored for the unique risks and opportunities in the digital asset markets.

3. **DeFi markets –** Our on-chain business includes our wallet and our Layer 2 blockchain, called Ink, which serves as a seamless bridge to DeFi for our new frontier of innovative developers and users.[7]

Bipartisan legislation for centralized intermediaries will create a level playing field to support innovation, market integrity, customer protection and asset safeguarding.

The regulation by enforcement approach of the past several years has punished responsible American businesses, created gaps in customer protections, and pushed innovation and market activity outside of the United States.

Healthy and vibrant markets are built on safety, security, and transparency. Passing market structure legislation will provide clear rules and level the playing field for centralized intermediaries operating in the United States with critical standards for cybersecurity protections, operational resilience, market manipulation monitoring, regulatory reporting, public disclosures, and other core principles to ensure robust markets that protect consumers.

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https://www.sec.gov/newsroom/speeches-statements/peirce-journey-begins-020425.

[5] For further information on our risk management, security, and client protection standards, see *"Industry-leading security protects your investments,"* https://www.kraken.com/features/security.

[6] CF Benchmarks administers indices that support ETFs/ETPs listed in the U.S., Europe, Canada, Brazil, Australia, and Hong Kong, https://www.cfbenchmarks.com/.

[7] For further information on our on-chain platform, visit *Ink*, https://inkonchain.com/.

Market structure legislation will ensure all centralized intermediaries operate at the same minimum standards in order to protect American consumers in the digital asset marketplace. Among other fundamental components, an effective legislative framework for market structure in the United States should:

1. **Create a clear path for registration and oversight over centralized markets –** Oversight over centralized intermediaries and secondary market transactions, complemented by effective disclosure requirements, will create a durable approach for supporting innovation and protecting customers. The Administration, SEC, and CFTC should enhance and accelerate cooperation towards this legislative goal. Legislation to grant the CFTC clear authority to regulate spot markets will support these goals, building on the CFTC's experience regulating other retail commodity markets[8] and working through close inter-agency coordination with the SEC to build an effective regulatory framework.

2. **Avoid blunt application of centralized rulebooks to decentralized protocols –** Similar to the approach taken by other major economies, the United States should not apply centralized intermediary rules to decentralized protocols. Open and transparent decentralized blockchain networks do not have centralized governance systems, infrastructure or management. Applying centralized exchange-styled registration and reporting requirements to DeFi protocols like smart contracts would be both impractical and contrary to the well-established fundamental freedoms in our internet-based economy. Rather, the industry and policymakers must continue to evaluate and craft best practices and distinct policy approaches that account for the unique characteristics of DeFi.

The United States has fallen behind other major jurisdictions in passing foundational market regulation for centralized intermediaries.

Many major economies have finalized or are actively advancing fit-for-purpose regulatory frameworks for digital assets, recognizing that blunt application of traditional financial regulations are not effective at addressing the unique risks and opportunities in the digital asset markets.

Major economies and jurisdictions such as the European Union (EU), United Kingdom (UK), and Canada, have advanced rules tailored to digital asset markets. These and many other markets have classified digital assets as a simple new category, commonly referred to as "crypto assets," rather than applying or modifying existing definitions from traditional market regulation.

These frameworks acknowledge the unique characteristics of digital assets, including decentralized networks, smart contracts, and staking mechanisms, ensuring regulatory clarity while fostering innovation.

Legislative and regulatory clarity in these markets is providing a clear path to investment and growth from a growing population of participants, ranging from large institutional players to innovators, builders and retail customers.

[8] In 2010, the CFTC finalized its regulations for retail foreign exchange dealers (RFEDs), which requires registration with the CFTC and NFA and financial obligations, including minimum capital requirements. 17 C.F.R. §1.17, §5.7.

Among other G20 jurisdictions, notable examples include:

- **European Union –** The EU finalized the Markets in Crypto Assets (MiCA) Regulation in 2022. Since then, policymakers have proposed and finalized a comprehensive set of regulations for centralized intermediaries. MiCA became effective on December 30, 2024.[9] MiCA provides a harmonized approach to regulating the new legal category of "crypto assets" across 27 EU Member States.

- **United Kingdom –** Following legislative progress in 2023 for a new category of "crypto assets", the UK's Financial Conduct Authority (FCA) has begun a comprehensive consultation process to establish a tailored regime for centralized intermediaries and a bespoke regime for staking crypto assets.[10] These rules are expected to be finalized next year, allowing centralized intermediaries to be fully authorized within the FCA regulatory perimeter.

- **Canada –** In Canada, provincial regulators have advanced rules for centralized exchanges and other intermediaries in "crypto asset" markets with federal coordination through the Canadian Securities Administrators (CSA), ensuring businesses meet robust compliance requirements. The CSA established a regulatory approach to crypto assets in 2023, which requires centralized intermediaries to register with a provincial regulator in order to provide centralized products and services in Canada, such as exchange offerings and staking.[11]

Many other jurisdictions have already finalized regulatory frameworks for centralized exchanges and intermediaries, including Japan, Hong Kong, Singapore, Switzerland, Brazil, Turkey, and Bermuda. Other jurisdictions such as Australia, Argentina, and India are currently developing and advancing their frameworks for registration and regulation of centralized intermediaries.

Market structure legislation will complement Anti-Money Laundering requirements to ensure a holistic approach to customer protection.

Policymakers in major markets around the world advanced anti-money laundering (AML) standards for digital assets platforms many years ago. Kraken has been registered as a Money Service Business with Financial Crimes Enforcement Network (FinCEN) since 2014, holds over 40 Money Transmitter Licenses in the United States, and AML registrations in over 60 jurisdictions around the world.[12]

Kraken is committed to maintaining the highest standards of security, compliance, and transparency to prevent illicit financial activity within the digital asset ecosystem. Kraken has built a global compliance program consistent with regulatory requirements that includes: AML and countering the financing of terrorism; transaction monitoring through the use of third-party blockchain analytics; market leading cybersecurity standards; Know Your Customer and Customer Due Diligence tests; Suspicious Activity Reporting; and sanctions compliance.

[9] ESMA, *"Markets in Crypto-Assets Regulation (MiCA),"* https://www.esma.europa.eu/esmas-activities/digital-finance-and-innovation/markets-crypto-assets-regulation-mica.
[10] HM Treasury, *"Future financial services regulatory regime for cryptoassets,"* https://www.gov.uk/government/consultations/future-financial-services-regulatory-regime-for-cryptoassets.
[11] Canadian Securities Administrators, *"Staff Notice 21-332,"* https://www.osc.ca/sites/default/files/2023-02/csa_20230222_21-332_crypto-trading-platforms-pre-reg-undertakings.pdf.
[12] For the full list of Kraken's licenses globally, see Kraken, *"Legal Disclosures,"* https://www.kraken.com/legal/disclosures.

Through robust compliance personnel and programs, cutting-edge technology, and proactive engagement with regulators and law enforcement, Kraken continues to lead the industry in combating illicit finance while fostering a secure and compliant digital asset marketplace.[13]

Transactions that occur on public, immutable blockchains, allow real-time tracking and forensic analysis. Law enforcement agencies worldwide use these records to track, freeze, and recover stolen or illicit funds. This level of transparency makes illicit activity far easier to detect and investigate relative to cash and other forms of value transfer. Policymakers should embrace blockchain technology as a tool to promote innovation, enhance financial security and combat crime more efficiently.

Policymaking in the United States is now moving in the right direction. It is time to accelerate.

Without a clear regulatory framework for centralized markets, digital asset intermediaries in the United States will continue to face regulatory uncertainty and an inconsistent approach across state and federal agencies. The United States must move quickly to establish a comprehensive, bipartisan framework that provides clarity for businesses, protects consumers, and fosters responsible innovation.

After many years of legislative work, the time has come for Congress to pass market structure legislation to ensure the U.S remains at the forefront of innovation and the next era of the global financial markets. This will also support U.S. regulators with greater ability to engage their foreign counterparts in order to rationalize cross-border market access models and international standard setters, such as IOSCO, to drive harmonization in areas that are critical to supporting the global nature of the digital asset markets.

I appreciate the opportunity to testify and look forward to your questions.

[13] For further information on Kraken's engagement with law enforcement, see Kraken, "*Announcing the 2024 Kraken Transparency Report*," https://blog.kraken.com/news/2024-kraken-transparency-report.

PREPARED STATEMENT OF JAI MASSARI

CHIEF LEGAL OFFICER, LIGHTSPARK

FEBRUARY 26, 2025

Introduction

Bitcoin—the first cryptocurrency—set out a radical, new vision for financial infrastructure. It created the technological foundation for real-time, trustless transfers of value directly among participants on a global, open network. A network that can be used securely by anyone who downloads and runs Bitcoin's open-source software. This new type of financial infrastructure does not observe banking hours, is resilient without being centrally operated, and is inherently global. It was designed for our modern world.

When I began advising crypto projects a decade ago, after the typical initial skepticism, I came to understand and be inspired by Bitcoin's promise of better, faster, open financial infrastructure, which in turn could lead to better financial services. As a financial regulatory lawyer then working with large banks, asset managers, and other similar financial institutions, it seemed clear that an infrastructure upgrade was due—particularly in payments. And today, my work at Lightspark, which is building modern payment technology and services on Bitcoin, reflects my belief that modern payments must be built upon upgraded infrastructure.

Building new, global financial infrastructure is an enormous undertaking that cannot and should not happen overnight. The industry has made important progress over the past decade. Bitcoin has been operating for more than 15 years without major disruption. Consumers and businesses worldwide can access and use cryptocurrencies for onchain transactions, with choices for how they do so. Stablecoins have grown steadily, with new issuers and use cases coming to market with increasing frequency. A proliferation of regulated financial market products, from ETFs to derivatives, provide needed depth and liquidity to the markets. There is strong financial markets expertise and competition among exchanges, prime brokers, dealers, and wallet providers. And of course, companies like Lightspark are building payments infrastructure and services from these building blocks, so that the ultimate vision of Bitcoin—as an open global payment system—can be realized.

At the same time, the industry has created and experienced some remarkable and terrible detours from this vision. While it is natural for well-intended experiments to fail, we also have seen the absolute worst types of scams, frauds, and grifts carried out using cryptocurrencies, often with little regulator or law enforcement attention until it is too late.[1] Unfortunately, regulatory responses and enforcement actions seem to have been focused on ring-fencing cryptocurrencies and blockchain technology from traditional financial services, rather than bringing crypto activities within the regulatory perimeter. This approach ostensibly was meant to protect consumers, businesses, and the U.S. capital markets. Instead, it has reduced the regulatory and legal protections available for Americans, driven innovation outside the United States, reduced competition, and protected powerful incumbents. Consumers have been hurt.

[1] As an example, U.S. regulators and law enforcement agencies took action against FTX, Terra/Luna, Voyager, and Celsius only after each of them failed, all in very public ways. Bringing enforcement actions with fines levied against their bankruptcy estates did little to protect consumers whose assets were caught up in the failures.

Trust in the industry has faltered. And our regulatory policy is in need of a fresh and balanced approach.

The Subcommittee now has a chance to set us on a better path. One that brings sensible and appropriate regulation to stablecoins and crypto markets, better protecting consumers and markets while also spurring innovation.

We must be careful, however, not to enshrine in law the crypto industry as it is today, without also having a clear vision for how the industry can and should evolve. Yes, new laws are needed to provide clarity and a clear and safe path for builders and companies. But innovation inevitably will center around the path prescribed by those laws—because it is clear and safe. New laws should not only provide clarity; they should also be sufficiently flexible to accommodate rapidly evolving technology and businesses.

This flexibility will come from grounding new laws in strong fundamentals that reflect our best views about the benefits and risks of stablecoins and crypto markets as they can and should exist. My testimony today reflects my own views about how stablecoins and crypto markets should be regulated to achieve the goal of an open, more modern financial infrastructure.

Payment Stablecoins[2]

Historically, stablecoin use cases have largely centered on facilitating crypto trading, DeFi activities, and making dollar-based money available to those who cannot otherwise access it. More recently, we have seen stablecoins being used as fast and efficient tools for corporate treasury management. We are starting to see how stablecoins can lower payment frictions and transaction costs, spur new kinds of payments, and, crucially, unlock new kinds of economic activity. We expect access to instant, secure, interoperable communications like email and messaging globally; we should demand the same from payments. Stablecoins can drive new use cases uniquely suited for open, online commerce.

For stablecoins to support more mainstream payments use cases, users must be able to think of stablecoins as digital cash. This requires users having confidence that stablecoins are protected by a strong legal framework and operational infrastructure so they will be widely accepted by the public as payment instruments without question. Stablecoin issuers must have clear regulatory requirements tailored to stablecoin issuance, both to provide legal certainty and also to compete on a level playing field. Only then will issuers focus on building utility and users benefit from new use cases driving new economic activity.

[2] My comments focus on what are commonly referred to as "payment stablecoins," which are national currency-denominated stablecoins issued by a legal entity issuer, backed by safe and liquid assets denominated in the same currency as the stablecoin, and issued and redeemed for national currency to maintain a peg to a national currency face value. Other types of stablecoins should be subject to different rules because they will have different uses and are subject to different risks.

1. The stablecoin innovation: digital, always-on, non-credit money.

Stablecoins promise the same functionality as cash, in native digital form. The potential for inherent fungibility, interoperability between wallets, and real-time actual settlement make stablecoins different from other readily available forms of electronic money—namely, commercial bank deposits and stored value instruments. When stablecoins are properly regulated, these features, together with programmability and composability, form an essential foundation for modern payments infrastructure.

We have recently seen a proliferation of stablecoins. These stablecoins are issued by many different entities, which take many corporate forms, are formed under a variety of different laws, and today have a variety of approaches to reserve design and redemption rights for holders. As a result, users correctly do not, and cannot, treat different stablecoins as fungible for payments. Users and the market today distinguish between even non-yield-bearing stablecoins such as USDT, USDC, USDP, USDG, and so on.

Yet if stablecoins are to function as digital cash, they will need to be fungible across issuers. That is, users should be able to view a USD stablecoin from one issuer as economically indistinguishable from that of any other issuer—without the need for deposit insurance or central bank clearing. Someone using a stablecoin to pay, or accepting a stablecoin for payment, should not care which stablecoins are being used. A digital wallet could contain stablecoins from many different issuers, displayed as an undifferentiated USD balance available for fast onchain transactions. A user should be able to identify the issuers of different stablecoins held in their wallet, but this information would not be important or necessary for day-to-day transactions.

Fungibility across stablecoins for payments will make them ideally suited for onchain transactions. Without this, stablecoins will fail to fully utilize the core innovation of blockchains as open settlement systems, available to anyone, with real-time actual value settlement, 24/7, and globally. Delivery of any stablecoin onchain should be the only mechanism necessary to complete a payment. No complex system that runs only during bank hours is needed to clear and settle stablecoin payments, regardless of which stablecoin is used. No connectivity between local, national, or regional systems must be built.

In contrast, deposits issued by one commercial bank are not fungible with those of other commercial banks, except to the extent that the holders' accounts are FDIC-insured. Deposits that exceed the FDIC insurance limit are mere unsecured claims on the bank, which are not fungible with either FDIC-insured deposits or uninsured deposits at another bank. They are made interoperable only by central bank money and clearing services, which are available directly only to some banks and financial infrastructure providers. And unlike stablecoins, they are not "always on"—we rely on complex correspondent banking networks to make international

payments, by debiting and crediting the accounts of intermediary banks during bank hours, which slows payment settlement times and increases costs.

For stablecoins to operate as digital cash, legislation must focus on providing a framework that supports their fungibility for payments. The money value, quality, and reliability of a stablecoin should be independent of the creditworthiness of the issuer. This can be accomplished by three mechanisms.

First, stablecoin issuers must back stablecoins one-to-one (plus a tailored capital buffer) with reserves of high-quality liquid assets in the same denomination as the face value of the stablecoin they back, that can be easily liquidated in times of stress. Stablecoin issuers should be allowed a mix of safe assets, from the usual categories of US treasuries, commercial bank deposits, Treasury repos, and similar instruments, with capital buffers and liquidity requirements calibrated based on the market and credit risks of the reserves–not leverage requirements that are appropriate for banks.

Second, issuers must always be available to redeem the stablecoin at face value (e.g., $1). This could be done directly by an issuer or through intermediary arrangements with market makers or dealers. This is how a stablecoin maintains its peg to its USD face value and its fungibility with other stablecoins.

Third, in the resolution or bankruptcy of a stablecoin issuer, reserve assets should be segregated and beneficially owned by stablecoin holders, so that reserve assets can be quickly liquidated and paid out to these holders in an orderly manner. This fosters confidence in stablecoins as cash equivalents.

2. Competition should be encouraged on complementary use cases, not on reserve design.

Stablecoin issuers' business models today largely revolve around revenues from returns on stablecoin reserves.[3] Particularly in high interest rate environments and at scale, this business model can be extremely lucrative.[4] But it incentivizes a stablecoin issuer to maximize the interest and other returns on its reserve assets rather than minimize their credit and liquidity risks. The natural result is that stablecoin issuers will build their reserves with the riskiest allowable assets, deploy these returns to increase distribution of the stablecoin and, in turn, increase reserve size. Competition on reserve design among issuers does not promote innovation in stablecoin use cases and, absent strong guardrails, risks undermining the public confidence in stablecoins as high-quality, digital cash.

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[3] See, e.g., Governor Waller, Reflections on a Maturing Stablecoin Market https://www.federalreserve.gov/newsevents/speech/waller20250212a.htm (Feb. 12, 2025).

[4] Tether Reports $13B Profit for 2024, With Rising Bitcoin, Gold Prices Contributing, https://www.coindesk.com/business/2025/01/30/tether-reports-usd13b-profit-for-2024-with-rising-bitcoin-gold-prices-contributing (Jan. 31, 2025).

There are also potential anti-competitive effects for stablecoin reserve requirements that are overly conservative. Some legislative proposals, particularly outside the United States, have suggested limiting stablecoin reserve composition to central bank money with no interest paid on balances held at the central bank.[5] Others would impose liquidity requirements on stablecoin issuers in line with those for deposit-taking banks, whose core business involves liquidity and maturity transformation. These approaches risk making stablecoin issuance attractive only for the largest market participants because at-scale reserve returns are sufficient to satisfy investors, or for those that can subsidize stablecoin issuance with other business. At worst, they can make stablecoin issuance uneconomical altogether.

Stablecoin legislation must envision and provide viable paths for different types and sizes of stablecoin issuers, who are all incentivized to develop new and better payment solutions that use stablecoins. This should include stablecoin issuers that take different organizational forms and that have different charters, so long as they are subject to common, baseline regulatory, compliance, operational, and reserve requirements. We should also encourage issuers across different types of corporate organizations—banking organizations, payment services firms, and, yes, even technology firms.

Well regulated stablecoin issuance is less risky in terms of run risk and contagion compared to traditional bank deposit-taking and lending because it does not involve money creation through maturity and liquidity transformation. And in a strongly competitive environment, the usual rationale behind our banking-commerce divide is less compelling, particularly when applied to stablecoin issuers. Absent a clear reason to restrict a stablecoin issuer's corporate affiliations, we should not do so, as this would limit competition and hamper innovation. Potential conflicts of interest and concerns about self-dealing and data privacy can be addressed through more specific, tailored means. A thoughtful and targeted approach on affiliate activities will lead to a more competitive, innovative stablecoin landscape. Today's dynamic, with an issuance duopoly held by Tether and Circle, is much less likely to deliver new, open, and modern payments.

One key way to foster competition is to have sensible, consistent, and clear reserve requirements, as described above. Another is to limit risks in stablecoin reserves and, at the same time, enable stablecoin issuers to be economically viable without having to rely on subsidies from other activities or support from affiliates. It may be premature, and perhaps counterproductive, to regulate or restrict the activities of a stablecoin issuer's affiliates. Instead, limits on amounts and types of affiliate transactions and restrictions on self-dealing could address potential conflicts of interest or other concerns about the relationship between a stablecoin issuer and an affiliate. Stablecoin legislation should also allow for issuers of different types with different kinds of business models. Access to Federal Reserve payment

[5] Bank of England, Regulatory regime for systemic payment systems using stablecoins and related service providers, https://www.bankofengland.co.uk/paper/2023/dp/regulatory-regime-for-systemic-payment-systems-using-stablecoins-and-related-service-providers (Nov. 6, 2023).

systems and master accounts for a stablecoin issuer could be conditioned on additional regulatory and supervisory requirements. And legislation that sets minimum reserve, operational, and compliance requirements across all issuer types should be sufficient to establish a level playing field while incentivizing the right kind of competition among these issuers.

3. Stablecoin legislation is a way to level up our approach to financial crimes and privacy.

The potential for stablecoins to be used in illicit finance or to evade economic sanctions is a threat to the viability of stablecoins in modern payments. Recognizing this, U.S. regulators have long applied the Bank Secrecy Act to stablecoin issuance and to crypto exchange and money transmission services involving stablecoins.

In response, the industry has built new compliance tools to help meet these requirements. The most common are analytics tools that trace onchain transactions to help identify and report illicit activity. Stablecoin issuers have also developed technology to freeze or block stablecoin transactions upon direction from law enforcement or regulators. And they are working to develop digital identity and verified credentialing services that can provide privacy-protecting ways to better identify and verify customers. These tools are good examples of how regulation can spur industry innovation to build compliance approaches that address regulatory requirements and policy concerns in new ways.

Onchain stablecoin transactions also raise privacy considerations for stablecoin users. Payments made using credit cards or banks are not made public, pseudonymously or otherwise. Nor would we want them to be. Financial services firms and regulators, across payments, banking and financial markets, take great care to protect nonpublic information, particularly in real time. Despite their pseudonymity, onchain stablecoin transactions reveal the existence and amount of stablecoin transactions between wallets. This information can be tied to real-world users, particularly with the help of advanced blockchain analytics tools. In turn, this puts user privacy at risk and can reveal sensitive information about consumer and business payments.

As before, the industry is developing new tools to address these questions. For example, zero knowledge proof solutions can protect user privacy while enabling regulated institutions to meet their compliance obligations under the BSA. And companies like Lightspark are building on systems like the Bitcoin Lightning Network that inherently protect the privacy of individual payment transactions, using messaging protocols to enable regulated institutions to obtain and exchange the information they need to meet their legal and compliance obligations.

This dynamic, with the industry having time, flexibility, and the right incentives to develop new and better ways to address regulatory requirements, creates an opportunity to improve the overall ability of regulated institutions to identify and report illicit finance and potential

sanctions violations. These developments can be useful not only in the context of stablecoins and crypto, but also can help positively shape the future of traditional financial services. These improvements are needed to reduce the significant costs borne by regulated institutions and, importantly, improve the quality of information being reported to regulators and law enforcement.

Stablecoin legislation should direct regulators to set out clearly the illicit finance and sanctions compliance expectations for firms issuing or providing services involving stablecoins. This legislation must also provide these institutions with the flexibility to address those requirements in new and better ways.

Market structure

I will briefly comment on one keystone aspect of crypto market structure regulation. As with the substance of my stablecoin comments above, my focus is on observing fundamentals about how we want the industry to evolve, as it seeks to build modern financial infrastructure.

Congress has put in significant effort to get us to where we are today, with several comprehensive and detailed bills under consideration. These bills make important strides in defining regulations for crypto markets based on their unique characteristics.

In one aspect, however, we should look to traditional financial markets as our guide: any crypto-asset market regulatory regime must provide clear and *ex ante* legal certainty for which tokens are securities and which are not. This status, for any token, should be based on the legal and economic characteristics intrinsic to the token, which should be publicly disclosed.[6] This status should not change over time unless the characteristics of the token itself fundamentally change—not activity on the blockchain on which the token was issued.

Fundamentally, no market can develop, let alone thrive, without certainty about the legal status of the assets traded in the market. In this regard, the application of the *Howey* test to crypto assets is an ill fit. *Howey* and its progeny were always meant to be applied to commercial transactions that—in retrospect—should have been conducted as securities offerings. It was never meant as a design template for a whole asset category that needs certainty upfront.

Many have been working on different approaches to this tricky problem and have made progress. It is a problem well worth the effort of solving, for the good of those who participate in crypto markets as well as for regulators who must regulate and oversee those markets.

[6] Jai Massari, Why Cryptoassets Are Not Securities, HLS Blog on Corporate Governance, https://corpgov.law.harvard.edu/2022/12/06/why-cryptoassets-are-not-securities/ (Dec. 2022).

PREPARED STATEMENT OF TIMOTHY MASSAD

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FEBRUARY 26, 2025

Testimony of Timothy G. Massad

Subcommittee on Digital Assets
of the Committee on Banking, Housing and Urban Affairs
U.S. Senate

"Exploring Bipartisan Legislative Frameworks for Digital Assets"

February 26, 2025

Subcommittee Chairman Lummis, Subcommittee Ranking Member Gallego, members of the Subcommittee and staff, I am honored to be testifying before you today.

I am currently a Research Fellow, and Director of the Digital Assets Policy Project, at the Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School. I am also an independent consultant. I was the chairman of the Commodity Futures Trading Commission from 2014 to 2017. I served at the U.S. Treasury Department from 2009 to 2014, primarily as the Assistant Secretary for Financial Stability, where I oversaw the Troubled Asset Relief Program. Prior to my government service, I was a partner at the law firm of Cravath, Swaine & Moore LLP. The views I express are my own and do not represent the views of the Harvard Kennedy School.

Since 2014, when under my leadership the CFTC declared bitcoin to be a commodity, I have spoken and written about the need to improve regulation of digital assets.[1] This has included appearances before several committees of Congress.

I believe digital assets and tokenization technology could be very valuable in numerous ways. They could potentially be used for a variety of financial transactions and processes, in ways that might generate greater efficiency, growth, choice, opportunity and financial inclusion. But although it has been sixteen years since bitcoin was launched, we have not yet seen that much use that has generated real world value.

The stated purpose of the President's Executive Order on "Strengthening American Leadership in Digital Financial Technology" is to "support the responsible growth and use of digital assets, blockchain technology, and related technologies."[2] The question

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[1] *See* Appendix: Recent Publications and Testimony on Digital Assets.

[2] United States, Executive Office of the President [Donald J. Trump]. Executive Order 14178: Strengthening American Leadership in Digital Financial Technology. 23 January 2025. *Federal Register*, vol. 90, no. 20, pp. 8647-8650 ("Executive Order 14178").

is how to fulfill those words. Will we create legal frameworks that encourage responsible development of digital technology in ways that create social utility, or frameworks that mostly encourage more speculative activity and more of the types of abuses we have seen far too much of to date?

To date, the crypto industry has been characterized by a primary focus on speculative activity as well as tokens and applications that have little social utility. There have been rampant abuses, fraud, manipulation, failures to protect consumers and the use of this technology for financial crime and evasion of sanctions. It is also true that the absence of a clear regulatory framework has caused some institutions to refrain from making investments that might lead to applications of greater utility. I believe that both the excessive speculative activity and the failure to develop more useful applications are in large part due to the absence of a strong regulatory framework—one that provides adequate consumer and investor protection and minimizes those risks. Yes, we need clarity of rules. But we need the right rules.

I will discuss how we accomplish that.

* * *

Stablecoins and the GENIUS Act[3]

I am pleased that Committee Chairman Scott and others have said we should prioritize the passage of stablecoin legislation. Stablecoins are the most useful application of blockchain and digital asset technology to date. Their primary use to date has been for trading crypto assets. But they could become important as a general means of payment, and could facilitate the tokenization and settlement of real world assets on chain. They could also be helpful in maintaining the dominant role of the dollar in international trade and finance. Whether they achieve widespread use will be for the market to determine, not the government. But it will only happen if we create a regulatory framework that puts the "stable" into stablecoins.

Two and a half years ago, Professor Howell Jackson of Harvard Law School, Professor Dan Awrey of Cornell Law School and I wrote a detailed paper on how this could be done by our bank regulators under existing law.[4] We did so because the stablecoin market was already large and growing, and there were significant risks that

[3] United States, Congress, Senate, Committee on Banking, Housing, and Urban Affairs. *GENIUS Act of 2025*. Senate Committee on Banking, Housing and Urban Affairs Press Release, 4 February 2025 ("GENIUS Act").
[4] Jackson, Howell E., Massad, Timothy G., and Awrey, Dan. "How We Can Regulate Stablecoins Now—Without Congressional Action." *Hutchins Center Working Paper*, no. 76, August 2022 ("Howell et al. (2022)").

needed to be addressed. A framework would also enable the private sector to realize their potential. But there was little sign then that Congress would take action.

The good news is there seems to be growing support within Congress for such a measure. Three legislative proposals have recently been introduced: the "Guiding and Establishing National Innovation for U.S. Stablecoins of 2025" or the GENIUS Act introduced by Senators Hagerty, Scott, Lummis and Gillibrand; the "Stablecoin Transparency and Accountability for a Better Ledger Economy Act of 2025 or the STABLE Act introduced by leaders in the House;[5] and the proposal introduced by Representative Waters that was the product of negotiations between her and former House Financial Services Committee Chair McHenry and others, which I will refer to as the McHenry-Waters Act.[6]

I will discuss these proposals by focusing on what I believe are the critical elements of a regulatory framework for this new technology: (i) the basic prudential and other requirements necessary to make stablecoins truly "stable"; (ii) preventing the use of stablecoins for financial crime and evasion of sanctions; (iii) the allocation of licensing, regulatory and supervisory responsibilities between federal and state authorities; (iv) issues pertaining to competition, concentration of power and achieving a level playing field; and (v) enforcement.

Making Stablecoins Stable. The critical elements necessary to make stablecoins stable include prudential requirements pertaining to reserves, capital, liquidity and other risk management standards. In addition, limitations on the activities of a stablecoin issuer, and a regulatory framework to deal with the possibility of financial distress, insolvency and bankruptcy, are necessary.

Prudential Requirements. All three proposals reflect the general consensus that a stablecoin issuer must hold reserves at least equal to the value of the outstanding tokens, and that those reserves should be invested conservatively—in bank deposits, Treasury securities, central bank reserves and similar high quality, liquid assets. All three proposals also call for capital and liquidity requirements. Capital provides a cushion to absorb not only losses on investments but also losses from operational events like cybersecurity breaches. Liquidity ensures that an issuer can meet its redemption obligations, particularly in periods of stress. The proposals also refer to regulators adopting other risk management standards, though these are not specified.

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[5] United States, Congress, House, Committee on Financial Services. *STABLE Act of 2025* [Discussion Draft]. House Financial Services Committee Press Release, 5 February 2025 ("STABLE Act").
[6] United States, Congress, House, Committee on Financial Services. *Untitled Legislation* [Discussion Draft]. House Financial Services Committee Press Release, 10 February 2025 ("McHenry-Waters Act").

There are important differences in the proposals with respect to these rules, however. For example, both the GENIUS Act and the STABLE Act include significant qualifications regarding the capital and liquidity requirements. Specifically, under both proposals, capital requirements "may not exceed what is sufficient to ensure the . . . [issuer's] ongoing operations," and liquidity requirements "may not exceed what is sufficient to ensure the financial integrity of the issuer and the ability of the issuer to meet [its] financial obligations. . ."[7] This language can lead to lower requirements than appropriate. For example, in the case of capital, it might be interpreted to mean that capital can only be required in respect of operational risks such as business disruptions. But issuers will also face other categories of risk, such as interest rate risk, market risk or counterparty risk, for which capital may be necessary. In addition, while the words "not exceed" may not sound unreasonable, they could easily lead to protracted disputes by issuers who do not like a regulator's decision. These qualifications could lead to lower requirements that may increase the probability and potential impact of an issuer failing to meet its obligations or experiencing financial distress.

This is a new and rapidly evolving technology. None of us can predict what risks or circumstances will arise. The new stablecoin framework that we design will also operate in the shadow of the Supreme Court's decision in the Loper Bright case.[8] Therefore, instead of explicitly constraining authority, and providing language that enhances the ability of rejected applicants or disgruntled issuers to challenge regulators, the legislation should explicitly provide sufficient authority and discretion for regulators to respond to whatever risks and circumstances arise. To be clear, the Loper Bright decision *invites* Congress to delegate authority; it does not prohibit it. If ever there were a case where that is needed, where we do not want courts making judgements about complex, technical issues—such as whether capital and liquidity requirements are "in excess"—it is here.

The GENIUS Act and the STABLE Act include central bank reserves among the permitted investments, which raises the general issue of whether stablecoin issuers have access to federal payments infrastructure. I discuss this below under "Competition, Concentration of Power and Achieving a Level Playing Field."

All three proposals include repurchase agreements among permitted investments (and the GENIUS Act includes reverse repurchase agreements) with a maturity of seven days or less that are backed by Treasury securities.[9] Query whether that is desirable since such instruments can be highly illiquid for a participant that does not have

[7] GENIUS Act, Section 4(a)(4)(A); STABLE Act, Section 4(a)(4)(A).
[8] United States, Supreme Court. *Loper Bright Enterprises v. Raimondo. United States Reports*, vol. 603, 28 June 2024.
[9] GENIUS Act, Section 4(a)(1)(A)(v).

access to the Federal Reserve discount window. In addition, secured repo transactions could prevent token holders from recovering their money in a bankruptcy, as discussed below under "Bankruptcy Protections."

Although there is agreement on the need for full reserves, there is not clarity on whether those reserves should be held in trust for the benefit of the holders to avoid possibility of attachment for other claims. None of the proposals require that reserves should be held by a third party custodian either.

None of the proposals says anything about diversification of investments. We should not overlook the lessons of the failure of Silicon Valley Bank, when a stablecoin issuer had a large amount of deposits in a single bank, most of which was uninsured. While regulators have authority to issue rules related to reserves, general language directing regulators to address issues of diversification, by type of investment as well as recipient, should be included.

I discuss how these prudential requirements should be set in the section on allocating responsibility between federal and state authorities.

Limitations on Activities. A second critical area necessary to make stablecoins stable, and on which there is a general consensus, is that the activities of a stablecoin issuer should be limited to those directly related to the issuance and redemption of stablecoins. All three proposals contain such limitations. However, none restrict incurring other indebtedness. There is also disagreement on whether there should be restrictions on an issuer's affiliate relationships and the activities of those affiliates. These types of restrictions are just as important, as discussed below in the competition section.

Bankruptcy Protections. A third critical area to make stablecoins stable concerns what happens in the event of a failure or bankruptcy of a stablecoin issuer. In the absence of addressing this issue, the standard corporate bankruptcy process would likely apply. That means holders of stablecoins would face a delay in recovering their money and potentially lose some or all of it. That is because a petition for a Chapter 11 reorganization would trigger the application of the automatic stay and begin a process that could take years. Holders would not be able to redeem their tokens until the conclusion of the process. It would also mean token holders would have an unsecured claim that is *pari passu* with all other unsecured debt claims. They must not only go to court to recover but would share the reserves that are supposed to back tokens one-for-one with all other unsecured creditors, thus creating doubt that they would get paid back in full.

Moreover, because the business model of some stablecoin issuers has been to have direct contractual relationships with only a small number of customers, there could be questions as to whether holders of tokens purchased on the secondary market would even have an equivalent claim against the issuer.

A stablecoin regulatory framework should also be designed to minimize the potential collateral damage of the failure of a stablecoin issuer. Even the failure of the relatively small, algorithmic stablecoin Terra quickly rippled through the crypto sector and triggered other defaults. A failure of a systemically important issuer could trigger much greater damage, particularly if authorities do not have the tools to swiftly respond.

Ideally, a stablecoin regulatory framework should exempt issuers from the application of the Bankruptcy Code and it should create a dedicated resolution process. That process should ensure that holders get their money back as soon as possible. That process should be fast so that we minimize collateral damage. It should involve the appointment of a dedicated receiver, and it should be designed to work for federal and state-chartered issuers. States do not write their own bankruptcy laws, so while a state-chartered issuer might be able to create a trust structure that reduces some of the risks related to a standard corporate bankruptcy process, we would be better off to create a process that will minimize risks and damage for both federal and state-chartered issuers.[10]

Neither the STABLE Act nor the GENIUS Act provides for such a process. While the STABLE Act does not address bankruptcy protection for customers in any way, the GENIUS Act at least states that in the event of an "insolvency proceeding" with respect to a stablecoin issuer, a claim of a person holding a stablecoin issued by that issuer will have "priority" over all other claims against the issuer.[11] While that provides some protection against diminution in value resulting from the claims of other unsecured creditors, holders would still have to wait until the end of the process to recover.

Only the McHenry-Waters proposal creates a dedicated resolution process involving a federal receiver. It also contains a statement that holders claims receive "priority."[12]

It should be noted that even stating that holders claims are "prioritized" may be illusory. Under the STABLE Act and the GENIUS Act, issuers are entitled to pledge

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[10] For a general discussion of risks of bankruptcy, see Howell et al. (2022), p. 5; Awrey, Dan. "Money in the Shadow of Bankruptcy." *Beyond Banks: Technology, Regulation, and the Future of Money*. Princeton University Press, 2025.
[11] GENIUS Act, Section 9(a).
[12] McHenry-Waters Act, Section 3(c)(10).

assets as collateral to secure a repo transaction for the purpose of creating liquidity. Participants to repo transactions have super-priority in bankruptcy and may be able to seize reserve assets without even having to create a post-bankruptcy claim.

The risk created by this ability to pledge is substantial. One can imagine a Bear Stearns-like scenario where a stablecoin issuer is facing liquidity pressures. It could enter into a repo contract covering a large part—or even all—of its reserves to generate liquidity. But news of the contract could put further pressure on its liquidity as customers anticipate that there will be fewer reserve assets available for distribution post-bankruptcy. Thus, subjecting stablecoin issuers to bankruptcy while letting them pledge assets for liquidity purposes exposes holders to greater risk.[13]

Moreover, users of other stablecoins might fear that other issuers will do (or might have already done) the same thing, in light of market conditions, similarity of business models, and equivalent restrictions on assets and activities. This could create conditions for the type of contagion we saw after the failure of the Reserve Primary Fund in September 2008 (the money market fund which had less than 1.5% of its assets in Lehman commercial paper at the time that Lehman filed for bankruptcy). Litigation related to its failure continued until September 2013.[14]

If we really want to promote stablecoins as a viable general means of payment, then creating an appropriate bankruptcy process supports that goal. It can give users of stablecoins more confidence about using them.

Addressing the Risks of Financial Crime and Evasion of Sanctions. Beyond the risks related to whether stablecoins really are stable and will hold their value, one of the greatest risks is their potential use for financial crime and evasion of sanctions. There were recent reports of some high-profile cases which underscored the risks, specifically the use of stablecoins by Russian smugglers to evade sanctions and by Hamas to fund its activities and launder money.[15] It is impossible to know with any certainty the scale of such illicit activity. As the digital asset and stablecoin market grows, however, it is likely to grow, absent sufficient steps to prevent it. Whether stablecoins can become a safe and trustworthy means of payment turns in large part on whether we can adequately address this risk.

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[13] I am grateful to Professor Awrey for our discussions on these issues.
[14] Raymond, Nate. "Settlement Reached in Reserve Primary Fund Lawsuit." *Reuters*, 7 September 2013.
[15] *See, e.g.*, Berwick, Angus and Ben Foldy. "Inside the Russian Shadow Trade for Weapons Parts, Fueled by Crypto." *Wall Street Journal*, 1 April 2024 ("'Inside the Russian Shadow Trade,' *Wall Street Journal*"); Berwick, Angus and Ian Talley. "Hamas Needed a New Way to Get Money From Iran. It Turned to Crypto." *Wall Street Journal*, 12 November 2023 ("'Hamas Needed a New Way to Get Money From Iran,' *Wall Street Journal*").

All three proposals make clear that the Bank Secrecy Act or BSA applies to stablecoin issuers. The STABLE Act, however, contains no express grant of responsibility or legal authority for the regulation, supervision, or enforcement of BSA compliance. The GENIUS Act directs the relevant stablecoin regulators to issue "appropriate operational, compliance, and information technology risk management standards, including Bank Secrecy Act and sanctions compliance, tailored to the business model and risk profile of the permitted payment stablecoin issuer, consistent with other legal authorities."[16] In addition to granting authority to the federal stablecoin regulators to take action, the McHenry-Waters proposal extends authority to the Treasury Department, which is desirable in light of its long-standing role in the design and implementation of the anti-money laundering (AML) and combating financial terrorism (CFT) framework, particularly through the Financial Crimes Enforcement Network (FinCEN) and the Office for Foreign Asset Control (OFAC).

While incorporating stablecoin issuers into the BSA framework is necessary, it is not sufficient. The BSA is designed for centralized intermediaries. While a stablecoin issuer is a centralized intermediary, one need not interact with a stablecoin issuer to acquire, transfer, redeem or otherwise cash out a stablecoin. One need not even interact with another centralized intermediary, such as a so-called "off ramp" or "on ramp" that itself might also be subject to the BSA—that is, crypto trading platforms or other entities on which one may acquire a stablecoin or redeem or sell it for fiat currency.

While the existing BSA/AML/CFT framework imposes compliance obligations on covered institutions, the actors and services within the digital asset world do not always fall within its categories. Stablecoins are transferred on decentralized blockchains, and transfers can be made from one self-hosted wallet to another. The "Travel Rule" adopted by the Financial Action Task Force extends the regulatory perimeter by requiring centralized entities to share or obtain information about transferors and transferees, but that only extends the perimeter one "hop" in the best case. Moreover, there are intermediaries in jurisdictions that do not comply with such rules or do a poor job enforcing compliance. It is easy to create a crypto exchange in a non-compliant jurisdiction at which stablecoins could be transferred, thus creating a means for money laundering.

Stablecoin legislation—as well as any other regulatory framework for digital assets—needs to be far more creative and comprehensive in addressing these risks. We need to expand the regulatory perimeter to include other actors and services in the DeFi world and expand the methods for addressing these risks. There have been many suggestions in this regard as well as innovations by other countries in their

[16] GENIUS Act, Section 4(a)(4)(A)(iii).

frameworks.[17] That should include addressing the risks that self-hosted wallets pose and requiring more aggressive monitoring of all transactions on chain by stablecoin issuers. (The GENIUS and STABLE Acts appear to address self-hosted wallets only in the customer protection section.) It should include requiring stablecoin issuers to continuously monitor transactions on-chain and report or freeze assets of suspicious parties. It could include giving the Office for Foreign Asset Control explicit extraterritorial jurisdiction over transactions in stablecoins pegged to the dollar as they generally would have over dollar transactions.

Congress could specify exactly how the existing AML/CFT framework should be modified, or it could grant the Treasury Department and the federal banking agencies charged with responsibility for overseeing stablecoin issuers clear authority to design, implement and enforce bespoke AML/CFT obligations that address the unique challenges. It should also encourage the development of technologies that might assist in addressing this risk, such as being able to program stablecoin smart contracts to reject transactions of parties who do not possess some sort of on chain identification credential provided by an appropriate authority .

I note that the general crypto legislation introduced by Senators Lummis and Gillibrand calls for a more comprehensive review of what is needed to combat terrorism and illicit finance with respect to digital assets and the creation of a working group involving Treasury, the Justice Department, the Department of Homeland Security, the Department of State and others to develop and recommend appropriate measures. It also directs the Secretary of the Treasury to "adopt guidance clarifying the sanctions compliance responsibilities and liability of an issuer of a payment stablecoin with respect to downstream transactions relating to the stablecoin that take place after the stablecoin is first provided to a customer of the issuer."[18]

Allocation of Responsibilities Between Federal and State Authorities. The allocation of responsibilities for the licensing, regulation and supervision of stablecoin issuers between federal and state authorities has been one of the most challenging issues in developing a stablecoin regulatory framework. A few states have recently developed their own frameworks and some favor building on a state-based regulatory model, as we currently have for other nonbank payment platforms like PayPal.

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[17] *See, e.g.*, Adeyemo, Wally. "Remarks by Deputy Secretary of the Treasury Wally Adeyemo at the 2023 Blockchain Association's Policy Summit." 2023 Blockchain Association's Policy Summit, 29 November 2023; Hall, Eric, et al. "December Brings Flurry of Treasury Activity Against Virtual Currency Services." *DLA Piper*, 19 December 2023; Rettig, Rebecca, et al. "Genuine DeFi as Critical Infrastructure: A Conceptual Framework for Combating Illicit Finance Activity in Decentralized Finance." *SSRN*, accessed on 7 February 2025.

[18] United States, Congress, Senate. Lummis-Gillibrand Responsible Financial Innovation Act. *Congress.gov*, 118th Congress, Senate Bill 2281, introduced 12 July 2023 ("Lummis-Gillibrand Responsible Financial Innovation Act"), Section 305. *See also* Lummis-Gillibrand Responsible Financial Innovation Act, Section 304.

On the other hand, the policy arguments for a strong federal role in stablecoin regulation are compelling. State-based regulation can lead to regulatory arbitrage and a race to the bottom. Indeed, the state laws that regulate nonbank payments today are quite inconsistent and minimal. Many of the critical elements of a robust regulatory regime, such as insolvency protections and AML/CFT oversight, are inherently federal responsibilities. In addition, a strong federal role is necessary given the global nature of blockchain technology and potential growth of stablecoin usage. Clearly there already is a need for cross-border harmonization of rules which can only occur at the federal level. If usage of stablecoins grows dramatically as some predict, there could also be macro-economic implications of that growth. Only the federal government possesses the tools and resources that would be needed to respond to any systemic instability within the stablecoin market. Finally, whether stablecoin issuers should have access to central bank reserves and the federal payment infrastructure is a federal responsibility.

The critical design choice thus becomes establishing the right balance between state and federal responsibilities, as it pertains to licensing, regulation including the setting of prudential requirements and other standards, and ongoing supervision to ensure compliance with those standards and to respond to any distress or instability. All three proposals envision the coexistence of federal and state responsibility. I have recently testified as to what I believe are the many weaknesses of the STABLE Act in allowing issuers to choose whether to be subject to state or federal law, and allowing states to engage in licensing, regulation and supervision without sufficient federal standards or supervision. The GENIUS Act contains very similar language but provides, by contrast, at least a few desirable constraints. A stablecoin issuer can only select a state licensing, regulatory and supervisory framework where the relevant state framework is "substantially similar" to the federal framework, and second, the total market capitalization of the relevant stablecoin is not more than $10 billion. The Act creates a process for the Treasury Department to review whether a state framework is "substantially similar" to the federal framework.[19] If those two criteria are not met, the GENIUS Act provides for a transition process to federal regulation and supervision.

I think the idea of a trigger that if tripped would mean that federal regulation and supervision would apply is a workable one. The specific elements of that trigger can be debated, but I would prefer a lower monetary cap, and also that there be a faster transition process for an issuer exceeding the cap (the Act refers to a 360-day period and it is not clear whether an issuer must secure federal registration within that time).

[19] GENIUS Act, Section 4(a)(7)(B)(4)(B).

In addition, I think there still need to be federal minimum standards with respect to the prudential requirements noted earlier—investment of reserves, capital, liquidity and risk management standards. The state role should be to apply them in the licensing process, and supervise compliance with them, except in the case of an issuer that crosses the threshold which triggers federal oversight. The states could also supplement the federal standards but not lower them. (While the GENIUS Act language requiring state standards to be "substantially similar" to federal standards is useful in this regard, expressly providing for federal minimum standards would provide greater regulatory clarity and certainty.)

The McHenry-Waters proposal has some other provisions which favor federal oversight. It requires all issuers to register with a federal regulator and be subject to coordinated federal and state regulation, supervision and enforcement. In addition, the Federal Reserve Board is required to enter into memoranda of understanding with state regulators governing information sharing and supervision and to consult with state regulators.

Competition, Concentration of Power and Achieving a Level Playing Field.
Stablecoins first caught the attention of Congress when Facebook, now Meta, proposed launching Libra. Many in Congress on both sides of the aisle were concerned about the risks of concentration of power and misuse of data, and the erosion of the traditional separation of banking and commerce. Those issues, and in particular limitations on affiliate relationships and activities, remain important and need to be addressed. There are also critical policy choices that may shape how stablecoins affect banks and traditional means of intermediation, and competition and innovation generally. These include whether a stablecoin issuer should be allowed to pay interest, whether it should be granted access to the federal payments infrastructure, and whether the regulatory framework should be technology-neutral or technology-specific. These are addressed below.

Limitation on Affiliate Relationships and Activities. While the GENIUS Act and the STABLE Act limit the activities of a stablecoin issuer to those directly pertaining to stablecoins, there are no restrictions on the entities that could own an issuer or on its affiliate relationships, or on transactions with those affiliates. Yet those affiliate relationships pose multiple risks and concerns.

First, many of the same concerns that motivate strict prudential standards at the *entity level* apply with equal or greater force at the *group level*. Especially in the presence of significant intra-group exposures, financial distress within the wider corporate group can quickly engulf a stablecoin issuer, preventing it from meeting its financial obligations to customers. As a consequence, regulators should be given the power to establish rules governing intragroup relationships and transactions. At a minimum,

and as a corollary to the entity-level prohibition against borrowing, these restrictions should include a prohibition against any direct or indirect lending by a stablecoin issuer to its affiliates. They should also include restrictions on the ability to transfer or otherwise share customer or transaction information with its affiliates.

Second, the United States has long sought to separate "banking" from "commerce." While the rationales for this separation have evolved over time, a principal one is to avoid concentration of private market power over key inputs like capital, money and payments. Members of Congress on both sides of the aisle have expressed concerns about the power of a handful of technology firms. Permitting them to enter—or expand further into—the market for payments, where their enormous networks and privileged access to customer information give them substantial advantages, would only entrench their power further. To avoid this, a stablecoin issuer should be prohibited from affiliations with firms engaged in general commercial activities.

Other types of relationships raise concerns as well, such as those between a stablecoin issuer and other crypto firms, such as crypto trading platforms—relationships which already exist today. In the absence of any rules on affiliate transactions, such relationships might lead to the favoring of one particular stablecoin on a platform and policies to discourage the use of others. These relationships also raise concerns about the sharing of customer and transaction data.

Neither the STABLE Act nor the GENIUS Act contain any restrictions on affiliate relationships or transactions. Nor do they impose any separation between payments and commerce.

By contrast, the McHenry-Waters proposal provides that stablecoin issuers that are subsidiaries of IDIs are subject to the affiliation and group level activity restrictions of the Bank Holding Company Act. It also requires the Federal Reserve to issue regulations to prevent a "non-financial commercial company" from controlling a nonbank payment stablecoin issuer, to restrict the affiliates of such a nonbank issuer to activities that are "financial activities" or "incidental to such activities," and to impose restrictions on affiliate transactions similar to those for banks.[20]

Payment of Interest. The proposals do not prohibit an issuer from paying interest on a stablecoin. That raises the possibility that stablecoins would serve not only as a means of payment but as an investment vehicle, much like a money market fund. It also could generate greater competition with banks and their ability to attract deposits. To date, there has been a substantial disincentive for stablecoin issuers to pay interest because a stablecoin might then be deemed a security. But the GENIUS Act and

[20] McHenry-Waters Act, Section 3(e)(2).

STABLE Act would eliminate that disincentive by providing explicitly that stablecoins are not securities. Because this is a new and evolving technology, and because we do not yet know how it might impact the financial sector generally, we should tread cautiously for the time being. The legislation should either prohibit the payment of interest or at least empower regulators to do so.

Access to Central Bank Reserves and the Federal Payment Infrastructure. Although the GENIUS Act and Stable Act include central bank reserves as a permitted investment, a stablecoin issuer can only hold central bank reserves if the Federal Reserve permits it to have a master account, and the Federal Reserve has taken the position that it does not currently have the authority to do so. Investing reserves in U.S. dollar central bank reserves would eliminate any risk related to intermediation, and access to the Federal Reserve's payment infrastructure would enhance efficiency of settlement and might enhance competition with banks with respect to payments. While there are many issues as to whether the Federal Reserve should grant access to a master account and the payment infrastructure that deserve full consideration, in a process that involves public comment, the legislation should give the Federal Reserve the *authority* to do so.[21]

Creating a Level Playing Field. Another element relative to competition is whether the legislation should be technology-neutral rather than technology-specific. That is, all three proposals create a new framework only for stablecoins, built on specific and largely similar definitions of "stablecoins," which are defined as a type of "digital assets" recorded on "cryptographically-secured distributed ledgers". The danger is that another technology will come along that will raise many similar issues but not be covered. In addition, we already have other nonbank payment platforms that will not be subject to this framework. To the extent there are benefits from this framework—in terms of customer confidence in the stability of stablecoins or otherwise—they will not be entitled to them, nor will they be subject to the requirements of the framework. Thus, the framework may create an unlevel playing field relative to existing and possible future entrants to the market for payments. I recognize that there is bipartisan momentum to pass legislation that applies only to stablecoins, so this ship may have sailed. But we should recognize that the framework could become legally and technologically obsolete.

Similarly, although the proposals all permit federal regulators to prescribe standards for interoperability, any such standards are likely to focus only on interoperability as

[21] I note also that the language on central bank reserves is not limited to U.S. dollar central bank reserves. GENIUS Act, Section 4(a)(1)(A)(vii).

between stablecoin issuers. Because other payment providers would not be subject to the framework, it is difficult to see how interoperability would apply to them.

Enforcement. A final issue is how to extend the regulatory perimeter to capture stablecoin issuers operating outside of the U.S. Tether is and has always been the largest stablecoin issuer, with a market capitalization today of $142 billion.[22] Tether is incorporated offshore and is not subject to U.S. regulation (other than being registered as a money service business). For years now, many commentators and officials have expressed concerns about its practices, including the nature of its investments, its lack of transparency, and the use of Tether for money laundering and evasion of sanctions.[23] Of the five largest dollar-denominated stablecoins, two others are also not subject to U.S. regulation (FDUST and DAI), and we may see more as the market grows.

The GENIUS Act makes it "unlawful for any person other than a permitted payment stablecoin issuer to issue a payment stablecoin in the United States."[24] The STABLE Act contains slightly different language, prohibiting the issuance of stablecoins "for use by any person in the United States."[25] However, neither proposal has specific enforcement provisions. Both provide for modest civil monetary penalties for knowingly participating in the issuance of a prohibited stablecoin, but it is not clear who is responsible for enforcing this prohibition, nor are there any criminal penalties. By contrast, the McHenry-Waters proposal has a broader prohibition, gives the Attorney General enforcement power, provides explicitly for extraterritorial application, and has higher civil penalties as well as criminal penalties.

Of course, even if such enforcement provisions are added, a lenient state chartering path might offer a way for a stablecoin issuer that cannot or does not wish to meet federal requirements to remain in business without changing any practices. An issuer might persuade a state to design regulations to accommodate the issuer's registration, particularly if the issuer brought business to that state. Tether is an extremely profitable firm and surely has the ability to offer such inducements.[26] That is a

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[22] "Tether Market Cap." *CoinMarketCap*, accessed on February 25, 2025.
[23] *See*, *e.g.*, New York State, Office of the Attorney General. *Attorney General James Ends Virtual Currency Trading Platform Bitfinex's Illegal Activities in New York.* New York State Attorney General Press Release, 23 February 2021; Prentice, Chris. "Crypto Firms Tether, Bitfinex to Pay $42.5 [Million] to Settle U.S. CFTC Charges." *Reuters*, 15 October 2021; "Inside the Russian Shadow Trade," *Wall Street Journal*; "Hamas Needed a New Way to Get Money From Iran," *Wall Street Journal*; Faux, Zeke. "A Thin Crust of Ice." *Number Go Up*. Crown Currency, 2023.
[24] GENIUS Act, Section 3.
[25] *See* STABLE Act, Section 3.
[26] *See* Kharif, Olga. "Tether Sees $10 Billion in Net Profits for 2024." *Bloomberg*, 20 December 2024.

reminder of the importance of getting a proper allocation of responsibility between state and federal authorities.

I note also that the GENIUS Act and the STABLE Act have provisions calling for the development of reciprocal arrangements or bilateral agreements with jurisdictions having substantially similar stablecoin regulatory frameworks to enhance interoperability, which I think is a good provision.

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Market Structure

I would also like to make a few comments on market structure regulation.

First, designing market structure regulation is a far more difficult challenge than designing a stablecoin regulatory framework, and there is far less consensus on what to do. Market structure regulation requires resolving some complex regulatory boundaries, including when is a digital asset a security, a commodity, both or neither. There is a risk that we will significantly undermine the securities law framework that has served this country so well and has made our securities markets the envy of the world. The leading legislative proposals that have been introduced would likely do just that.

Second, while these issues need to be addressed, there are better ways to proceed at this time than to have Congress rewrite the securities and commodities laws in an attempt to define these jurisdictional boundaries properly. Congress should defer to the regulators for the time being. The SEC has already launched a crypto task force that is taking on these challenges. It is engaged in several areas of work, including examining "the status of crypto assets under the securities laws."[27] The CFTC has also announced its intention to engage in a variety of efforts to bring clarity to digital asset regulation. We should let the SEC and the CFTC engage in this work, and work together, to address these issues. Ideally, the agencies will engage in these efforts by also engaging with the public and soliciting input either through formal rule making or in other ways. Congress can then review what the agencies can do on their own, and what Congress may need to do, to achieve the proper framework.

It is especially ironic that many in the crypto industry want Congress to move forward quickly with market structure regulation even though that would effectively pre-empt

[27] Peirce, Hester M. "The Journy Begins." Statement by Securities and Exchange Commissioner Hester M. Peirce, 4 February 2025.

the SEC and CFTC from developing the rules and guidance they have requested for four years now.

Third, if Congress wishes to take action now, it should focus on directing the two agencies to work together to come up with appropriate rules. I have advanced a few suggestions in this regard. Former SEC Chair Jay Clayton (who was appointed by President Trump in his first term) and I proposed that the two agencies get together to develop joint rules for the crypto market, and Congress could mandate that this should happen.[28] Professor Howell Jackson and I also wrote a paper detailing how the two agencies could develop joint rules through a self-regulatory organization.[29] (I use the term SRO consistent with our laws—which is entities that are overseen in numerous ways by the regulator, as described in our paper. I do not mean simply an organization of industry representatives that claims it can regulate participants.) While the agencies could do this on their own, Congress could also mandate it.

Fourth, another way for Congress to provide a regulatory framework and some clarity to the market without drastically revising the securities laws is as follows: Congress would assign responsibility for regulating the "spot" market for tokens that are not securities to the CFTC, but it would not revise the definition of securities. It would also not define a new category of "digital commodities" that are deemed not to be securities. Instead, it would give the CFTC authority over any trading platform that trades bitcoin or ether. That would be a simple way to establish jurisdiction over the market—it is easy to identify such platforms, and there is no significant platform that does not trade those tokens. It would prescribe some core principles and direct the CFTC to develop rules to implement such principles—like prevention of fraud and manipulation, prevention or minimization of conflicts of interest, protection of customer assets, disclosure to investors, reporting requirements, and so forth. It would also mandate that those rules should apply not only to the trading of bitcoin and ether, but to ***all other tokens*** listed on the platform. That is critical to achieving full investor protection. It would further specify, however, that the platforms are not to trade securities, and that the CFTC and SEC should consult to determine if a token is a security. If a token is deemed a security, it would be removed from the platform and required to be traded on a securities platform, unless the SEC agreed otherwise. There would be provisions to deal with disagreements between the agencies.

This would create an immediate framework for regulation that protects investors without rewriting the securities laws. It would complement, rather than undermine,

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[28] *See* Clayton, Jay and Timothy Massad. "How to Start Regulating the Crypto Markets—Immediately." *Wall Street Journal*, 4 December 2022; Clayton, Jay and Timothy Massad. "A Path Forward for Regulating Crypto Markets." *Wall Street Journal*, 7 July 2023.

[29] *See* Massad, Timothy G. and Howell E. Jackson. "How to Improve Regulation of Crypto Today—Without Congressional Action—and Make the Industry Pay For It." *Hutchins Center Working Paper*, no. 79, October 2022.

the work of the SEC's task force in defining the status of crypto assets under the securities laws and what areas fall out of their jurisdiction. It could be seen as a permanent or interim solution. As the market develops and we gain more knowledge, the approach could be refined. But it could very quickly bring investor protection to the market without undermining decades of securities laws and without creating more questions than answers.

Fifth, some of the legislative proposals for addressing market structure are deeply flawed in ways that could easily undermine our securities laws and frankly bring more confusion than clarity. This is especially true with respect to the use of the concept of "decentralization", which is a key metric in the Financial Innovation and Technology Act for the 21st Century (FIT 21).

Blockchain and smart contracts offer the potential to automate certain functions and reduce the role of traditional intermediaries exercising discretion. However, the term "decentralization" and "DeFi" are used to describe all sorts of protocols, processes and services taking place in the crypto universe that vary tremendously with respect to the degree to which they are automated, decentralized or distributed, or with respect to the degree to which firms or human actors exercise control or discretion. DeFi protocols and services often have what some in the academic community have called "centralization vectors"—that is, ways in which there is some degree of control or discretion, including administrative keys that permit modification of code or restricting access.[30] It is also the case that there may be an automated protocol but a related "front-end" service provided by a firm or person in which discretion and control are being exercised. Therefore, the term "decentralization" is of little value. We need more precise analysis and language to determine whether and how regulations might need to be adjusted.

In addition, calling something "decentralized" or "DeFi" should not be an exemption from regulation. On the contrary, we should look at the processes being performed or the services being provided and consider what are the best ways to achieve the regulatory goals that are nevertheless present. While automation and ability for users to control assets may reduce certain types of risks that are often the targets of regulation, they may introduce others, and in any event we must still ensure that the regulatory goals of consumer and investor protection, market integrity and transparency, financial stability or prevention of financial crime are achieved.

A simple example is to imagine a "decentralized" or automated platform for the trading of Treasury securities that becomes a dominant, and indeed systemically

[30] Shuler, Katrin, et al. "On DeFi and On-Chain CeFi: How (Not) to Regulate Decentralized Finance." *Journal of Financial Regulation*, vol. 10, no. 2, 2024.

important, platform given the importance of that market. Even if such a platform truly was automated and not subject to the control of a human operator, we would still want to make sure various regulatory goals were achieved.

When it comes to market structure, I do not think the concept of "decentralization" is the proper way to distinguish between tokens that should be considered securities and those that should be considered commodities, or the way to draw the line between the jurisdiction of the SEC and that of the CFTC. It is difficult to measure and not a good indicia of whether the securities law or commodities law framework should apply.

The FIT 21 Act in particular proposes a way to delineate jurisdiction between the agencies that is based on decentralization, how a digital asset is acquired, and who holds the digital asset. It is a very complicated test that is difficult to apply. Among other things, the classification of a token could change over time—not simply from a restricted security to a digital commodity, but back again. The "self-certification" process is an invitation for abuse. It is not clear there would even be sufficient information to apply the test accurately, and the decentralization component of the test has metrics that hardly seem "decentralized." The application of the test could also fracture the market with respect to any individual token—some might be commodities and some securities. It would not bring the regulatory clarity that its proponents claim.

Moreover, it could undermine our capital markets generally, by making it easy to evade the regulation that has been a foundation of their strength and attractiveness globally. The issue is not only that we must make sure the SEC retains authority for digital assets that have indicia of investment contracts. There is the risk that stocks, bonds and other securities could be wrapped in a digital token issued on a decentralized blockchain in an attempt to avoid securities law regulation altogether. Thus, the legislation could create the risk of wholesale regulatory arbitrage for securities of all sorts.

Sixth, the issues of preventing financial crime and sanctions evasion are critical in overall market structure regulation as they are with stablecoins. This is another reason first to put in place a stablecoin regulatory framework that gives the Treasury Department and regulators sufficient authority to develop appropriate measures to address those risks, and then build on that in addressing market structure.

For all these reasons, we should proceed carefully in addressing the market structure question, and should get stablecoin legislation in place first. Stablecoins are a product that have great potential, as discussed above. What regulators learn in addressing this market will be useful as we think about other aspects of digital asset regulation.

* * *

I would like to make comments on two other issues in the Executive Order, as the Subcommittee may be asked to consider these issues in the future, one being the crypto stockpile and the other concerning the language prohibiting a CBDC.

Bitcoin Strategic Reserve or Crypto Stockpile

The working group created by the Executive Order is directed to "evaluate the potential creation and maintenance of a national digital asset stockpile and propose criteria for establishing such a stockpile, potentially derived from cryptocurrencies lawfully seized by the Federal Government through its law enforcement efforts."[31]

I believe the creation of a crypto stockpile is a bad idea for several reasons, as is the idea of a bitcoin strategic reserve. The President suggested the latter during the campaign, and some have gone even further by suggesting that not only should the government hold on to bitcoin it seizes but also the government should actually buy more bitcoin.

Assets seized through law enforcement efforts are typically sold in auctions or returned to the victims of the crimes which led to the seizures. I do not believe we should make an exception and hold on to crypto. It would create an unlevel playing field in this regard, and there is no good argument in its favor.

The expectation that prices of crypto will appreciate is not a good reason to retain what we seize or to buy more. There is no assurance prices will appreciate, of course. Crypto prices have been extremely volatile and there are plenty of examples of tokens that shot up in price only to later crash (e.g., FTT (the FTX token), or Luna, the token backing the Terra stablecoin that collapsed). A better argument can be made on that basis for holding on to equity securities that the government seizes—they have a longer and more consistent record of appreciating in price and are just as easy to store, but the government should not retain, or generally invest in, those either.

There is no strategic reason for the government to hold on to bitcoin or other crypto tokens. Doing so would not serve an important use case as there is with oil, for which we created a strategic reserve. It is also neither necessary nor desirable to create such a stockpile or reserve to advance the country's leadership in this technology. The way to do that is to create legal frameworks that allow for responsible private sector innovation. It is more likely that government investment would distort policy choices and create risks of conflicts and corruption. Finally, the idea that a bitcoin reserve

[31] Executive Order 14178.

would support the dollar or the monetary system has been thoroughly debunked by George Selgin at the Cato Institute and others.[32]

Executive Order Language on a CBDC

The Executive Order language concerning a CBDC also raises concerns.

I recognize there are strong views on the subject of a retail CBDC among the members of this Subcommittee and I do not wish to focus on that issue. However, if we want the private sector to develop digital asset and blockchain technology to facilitate tokenization of assets of real value, and utilize atomic settlement so that transactions involving such assets settle instantly and efficiently on chain, the federal payments infrastructure operated by the Federal Reserve must be compatible. Banks (and other payment institutions that might be granted access to the system in the future) must be able to settle the digital asset transactions of their customers in a compatible and efficient manner. While settlement between banks is already electronic, there may be systems improvements that are necessary to facilitate interbank settlements involving their respective on-chain atomic settlement transactions.

In addition, the dollar is the primary currency for international trade and transactions. With the growth of stablecoins and digital assets as well as fast payment systems generally around the world, we must make sure that the technology for cross-border payments flowing through the federal payments infrastructure remains at the cutting edge. That does not require the issuance of a CBDC that individuals would hold. But it means making sure the Federal Reserve continues to do necessary research and development.

Unfortunately, the language in the Executive Order has such breadth that it raises concerns as to whether any such research and development can continue. That is because it defines a CBDC very broadly, as "a form of digital money or monetary value, denominated in the national unit of account, that is a direct liability of the central bank," and it prohibits "any action to establish, issue, or promote CBDCs within the jurisdiction of the United States or abroad" and any "plans or initiatives" related to the creation of a CBDC.[33]

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[32] Selgin, George. "The 'Digital Gold' Fallacy, or Why Bitcoin Can't Save the US Dollar." *Cato Institute*, 29 November 2024. *See also* Carter, Nic. "I Don't Support a Strategic Bitcoin Reserve, and Neither Should You." *Bitcoin Magazine*, 30 December 2024.
[33] Executive Order 14178.

If the Subcommittee wants to bring about development and innovation with respect to digital assets, it should make sure our core payments infrastructure can handle it.

Finally, I know that many are opposed to a retail CBDC because they are concerned the government would use that technology to monitor transactions of individuals, collect data on individuals, target political opponents, or even censor transactions. We have witnessed an unprecedented seizure of the Treasury payment system recently in a manner that creates many of the same risks. The Treasury payments system is critical to the operation of the government and our economy. Approximately 90% of all government payments flow through that system. Approximately 1.3 billion payments, having a value of over $6 trillion, were made last year. Tens of millions of individuals depend on it for direct payments or for payments made by institutions paid through that system. Access to that system is normally limited to a handful of people even within Treasury. But in this case, a few young programmers who had no prior experience with the system or even working in the government obtained access. While the courts have at least temporarily limited their access,[34] the seizure creates risks similar to those that many worry would come with a retail CBDC. It creates the possibility that payments could be stopped or "edited" notwithstanding the absence of legal authority to do so, thereby usurping the power of Congress. It creates the risk that huge quantities of data on individuals could be harvested and used in inappropriate ways. It poses additional serious risks—including simply interfering with or damaging the system in such a way that payments are disrupted, or undermining confidence in a manner that negatively affects the credit and standing of the United States.

* * *

The Trump Meme Coins

Finally, although the Trump meme coins are not part of the Subcommittee's agenda, they cannot be ignored when the Subcommittee's desire is to create frameworks that can encourage responsible and useful innovation. It is difficult to imagine an action that the President could take which would be more contrary to the spirit and opening words of the Executive Order, issued just a few days later, which is to "promote United States leadership in digital assets" and "responsible growth

[34] *See* United States, United States District Court for the Southern District of New York. *State of New York v. Trump* [Court Opinion and Order]. Docket no. 25-1144, 21 February 2025; United States, United States District Court for the District of Columbia. *Alliance for Retired Americans v. Bessent* [Court Order]. Docket no. 25-0313, 6 February 2025. *See also* United States, United States District Court for the District of Columbia. *Alliance for Retired Americans v. Bessent* [Complaint]. Docket no. 25-0313, 3 February 2025.

and use of digital assets."[35] One does not have to be a digital assets expert to understand why the issuance of the meme coins contradicts the spirit of that order and was plainly wrong. It was a money grab and a conflict of interest. The potential for conflicts of interest will also continue over time. Companies and countries looking to curry favor with the Administration or seeking government action may believe it is in their interest to purchase the coins to show their support. That risk is heightened by the structuring of the issuance, because additional tokens will be released over the next four years which will presumably generate additional revenue to the Trump Organization, which creates incentives for others to push up the price.

It is a black eye for digital assets. It is exactly the kind of speculative behavior that we have seen too much of and it reinforces many of the negative perceptions of digital assets. It is simply, as one observer said, a "classic meme-coin pump and dump scheme."[36]

Conclusion

I share your desire to create responsible digital asset regulation. The United States created an excellent regulatory framework for securities markets beginning in the 1930s, one that remains a model for countries around the world and has been a foundation for our markets to become the most important in the world. We can do the same here.

[35] Executive Order 14178.
[36] Khalili, Joel. "The Trump Memecoin's 'Money-Grab' Economics." *Wired*, 20 January 2025 (citing Interview with Jacob Silverman).

Appendix: Recent Publications and Testimony on Digital Assets

"Stablecoins and national security: Learning the lessons of Eurodollars," Timothy G. Massad, The Brookings Institution, April 17, 2024, https://www.brookings.edu/articles/stablecoins-and-national-security-learning-the-lessons-of-eurodollars/

"The U.S. Can Make the Rules on Stablecoins, or We Can Take Them," Barron's, July 19, 2023, https://www.barrons.com/articles/stablecoins-regulation-currencies-us-6e759212

Jay Clayton and Timothy Massad, "A Path Forward for Regulating Crypto," The Wall Street Journal, July 7, 2023, https://www.wsj.com/articles/regulating-crypto-markets-1e5ec5c5

Testimony before the Subcommittee on Digital Assets, Financial Technology and Inclusion of the U.S. House of Representatives Financial Services Committee and the Subcommittee on Commodity Markets, Digital Assets and Rural Development of the U.S. House of Representatives Committee on Agriculture, "The Future of Digital Assets: Measuring the Regulatory Gaps in the Digital Asset Market," May 10, 2023, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408754

Testimony before the Subcommittee on Commodity Markets, Digital Assets and Rural Development of the U.S. House of Representatives Committee on Agriculture, "The Future of Digital Assets: Identifying Gaps in Spot Market Regulation" April 27, 2023, https://agriculture.house.gov/calendar/eventsingle.aspx?EventID=7604

Jay Clayton and Timothy Massad, "How to Start Regulating the Crypto Markets—Immediately," The Wall Street Journal, Dec. 4, 2022, https://www.wsj.com/articles/how-regulate-cryptocurrency-markets-11670110885

"How We Can Improve Regulation of Crypto Today—Without Congressional Action—and Make the Industry Pay For It," Timothy Massad and Howell Jackson, October 13, 2022, https://www.brookings.edu/research/how-to-improve-regulation-of-crypto-today-without-congressional-action-and-make-the-industry-pay-for-it/

"Former CFTC Chair on How to Regulate Stablecoins Without Passing Any New Laws, "Odd Lots Podcast, September 22, 2022, https://podcasts.apple.com/us/podcast/former-cftc-chair-on-how-to-regulate-stablecoins-without/id1056200096?i=1000580279346

"How We Can Regulate Stablecoins Now—Without Congressional Action," Howell Jackson, Timothy Massad and Dan Awrey, The Brookings Institution, August 2022, https://www.brookings.edu/research/how-we-can-regulate-stablecoins-now-without-congressional-action/

"The Treasury Option: How the U.S. Can Achieve the Financial Inclusion Benefits of a CBDC Now," Howell Jackson and Timothy Massad, The Brookings Institution, March 2022, https://www.brookings.edu/research/the-treasury-option-how-the-us-can-achieve-the-financial-inclusion-benefits-of-a-cbdc-now/

Presentation to SEC Investor Advisory Committee on digital assets regulation, Dec 2, 2021

Banking With Interest Podcast, November 30, 2021, https://bankingwithinterest.libsyn.com/a-better-way-forward-for-cbdcs-stablecoins

Testimony before the Joint Economic Committee of Congress, November 17, 2021, on regulation of digital assets and central bank digital currencies, https://www.jec.senate.gov/public/index.cfm/hearings-calendar?ID=215B7EAF-1838-4CE3-A499-55B99EA864F9

"Regulating Stablecoins Isn't Just About Avoiding Systemic Risk," The Brookings Institution, October 5, 2021, https://www.brookings.edu/research/regulating-stablecoins-isnt-just-about-avoiding-systemic-risk/

"A Bitcoin ETF Would Be Good for Investors and Regulators," Bloomberg, July 7, 2021, https://www.bloomberg.com/opinion/articles/2021-07-07/a-bitcoin-etf-would-be-good-for-investors-and-regulators?sref=hU7uPhn8

"Can a Cryptocurrency Break the Buck?" Bloomberg, May 31, 2021, https://www.bloomberg.com/opinion/articles/2021-05-31/stablecoins-like-tether-should-face-regulators-scrutiny?sref=hU7uPhn8

"Coinbase's Small Fine Is a Big Warning to IPO Investors," Bloomberg, April 8, 2021, https://www.bloomberg.com/opinion/articles/2021-04-08/coinbase-s-small-fine-is-a-big-warning-to-ipo-investors?sref=hU7uPhn8

"Cryptocurrencies: Speculative Bubble or the Future of Money?" Presentation at Harvard University, April 1, 2021, https://www.youtube.com/watch?v=4cJB11qnVqA

"Libra 2.0: Why you might like it even if we can't trust Facebook," The Brookings Institution, June 2020, https://www.brookings.edu/research/facebooks-libra-2-0/

"It's Time to Strengthen the Regulation of Crypto-assets," The Brookings Institution, March 2019, https://www.brookings.edu/research/its-time-to-strengthen-the-regulation-of-crypto-assets/

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Statement for the Record

On Behalf of the

American Bankers Association
before the

Subcommittee on Digital Assets

of the

Senate Banking, Housing and Urban Affairs Committee

February 26, 2025

The American Bankers Association (ABA) appreciates the opportunity to provide a Statement for the Record for this hearing, *Exploring Bipartisan Legislative Frameworks for Digital Assets*. ABA is the voice of the nation's $24.2 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2.1 million people, safeguard $19.1 trillion in deposits and extend $12.6 trillion in loans.

The digital asset market has been the subject of much attention over the last several years. Congress is right to focus on the ecosystem to better understand how the various entities in the market operate, what risks those operations present, and what regulations and legislation are necessary to ensure consumer and investor protection and financial stability without inhibiting innovation. In addition, Congress has an important oversight role to play in ensuring regulators do not – through guidance, policy, and other actions – inappropriately pressure banks to limit legal and permissible activities they perform safely and soundly. To that end, we appreciate the effort of many members of this Committee to rescind the Securities and Exchange Commission's misguided Staff Accounting Bulletin 121 policy.

As Congress, regulators, and the Administration develop a regulatory framework for digital assets, we urge them to apply the principle of "same activity, same risk, same regulation" and to ensure the resulting ecosystem operates with safeguards that appropriately mitigate financial stability and consumer protection risk. When these objectives are achieved, Congress will ensure all customers are protected equally, regardless of where they engage with the financial marketplace, and that the U.S. financial system remains strong, safe, and competitive.

Stablecoin is an area of particular interest to our members, given the token's similarity in use to commercial bank money. We have appreciated the opportunity to engage with stakeholders on development of a regulatory framework for stablecoin over the last several years, and we look forward to continuing that partnership. As we review proposals like the GENIUS Act, the key issues we are considering include how effectively the legislation applies the principle of "same activity, same risk, same regulation," mitigates financial stability and consumer protection risk, and preserves the foundational value of financial intermediation through the banking system and bank deposits relative to payment stablecoins. These issues come up regarding the robustness of

the regulatory framework; the degree of supervision and mechanism for enforcement; the application of the Bank Secrecy Act (BSA) to the payment stablecoin ecosystem; and the limits placed on nonbanks, including commercial activities restrictions, master account access, and the ability to pay interest on tokens. In addition, we want to ensure that banks can issue stablecoin on an equal footing to nonbanks, and that tokenized deposits are not captured in the definition of payment stablecoin.

Through a range of guidance and policy documents, banking regulators have instructed banks to proceed into the digital asset ecosystem with extreme caution, requiring advanced supervisory notice and formal approval[1], which is an atypical standard for many product and technology implementations. Given the regulatory uncertainty and regulators' concern, banks have moved more carefully to market, if at all, than many of the less regulated providers of these services. On February 5, 2025, Acting Vice Chair of the FDIC, Travis Hill, released documents supporting this outcome, and his accompanying statement[2] sums up the obstacles banks have faced well:

> "The documents that we are releasing today show that requests from these banks were almost universally met with resistance, ranging from repeated requests for further information, to multi-month periods of silence as institutions waited for responses, to directives from supervisors to pause, suspend, or refrain from expanding all crypto- or blockchain-related activity. Both individually and collectively, these and other actions sent the message to banks that it would be extraordinarily difficult—if not impossible—to move forward. As a result, the vast majority of banks simply stopped trying."

The documents recently released by the FDIC and recent testimony in Congress[3] demonstrate how guidance and policy statements from prudential regulators over the last four years have discouraged banks from pursuing business in the digital asset market. And while not every bank will choose to engage in the digital asset ecosystem, that decision should be theirs, not their regulator's. Banks specialize in offering diverse products and services, ranging from personal loans and mortgages to financing infrastructure in cities and towns across America such as schools and bridges, and preserving the flexibility to serve legal businesses that fit within their unique business models and risk appetite is critical.

There are ways banks may engage with the digital asset market beyond banking crypto businesses, for example, providing custody and safeguarding of digital assets and tokenizing deposits and real-world assets. It is critical that banks have the legal and regulatory clarity that reaffirms their ability – if they make that decision - to safely and soundly provide a range of digital asset-related products and services.

Banks have long provided safe and well-regulated custody services to investors in securities and other assets. However, the combination of prudential regulators' posture and SAB 121 has resulted in few banks currently offering custody services for digital assets. Rescinding SAB 121, which effectively precluded banks from offering digital asset custody at scale, is an important step toward ensuring customers have access to a safe, well-regulated custody service for digital assets.

Tokenization, an application of distributed ledger technology with potential to enable near real-time transfer of value and exchange of value (asset settlement) that is programmable and transparently recorded on a shared system of record, is another important area of financial innovation in the digital asset market. One application of tokenization is the opportunity to create a digital token representing commercial bank money, or a tokenized deposit. The same regulatory and legal framework that applies to a traditional bank deposit would apply to the tokenized deposit – the primary difference is how the deposit is recorded. The use of tokenized deposits could enable more efficient use of commercial bank money in payments and asset transactions.

ABA remains strongly opposed to a consumer-facing or retail CBDC, which would set the Federal Reserve up as a direct competitor for bank deposits and limit banks' ability to make the loans that power economic growth. In fact, tokenization may address some of the goals proponents of a CBDC seek to achieve, for example by increasing efficiency of payments and supporting near real-time settlement of real-world assets. With tokenization, these goals can be achieved without introducing a fundamental change in consumers' relationship with the Federal Reserve or reducing the availability of liabilities banks can use to support lending, both of which are likely consequences of CBDC.

Banks have a critical role to play in the digital asset ecosystem, which has the potential to be a catalyst for change in traditional financial markets, with significant implications for our financial system, economy, markets, and most importantly for the American consumer. Thank you for the opportunity to express our views, and we look forward to working with the Committee and other policymakers on this important topic.

America's Credit Unions

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February 26, 2025

The Honorable Cynthia Lummis
Chair
Subcommittee on Digital Assets
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Ruben Gallego
Ranking Member
Subcommittee on Digital Assets
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20510

Re: Today's Hearing: "Exploring Bipartisan Legislative Frameworks for Digital Assets"

Dear Chair Lummis and Ranking Member Gallego:

On behalf of America's Credit Unions, I am writing ahead of today's Subcommittee on Digital Assets hearing titled "Exploring Bipartisan Legislative Frameworks for Digital Assets." America's Credit Unions is the voice of consumers' best option for financial services: credit unions. We advocate for policies that allow the industry to effectively meet the needs of their over 142 million members nationwide. America's Credit Unions appreciates the opportunity to share the perspective of credit unions on measures being considered by the Subcommittee regarding digital assets and stablecoins.

General Comments

Digital assets, including cryptocurrencies and stablecoins, have garnered much attention and popularity in the financial services marketplace. With the continued interest and growing investment, there is both a need and opportunity for financial institutions to provide safe keeping of digital assets.

America's Credit Unions believes that credit unions should be able to offer consumers an entry point to purchase and use digital assets, including stablecoins. Credit union members trust their credit unions to provide necessary financial services, and the ability to provide new financial services products is needed for credit unions to fulfill their mission. Moreover, credit unions' focus on financial literacy and financial education can be extended to digital asset related products, like stablecoins, to help credit union members use these new products prudently. And as regulated entities, by law, credit union members receive robust protections not available when obtaining financial services from fintech or other providers.

In December 2021, the National Credit Union Administration (NCUA) clarified that the agency does not prohibit federally insured credit unions (FICUs) from partnering with third-party providers of digital asset services that leverage evolving technologies. This includes facilitating member relationships with third parties that allow FICU members to buy, sell, and hold various uninsured digital assets with the third-party provider outside of the FICU. As expected, FICUs

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must conduct proper due diligence and ensure compliance with all applicable laws and regulations. At the time, the NCUA acknowledged that further guidance may be needed as questions continue to arise related to digital assets, digital ledger technology, and stablecoins. America's Credit Unions, therefore, welcomes Congress's interest and growing support for this legislation and the clarity it will provide.

With that in mind, America's Credit Unions would like to highlight some areas that we support as well as areas where clarification would be helpful.

A Compatible Subsidiary

We are pleased to see that S. 394, the Guiding and Establishing National Innovation for U.S. Stablecoins of 2025 (GENIUS Act of 2025) contains appropriate language identifying the appropriate subsidiary entity for a credit union as a credit union service organization (CUSO). The House's discussion draft of the STABLE Act does so as well. To the extent stablecoin regulatory frameworks seek to separate the business of issuing stablecoins from the primary banking functions of depository institutions, legislators must ensure that subsidiary arrangements designed to firewall stablecoin risk are compatible with the organization and structure of credit unions. We support stablecoin legislation which recognizes CUSOs and organizations associated with the routine operations of credit unions as appropriate subsidiary vehicles (among others) for issuing activities.

By contrast, some other proposed frameworks designating a stablecoin issuer as a type of bank-specific entity (e.g., a bank holding company) would generally be incompatible with the structure and design of credit unions as cooperatives.[1] Bank holding companies are overseen by the Federal Reserve, which has no experience regulating or supervising credit unions. To ensure that the NCUA remains the primary agency responsible for overseeing credit union stablecoin activities, including those performed by subsidiaries, the subsidiary must be recognized as an organization associated with the routine operations of credit unions or a CUSO.

Central Bank Reserve Deposits and Foreign Deposit Accounts

The GENIUS Act requires stablecoin issuers to maintain reserves that are comprised of various types of liquid assets. One of the types of assets listed in both proposed bills is "central bank reserve deposits." It is unclear from the legislative text whether these central bank reserve deposits are inclusive of currencies other than the U.S. dollar. If they are, we are concerned that the adequacy of a stablecoin issuer's reserves could be less robust if a share of those reserves are comprised of foreign currency subject to the monetary policy of a foreign state. We would recommend additional clarity regarding how central bank reserve deposits are defined and would caution against proposals that invite stablecoin issuers to establish reserves denominated primarily in foreign currency.

The GENIUS Act specifically provides that stablecoin reserves may be comprised of funds held as demand deposits at "regulated foreign depository institutions." It remains unclear whether

[1] *See* https://democrats-financialservices.house.gov/uploadedfiles/02.10.25_stable_2024_xml_12.3.24.pdf.

federal payment stablecoin regulators or states would assess the quality of reserves in foreign banks, or what factors they might consider in terms of evaluating the safety of foreign banking institutions that might play a prominent role in supporting U.S. stablecoin issuer activities. Furthermore, to avoid unexpected outflows of U.S. funds into foreign banks, it may be appropriate to limit the extent to which reserves may be held at foreign institutions. In this regard, it is noteworthy that the STABLE Act does not contain any provision permitting the use of foreign demand deposit accounts for reserve purposes.

We are also skeptical of claims that stablecoins backed by foreign currency reserves would meaningfully support the status of the U.S. dollar. The Bank of International Settlements (BIS) has noted that "[f]or some jurisdictions, the widespread cross-border use of foreign currency-denominated stablecoins could increase the risk of currency substitution and potential loss of seigniorage."[2] To ensure that stablecoin legislation does not inadvertently undermine the role of U.S. institutions, we ask that you consider limiting the role of foreign deposits and foreign central bank money as categories of reserves.

Prohibition on Rehypothecation

The GENIUS Act (and the STABLE Act) includes a ban on rehypothecation, which prohibits an issuer of stablecoins from pledging, reusing, or rehypothecating reserves except for the purpose of creating liquidity. We agree that reserves should be robust for nonbank issuers that lack the prudential safeguards of depository institutions. However, the flow of money into reserve accounts for the purpose of supporting stablecoin transactions and redemption activity could adversely impact credit creation activity to the extent that those reserves are no longer available for the purpose of funding loans and credit. It is unclear whether credit unions holding reserves in the form of deposit balances would be allowed to lend against those funds.

The core business of credit unions and other depositories is to fund loans with deposits. The long-term impact of money flowing out of traditional deposit accounts and into stablecoin markets raises concern about how stablecoin activity meaningfully translates into positive economic growth for Main Street communities. While we are supportive of mechanisms to limit the risks inherent with leveraging stablecoin reserves, such safeguards may be more appropriately targeted toward nonbank entities that are not chartered as banks or credit unions, lack a dedicated functional regulator, and are not subject to federal capital and liquidity requirements. Credit unions that hold stablecoin reserves in the form of deposit balances under the proposed legislative frameworks should have certainty about whether those funds can be used to fund credit. For reserves not held as deposits, we encourage Congress to evaluate how large stablecoin issuers could influence credit creation activity if reserves must remain largely dormant as a hedge against future cryptocurrency crashes, similar to those witnessed in 2022.[3]

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[2] Bank of International Settlements, Committee on Payments and Markets Infrastructures, "Considerations for the use of stablecoin arrangements in cross-border payments," October 2023, available at https://www.bis.org/cpmi/publ/d220.pdf.

[3] *See* e.g., Liu, Jiageng and Makarov, Igor and Schoar, Antoinette, "Anatomy of a Run: The Terra Luna Crash" (April 2023). NBER Working Paper No. w31160, Available at SSRN: https://ssrn.com/abstract=4426941.

Custodial Authority

The provision of custodial services for cryptocurrencies is both convenient and useful in carrying out the mission of credit unions. Such activities are not inconsistent with the Federal Credit Union Act (FCU Act). Individual interest in digital assets continues to rise and the cryptocurrency market cap has exceeded $3 trillion.[4] While one of the hallmarks of cryptocurrency is the use of a decentralized ledger, individuals and companies are still looking for secure places to hold their digital assets, including stablecoins. Credit unions need certainty that future stablecoin legislation will provide *affirmative* custodial authority. Credit union members who are users of stablecoins want to custody their stablecoins and other digital assets with their primary financial institution. While nothing in the FCU Act explicitly precludes credit unions from acting as custodians for digital assets, the NCUA, under previous leadership, was unwilling to interpret the FCU Act to affirmatively permit such activity—notwithstanding the interpretative latitude potentially afforded by analysis of federal credit unions' incidental powers.

Section 13(a) of the GENIUS Act describes the authorities of depository institutions, including state and federal credit unions, but do not offer the affirmative language credit unions need. Section 13(a)(3) of the GENIUS Act instead provides that "[n]othing in this Act may be construed to limit the authority of a depository institution [....] to engage in activities permissible pursuant to applicable State and Federal law, including [....] providing custodial services for payment stablecoins, private keys of payment stablecoins, or reserves backing payment stablecoins." The language could be read to remove barriers to certain types of activities provided those activities are already permitted under state and federal law; however, it does not create new authorities by itself.

Given the NCUA's reluctance to interpret the FCU Act in a way to permit custodial activity not affirmatively granted as an explicit credit union power, we recommend that the legislation state clearly that credit unions are authorized to perform all the activities listed in Section 13 of the GENIUS Act respectively as incidental powers.

Conclusion

America's Credit Unions supports the ongoing legislative efforts surrounding stablecoin regulation, particularly the GENIUS Act and STABLE Act. The credit union movement recognizes the growing need for digital asset services and advocates for policies that allow credit unions to responsibly offer these services while safeguarding member interests. Key priorities include securing custodial authority for stablecoins, ensuring compatibility with credit union structures, and addressing uncertainties around reserve deposits and rehypothecation. With clear legislative language and appropriate safeguards, these measures can empower credit unions to meet the evolving needs of their members while promoting financial stability and consumer protection.

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[4] Forbes, Cryptocurrency Prices Today By Market Cap, available at https://www.forbes.com/digital-assets/crypto-prices/?sh=4f96efa24785.

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We thank you for this opportunity to share our thoughts on the important role that credit unions play in the financial services ecosystem, particularly with newly emerging technologies, stablecoins, and digital assets. America's Credit Unions looks forward to continued engagement with the Subcommittee to ensure that legislation will improve the environment for all stablecoin issuers, including credit unions. Should you have any questions or require any additional information, please feel free to contact me or Greg Mesack, America's Credit Unions' Senior Vice President of Advocacy, at gmesack@americascreditunions.org.

Sincerely,

Jim Nussle

cc: Members of the Subcommittee on Digital Assets

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ICBA
One Mission. Community Banks.

February 26, 2025

Digital Assets Regulation: The Community Bank Perspective

The Independent Community Bankers of America, representing community banks across the nation with nearly 45,000 locations, appreciates the opportunity to provide this statement for the record for February 26 Senate Banking Committee Digital Assets Subcommittee hearing titled, "Exploring Bipartisan Legislative Frameworks for Digital Assets."

ICBA looks forward to working with Chairwoman Lummis, Ranking Member Gallego, and the members of the Senate Banking Committee on stablecoin legislation, including the Guiding and Establishing National Innovation for U.S. Stablecoins (GENIUS) Act (S. 394), to ensure economic stability without community bank disintermediation.

Community banks have a strong interest in ensuring that stablecoins issued by non-bank entities do not do harm to investors, consumers, or the financial system. Currently, stablecoin arrangements are not subject to comprehensive consolidated supervision and lack many critical consumer and anti-money laundering protections. This regulatory gap allows risks to the financial system to multiply, provides opportunities for illicit actors to engage in financial crimes, poses risks to consumers, and creates an unequal playing field with highly regulated community banks.

From the community bank perspective, stablecoin legislation should establish a clear federal regulatory framework that addresses gaps in existing regulatory authority. Moreover, as we expand upon below, regulatory frameworks must effectively address risks associated with stablecoins and not create opportunities for regulatory arbitrage and community bank disintermediation. We appreciate the ongoing dialogue with this Committee to address any concerns throughout the legislative process.

ICBA will evaluate any stablecoins regulatory framework against four broad principles:

- Potential for regulatory arbitrage
- Preserving the integrity of Federal Reserve Master Accounts
- Risks posed by commercial and "Big Tech" private currencies
- Community bank disintermediation

Regulatory Arbitrage

Consistent standards of regulatory and supervisory oversight and prudential requirements should be applied to similar activities. This is a longstanding principle of financial regulation and should be applied regardless of the nature of the firm conducting an activity or the technology used. Any regulatory or supervisory regime applicable to nonbank issued stablecoins should be comparable to a functionally similar product offered by a bank or other traditional financial services provider. This will

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ensure risks created by loosely regulated nonbank firms do not spill over into the traditional banking system.

In particular, ICBA would be concerned with any state pathway or opt-in state regime that would establish a regulatory race to the bottom ripe for exploitation by bad actors to take advantage of loopholes and lax oversight. Without a strong federal floor, nonbank stablecoin issuers would be incentivized to seek approval from the state with the least regulatory requirements and oversight. Further, it is unlikely that many states are prepared to regulate stablecoins at the level necessary to mitigate risk, especially given stablecoin issuers' capacities to quickly scale into global stablecoins that facilitate international payments.

Federal Reserve Master Account Access

ICBA has strong concerns about nonbank-stablecoin-issuers' access to Federal Reserve master accounts and other Fed programs. Highly regulated depository institutions are given access to Fed master accounts, as well as discount window and borrowing privileges, because they are subject to rigorous and comprehensive federal supervision and examination. Granting this access to nonbank payment stablecoin issuers, which are not subject to the same stringent regulatory oversight, would create systemic risk and put highly regulated community banks at a significant regulatory disadvantage.

Commercial and "Big Tech" Control

ICBA has strong concerns about the entrance of Big Tech and other commercial firms into the banking system, as this would erode the long-standing principle of the separation of banking and commerce on which the American system has flourished. The issuance of stablecoins by Big Tech and other commercial firms would create numerous conflicts of interest and give these firms significant economic power. This concern is heightened by the fact that current proposals do not prevent Big Tech firms from partnering with a stablecoin issuer or directly issuing a stablecoin, which could quickly scale to become a dominant payment method domestically, and even internationally.

This would be a radical change in economic policy carrying far reaching and unintended consequences for consumer security and privacy and American commerce. Such a change warrants rigorous examination.

Community Bank Disintermediation

Digital assets of all kinds, including stablecoins, create a risk of disintermediating community banks. Community banks rely on both business and consumer deposits to fund local lending, including consumer loans such as mortgage and auto loans, as well as small business and small farm loans which undergird local economies. If these deposits migrate to digital assets, they will not be available to fund this lending, and local economies and consumers will suffer reduced access to credit and less favorable borrowing terms. Disintermediation poses a significant threat to local prosperity, particularly in smaller communities.

To prevent this, it is critical that standards that apply to insured depository institutions apply equally to nonbank payment stablecoin issuers. Under current frameworks, the difficulty of creating a subsidiary,

obtaining regulatory approval, and the subsequent additional regulatory burden would effectively sideline community banks.

Additionally, frameworks must clarify that community banks are able to utilize any payment stablecoin reserve funds held as insured demand deposits to carry out the business of banking. Community banks need to be able to employ insured demand deposits for lending in their communities, and payment stablecoin reserve funds should be no different. ICBA strongly urges this Committee not to pass legislation that would lead, intended or not, to disintermediation.

Closing

Thank you for convening this hearing. As this subcommittee considers any digital assets legislation, including stablecoins legislation, we urge you to be mindful of the serious risks outlined above.

We remain grateful for the opportunity to review draft legislation and provide the community bank perspective.