

Insight



Bipartisan Senate Proposal Sets Out to Create a Complete Regulatory Framework for Cryptocurrencies

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Executive Summary

- In the past year at least 16 percent of Americans have traded cryptocurrencies – a \$1.7 trillion industry that has grown significantly since 2017.
- Despite this market’s size and growth, cryptocurrencies fall into several regulatory gaps, and federal regulatory oversight of the market is severely underdeveloped.
- Senators Cynthia Lummis and Kirsten Gillibrand deserve credit for introducing the Responsible Financial Innovation Act, which sets out to create the first complete regulatory framework for digital assets. Nevertheless, the decision to treat most cryptocurrencies as commodities as regulated by the Commodity Futures Trading Commission would create a remarkably pro-industry framework overseen in its entirety by a relatively small regulator without significant fintech experience.

Introduction

A market that did not exist prior to 2017 is now causing headaches for regulators and policymakers in Washington as a growing number of Americans – an estimated [16 percent](#) – invest in, trade, or use cryptocurrencies. Wyoming and Arizona are [reportedly considering](#) accepting tax payments in the form of digital currencies. New York’s new mayor [took his first paycheck](#) in cryptocurrencies.

Despite the growing use of digital assets and presence of new fintech entrants into the financial services sector, federal oversight and supervision of a market that exceeded [\\$3 trillion](#) in November of last year has been piecemeal, contradictory, and in many cases has relied on existing regulations [nearly a century old](#). The United States does not have an overarching, cohesive, federal regulatory framework for the “Wild West” of digital assets, and this is largely due to the difficulty posed by [several fundamental questions](#) the industry gives rise to. What, exactly, is a cryptocurrency? What is a fintech? How should either be regulated, and by whom? While a March [executive order](#) calling for a whole-of-government approach to regulating digital assets recognized the necessity of these structural questions, it deferred actually answering any of them, instead commissioning [a wide series of reports and research](#) across government.

In the proposed [Responsible Financial Innovation Act](#), Senators Cynthia Lummis and Kirsten Gillibrand have shown that Congress is prepared to be a little braver. In what the senators are calling “the most substantial and comprehensive bipartisan effort to provide certainty and clarity” the bill would create a “complete regulatory framework” for digital assets. Most notably, the Senators have taken a stance on what cryptocurrencies are (commodities for the significant majority) and which agency should regulate cryptocurrencies (the Commodity Futures Trading Commission (CFTC)). In doing so the senators have picked a side in a regulatory turf battle

between the CFTC and Securities Exchange Commission (SEC) that, if the bill is signed into law, would significantly impact both the future development of the crypto industry and the relevance of the CFTC.

The Responsible Financial Innovation Act

The bill would:

- *Create a set of standard definitions.* One key difficulty for regulators in creating an overarching framework for digital asset regulation is determining the nature of the financial instruments that the law should cover. Senators Lummis and Gillibrand propose standard definitions for terms including digital asset, virtual currency, and stablecoins.
- *Determine whether digital assets are commodities or securities.* A summary provided by the senators notes: “For the first time, this bill makes a clear distinction between digital assets that are commodities or securities by examining the rights or powers conveyed to the consumer, giving digital asset companies the ability to determine what their regulatory obligations will be and giving regulators the clarity they need to enforce existing commodities and securities laws.” While this seems to suggest that discretion should be left up to both regulators and cryptocurrency issuers “to determine what their regulatory obligations would be,” a truly astounding *codification* of the current lack of clarity on this question, the senators seem to set the scale by establishing as law that “ancillary assets” purchased under an investment contract “are not inherently securities,” thereby appearing to strongly favor the view that cryptocurrencies be treated as commodities. Despite this, certain ancillary assets determined to be commodities would still be required to submit disclosures to the SEC annually, raising the question as to why. Given that securities are regulated significantly more stringently than commodities, including, among other requirements, with restrictions on price fixing, this interpretation of digital assets can be viewed as being extremely favorable to the crypto industry.
- *Give the CFTC jurisdiction over all digital assets not otherwise deemed to be securities.* This new “authority” is of questionable use given that the SEC already regulates securities and the CFTC already regulates commodities; in that regard, a strict read of the bill would not seem to create any new authorities. The implication here, however, is clear: The senators believe that digital assets should be considered securities only as exception, giving the CFTC regulatory oversight over the majority of digital assets. This has meaningful implications for the agencies in question, as the CFTC is a considerably smaller agency with less expertise in fintech. The SEC by comparison has been [active in pursuing fintech regulation](#) and staffing for new needs posed by innovative technology. Not only would this decision arguably represent a poor use of either agency, but it would come as something of an insult to SEC Chair Gary Gensler, the (if not only) federal regulator to be covering fintech.
- *Seek to foreground consumer protection.* The bill would require digital asset issuers to provide a range of disclosures to consumers and would also clarify settlement terms and rights over digital ownership.
- *Create capital requirements for stablecoin issuers.* Stablecoin issuers would have to maintain highly liquid capital equal to 100 percent of outstanding payment stablecoins. Stablecoins are not currently subject to capital requirements ([or much in the way of regulation at all](#)). Here the senators’ aim seems to be to ensure that cryptocurrency issuers hedge against the risks posed by a run on assets that might occur if digital currencies are subject to the same stresses as real dollars.
- *Clarify the responsible taxation of digital assets.* The senators would allow cryptocurrency miners and “stakers” (those who commit their assets to support a blockchain network or verify payments) to avoid tax on their business income, an extremely generous interpretation that seems difficult to justify from the perspective of policy given both the lost revenue and the [environmental implications of bitcoin mining](#).

- *Commission a wide range of studies and further research from the federal financial regulators.*

Conclusions

In addition to raising a fascinating theoretical question, the decision to treat cryptocurrencies and digital assets as either commodities or securities has profound real-world implications. This distinction matters because securities are regulated significantly more stringently than commodities, which makes this bill notably benevolent to the cryptocurrency industry. Separately, the decision to house responsibility for the vast majority of digital asset regulation under the CFTC seems a peculiar choice given the relative size of the SEC and the expertise accrued by SEC Chair Gensler.

By far the greatest hurdle facing a government-wide integrated approach to regulating digital assets and cryptocurrencies has to date been an unwillingness to take a stand on the definitional questions of what a digital asset is and how it should be regulated. While Senators Lummis and Gillibrand deserve credit for taking a position, they have chosen an interpretation so favorable to industry that the bill will likely face an uphill battle in Congress.