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Senate Crypto Bill Eyes Bigger Role For CFTC

By **Tom Zanki**

Law360 (June 7, 2022, 10:09 PM EDT) -- U.S. Senate legislation introduced Tuesday would assign most oversight of cryptocurrencies to the U.S. Commodity Futures Trading Commission, a smaller regulator that can be seen as friendly toward digital assets, although lawyers said the proposal would not end jurisdictional disputes among federal agencies.

The Responsible Financial Innovation Act, a long-awaited bipartisan bill co-sponsored by Sens. Cynthia Lummis, R-Wyo., and Kirsten Gillibrand, D-N.Y., strives to create regulatory certainty among agencies governing cryptocurrencies. As drafted, Tuesday's proposal does so mostly by granting significant authority to the CFTC, a derivatives regulator that has a smaller budget and enforcement staff than its larger sister agency, the U.S. Securities and Exchange Commission.

"This is an attempt to be industry friendly," said Christopher LaVigne, a partner in Withers LLP's litigation and arbitration team. "The CFTC has, for the most part, been the friendlier of the various agencies, particularly compared to the SEC, in the digital asset space."

LaVigne added that the CFTC is perceived as responsive to regulatory inquiries and willing to offer market players guidance. This image may differ some from the SEC, which has intensified its crackdown on cryptocurrencies under chair Gary Gensler. The SEC worries that most digital tokens meet the definition of a security, which in turn compels trading platforms to comply with various investor protection laws.

Digital assets can exhibit tendencies similar to a currency, security or commodity depending on the context, leading to recurring debates over accurate definitions.

The Lummis-Gillibrand bill seeks to clarify jurisdictional gray areas by defining many digital currencies as "ancillary assets" — meaning an intangible, fungible asset that is offered in connection with the sale of a security — which would be treated as commodities under U.S. law. This definition would include bitcoin and ether, which together amount to more than half of all digital assets market capitalization.

But the bill also contains exceptions to that term. It exempts assets that offer investors a profit or revenue share of an entity whose fortunes are derived solely from the entrepreneurial or managerial efforts of others. This description resembles an investment contract, a catchall phrase for a security that the SEC relies on to assert its authority, backed by the 1946 U.S. Supreme Court case SEC v. W.J. Howey Co. and known as "the Howey test."

"In that definition, there are holes you can drive a truck through if you are the SEC," LaVigne said of the legislative proposal's description of ancillary assets. "I highly doubt that the SEC is going to hang up its sword after a decade of calling — across administrations — digital assets 'securities.'"

Even with the bill's exceptions detailing what assets can be considered commodities, one investor watchdog is worried that the bill defers too much authority to the CFTC.

Better Markets says the CFTC does an outstanding job with its existing mission but is chronically underfunded, making it hard for the agency to stay on top of physical commodities, let alone a technically complex industry such as cryptocurrency.

"Giving the CFTC jurisdiction over crypto is like New York City outsourcing crime fighting to a small-town police force," Better Markets CEO Dennis Kelleher said in a statement. "You might see a cop every now and then and they might even make the occasional arrest, but by and large the criminals will be running the place."

The CFTC has begun seeking more authority and resources from Congress to regulate cryptocurrencies. The commodity regulator's current chair Rostin Behnmam, like Gensler, was appointed by President Joe Biden and both agencies have a Democratic majority.

The Lummis-Gillibrand bill comes during a rocky period for cryptocurrencies, even for a nascent asset class accustomed to volatility. So-called stablecoins have plunged well below their $1 benchmark, while flagship digital currency bitcoin has lost more than one-third of its value year to date, and ether is down more than half since Jan. 1.

By empowering the CFTC, the legislation is placing trust in an agency that has a reputation as a principles-based regulator, meaning one that relies more on clearly stated principles to achieve regulatory aims than detailed, prescriptive rules.

Given the still-developing nature of crypto as an asset class, a flexible regulatory approach can be a good thing, according to Daniel Davis, a partner at Katten Muchin Rosenman LLP who was formerly CFTC general counsel.

"Principles-based regulation has a lot of benefits for an industry that's new," Davis said.

Davis noted that the CFTC isn't starting from scratch either. He said the agency has for years monitored spot markets for digital assets, which influence the price of futures, an area where the derivatives watchdog already has enforcement authority.

Spot markets involve financial instruments that are traded for immediate delivery in cash. The Lummis-Gillibrand bill is notable in that it grants the CFTC new regulatory authority over digital asset spot markets, which the authors say matches well with its oversight of other commodities.

"It introduces an entirely new digital-asset exchange framework," said Sarah Riddell, of counsel at Morgan Lewis & Bockius LLP and a former CFTC lawyer who advises hedge funds and other clients who interact with the agency.

The Lummis-Gillibrand bill, if it were to advance, would not solve all regulatory jurisdiction questions, but Davis said it could somewhat narrow the range of disputes.

"It can give a lot more specificity than what a lot of people feel is currently provided by the Howey test," said Davis. "Instead of arguing between the 30-yard lines, you are now arguing between the 40-yard lines or between the 45-yard lines, so to speak."

--Editing by Jay Jackson Jr.
