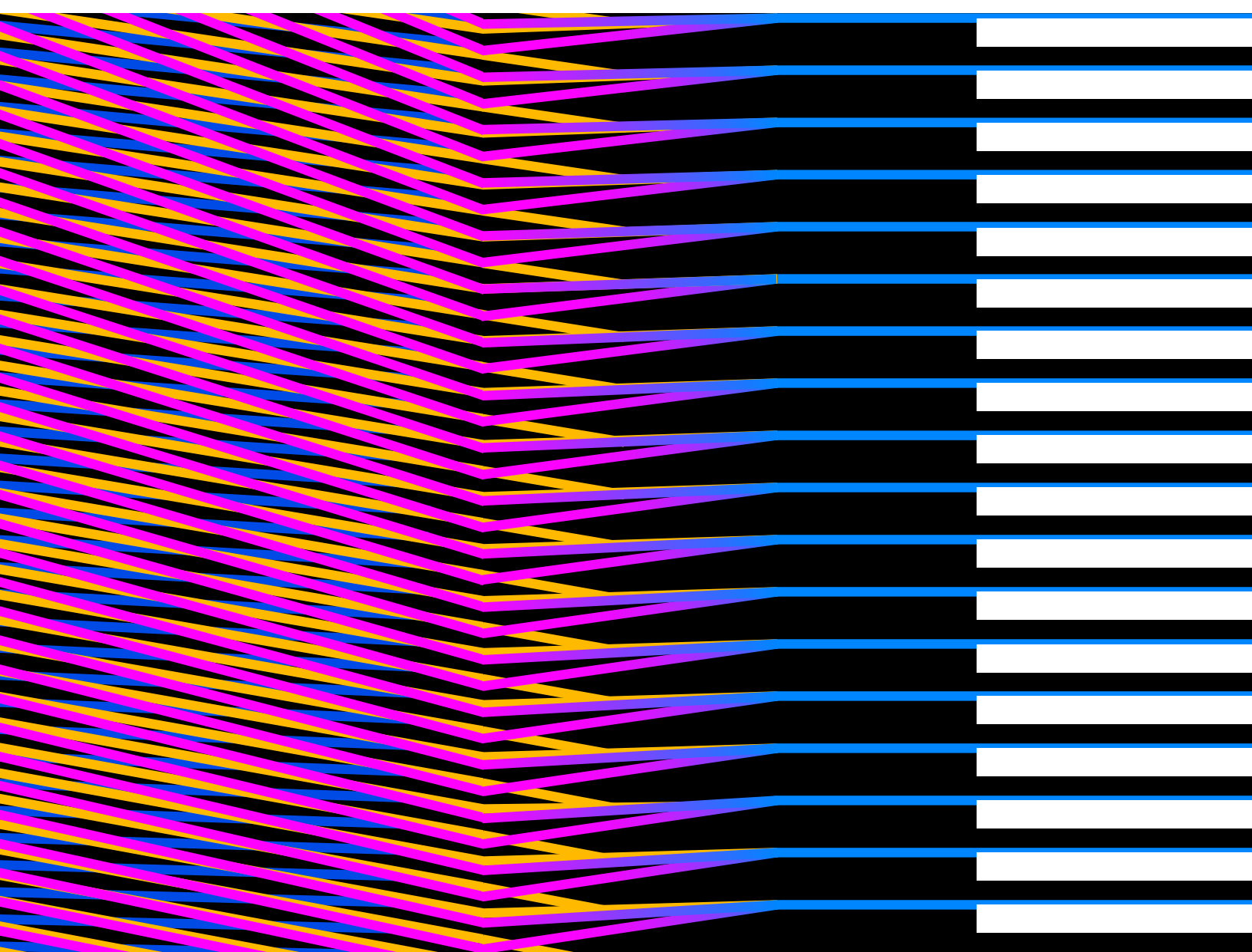


# Untangling the Web of Federal Crypto Regulation



# Untangling the Web of Federal Crypto Regulation

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# 01 Executive Summary

## Growing Crypto Adoption Means New Opportunities, Risks, and a Need for Regulation

The continued growth of cryptocurrencies and other digital assets has unlocked a new digital economy for millions of people globally, creating the groundwork to cultivate [financial inclusion](#) of the unbanked or underbanked in a system that has traditionally shut them out. With adoption estimated to near [1 billion users worldwide](#) by the end of 2022, crypto is set to play a significant role in fostering wealth creation, furthering equality, and more generally influencing the new era of finance. However, with increased adoption and opportunities come increased risks, including money laundering, hacking, and scams.

[Regulation is necessary to keep investors and companies safe from these threats. Unfortunately, legislators remain divided on what that regulation should entail.](#)

The industry's sudden growth caught governments unprepared, and the general lack of education regarding digital assets left them scrambling to release adequate regulations to oversee the surge of new users and organizations. Although a slew of legislation has come out both from a [federal](#) and [state](#) level, [many of these laws](#) are confusing or don't fit our new digital economy. As a result, digital asset businesses are often [trying to interpret](#) their responsibilities, and any misinterpretation can [result in fines](#), productivity loss, and other issues. Additionally, the gap between

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regulatory guidance and the increase in users has left those new to the digital economy [under-protected and vulnerable](#).

Prime Trust's *Untangling the Web of Federal Crypto Regulation* aims to provide context to the muddled regulatory landscape seen in the United States today. To do so, we've compiled insights from Prime Trust's VP of Regulatory Affairs, Jeremy Sheridan, and real-world examples to explain the United States' current frameworks. We've also analyzed the most notable regulations that have been proposed, are underway to become law, or are currently active, in order to explore how supportive the U.S. is to the cryptocurrency ecosystem.

This report will provide in-depth context to the current regulatory landscape and proposed bills that would change how digital assets are classified, monitored, or taxed. Further, it will evaluate the compliance obligations organizations face. We will also interrogate how these bills may impact the agency at large and what potential they offer to aid in the adoption of virtual assets.

The experts here at Prime Trust hope this comprehensive guide will provide the industry with a deeper understanding of current regulatory laws and potential innovations on the table. Additionally, we hope regulators will gain better insight regarding ways in which certain laws could improve, how that improvement will ultimately benefit the financial sphere, and why it's important for them to seriously acknowledge and provide direction for digital assets.

## 02 Your Regulatory Subject Matter Expert

### Jeremy Sheridan

VP of Regulatory Affairs, Prime Trust



With over 20 years of law enforcement experience and leadership in investigations for the United States Secret Service, Jeremy has a proven track record of achievement. He began his career in 1997 as a special agent in the Tucson, AZ, Resident Office. By 2002, he was assigned to the Presidential Protective Division (PPD), where he served under President George W. Bush.

By 2008, he joined the supervisory ranks as Assistant Special Agent in Charge (ASAIC) of the Human Capital Division. In 2021, Jeremy was promoted to Assistant Director of the Office of Intergovernmental and Legislative Affairs, with oversight of the Liaison Division, Congressional Affairs Program, Homeland Security Program, Privacy Office, and Freedom of Information Act Office. Before joining Prime Trust, Jeremy was named Assistant Director of the Office of Investigations, where he led the global investigative mission of the Secret Service, consisting of 161 offices and over 3,000 personnel. Follow Jeremy on [Twitter](#) and [LinkedIn](#).

## 03 Overview

Prior to 2020, federal legislators in the United States struggled to acknowledge or educate themselves on digital assets. They are now facing the consequences of an industry that's moved forward at lightning speed without clear direction. Compared to other industrialized nations, the U.S. is lagging behind in providing clear and actionable digital asset regulations. Governing bodies in recent years have taken a “regulate through enforcement” posture, creating an environment of uncertainty among institutional and nascent retail investors who are considering entering the digital economy.

As cryptocurrency's [market cap regularly hovers around \\$1 trillion](#), billions locked in the DeFi economy are inaccessible due to complicated compliance obligations that remain close to impossible for small businesses to meet without the proper resources and know-how. Three primary reasons have led us down this path: (1) the lack of a clear governing body to oversee virtual assets, (2) the insistence that decades-old laws governing traditional financial institutions are adequate to apply to decentralized assets, and (3) misconceptions that continue to permeate lawmakers' positioning when proposing regulations relevant to blockchain-enabled technology.

### SECTION ONE

## Lack of a Clear Governing Body

Since virtual assets bolted into the mainstream, the U.S. Federal Government has found itself sorting out the infighting between its regulatory agencies. While multiple government bodies have an interest in cryptocurrencies and claim they are the best positioned to regulate DeFi and DeFi assets — with some even [calling for a new regulatory body](#) to be created — many have a limited scope of what their oversight would entail.

Most of these organizations will support the overall regulation and use of virtual assets, and most experts believe the designated oversight [will be granted](#) to either the Commodity Futures Trading Commission ([CFTC](#)) or the Security and Exchange Commission ([SEC](#)). In order to determine who should provide guidance

and recommendations to businesses and law enforcement actions interacting with blockchain-enabled assets, the agencies will need to prove digital assets fall within their existing frameworks.

### The SEC's Case

The SEC was created by Congress with the passing of the [Securities Exchange Act of 1934](#). It was tasked with governing “securities,” which are defined within the legislation as “investment contracts.” The agency interprets and enforces federal laws that govern the U.S. securities industry, ensuring the public has access to vital information for investments being offered by a business and the manner in which sellers and traders of securities must treat investors.

It's important to note that “currency” is not a security. However, the SEC argues that digital assets are considered investment contracts as defined by the Howey Test (see call out).

[Gary Gensler](#), Chair of the U.S. Securities and Exchange Commission, has often been vocal regarding the cryptocurrency industry and has opined there is a widespread [lack of regulatory compliance](#) from players in the space. Though he has [publicly conceded](#) that bitcoin is a commodity, Gensler has [asserted](#) that most cryptocurrencies are not, [stating](#), “Many of these crypto financial assets have the characteristics of securities,” and are subject to SEC oversight.

Even though the SEC has not expressly been given permission to oversee digital assets, it has fined the industry over \$2 billion and nearly doubled the staff of its Crypto Assets and Cyber Unit [as of May](#). The agency's press release states:

The expanded Crypto Assets and Cyber Unit will leverage the agency's expertise to ensure investors are protected in the crypto markets, with a focus on investigating securities law violations related to:

- Crypto asset offerings;
- Crypto asset exchanges;
- Crypto asset lending and staking products;
- Decentralized finance (“DeFi”) platforms;
- Non-fungible tokens (“NFTs”); and
- Stablecoins

The industry has generally viewed the SEC as [overstepping its authority](#) — a view shared by multiple politicians, like those who are members of the Congressional Blockchain Caucus. The agency has been the focus of the high-profile [Ripple lawsuit](#) in which the SEC claims [Ripple](#), a blockchain-based money transfer network for the financial services industry, illegally raised funds through its native [XRP](#) token. The SEC classified the token as an unregistered security. Instead of conceding to this charge, Ripple is fighting the suit and has taken the issue to the courts. This case may prove pivotal to determining to [what extent the SEC may exercise its control](#) over digital assets.

Nevertheless, the SEC does have several positive intentions behind their actions. Specifically, they aim to protect investors, primarily against information asymmetries in the investing markets; ensure the financial markets operate fairly and efficiently; and promote capital formation in the US. These goals align with many of crypto's own, and if implemented from a pro-crypto stance, they could propel the industry forward. For example, [the SEC's approval of BTSX as an exchange](#) showed their willingness to support and uplift blockchain-based companies. Though BTSX is not truly decentralized or crypto-based, it does intend to tokenize future offerings, and the SEC's approval could serve as a proverbial toe in the water leading to greater involvement and inclusion of other assets.

### **Securities and Exchange Commission v. W. J. Howey Co. et al.**

In 1946, The SEC sued W.J. Howey Co., a Florida business that sold plots of land with citrus groves located on the premises. The company let buyers lease the land back to the company, which would then cultivate orange groves, sell the oranges, and give parts of the profits back to the buyers.

The SEC claimed W.J. Howey Co. needed to register these transactions with the agency, arguing that its offerings constituted an "investment contract," which is categorized as a "security" under the [Securities Act of 1933](#). The case was brought to the Supreme Court where the justices sided with the SEC.

According to the [decision](#), "investment contracts" are defined as when:  
"(i) there is the investment of money; (ii) in a common enterprise; (iii) with a reasonable expectation of profits to be derived; (iv) from the efforts of others."

The Howey Test has become the standard for the SEC and other regulators to decide whether or not an asset is a security.



## The CFTC's Case

The CFTC, created by Congress in 1975, oversees the U.S. derivatives market which includes [commodity futures](#), [options](#), [swaps markets](#) and all [over-the-counter \(OTC\) markets](#). The Commission “investigate(s) and prosecute(s) commodities fraud, including foreign currency schemes, energy manipulation and hedge fund fraud, and works with other federal and state agencies to bring criminal and other actions.”

In order for the CFTC to claim oversight, the agency needs to prove virtual currencies and tokens are commodities, thus giving them jurisdiction via the [Commodity Exchange Act](#). This would allow the organization to police fraudulent and manipulative activities. Yet, beyond this authority, the CFTC does not generally oversee virtual currency transactions or exchanges that do not involve margin, leverage, or financing (e.g. [spot markets](#)) and thus has limited authority to force these entities to register with them. Though, this could change with many of the current bills under review, which would give the CFTC [more power over spot markets](#) and similar institutions.

The CFTC has historically been more judicious in its quest to control the digital asset market. CFTC Chairman Rostin Behnam said in one [interview](#) that there are coins that will be considered securities and others that will be commodities. Though Behnam seemingly is more open to collaboration than Gensler, he has stated strongly that Ether falls under his agency's purview. Other than Bitcoin and Ether, the SEC has generally avoided making comment regarding whether specific coins are securities or commodities in recent hearings and interviews.

"I can say for sure bitcoin, which is the largest of the coins and has always been the largest regardless of the total market cap of the entire digital asset market capitalization, is a commodity. Ether as well. I've argued this before."

— Rostin Behnam

Many in the industry believe the [CFTC would be a friendlier regulator](#) to DeFi assets, seeing their enforcement actions and compliance requirements as more reasonable than those of the SEC. Pro-crypto lawmakers have woven this into their proposed legislation as well, a prime example being the Lummis-Gillibrand Bill, which would provide more resources to the agency and expand its scope of jurisdiction. But Behnam has [rejected the idea](#) that the CFTC would be kinder than other regulatory bodies:

“That is completely false, and that’s a bad narrative,” he said. “I’m as tough as anyone in this city, and our jurisdiction and our authority is as tough as anyone’s as well.”

The CFTC has settled cases with over 30 firms involved in digital assets and subjected fines totaling more than \$750 million since 2015.

### Why Would the Committee that Oversees Corn Regulate Crypto?

In February 2022, many were shocked to see [CFTC Chair Rostin Behnam](#) testify before the Senate Agriculture Committee [regarding cryptocurrencies](#). Why on Earth would the group responsible for overseeing crops, meat, dairy and wood have the right to dictate digital assets? This may seem odd, but under the current definition of a commodity, digital assets may fall under its oversight.

In 1922, Congress passed the [Grain Futures Act](#), which established the Grain Futures Administration. Tasked with regulating the agricultural commodity futures markets — which until then had been widely under-legislated — the group required all grain futures [to be traded on regulated futures exchanges](#), providing more farmers protections through formalized trading practices.

While the Grain Futures Administration no longer exists, subsequent laws eventually accumulated into the 1936 Commodity Exchange Act, creating guidance responsible for directing all derivative markets, not just those in the agricultural vertical. This history amassed into the current definition of commodities which the CFTC operates under today.

#### [7 U.S. Code § 1a](#)

The term “commodity” means...all services, rights, and interests...in which contracts for future delivery are presently or in the future dealt in.

In the CFTC’s view, cryptocurrencies could be used in a derivatives contract and could be subject to fraud or manipulation when traded through interstate commerce, therefore fitting into the requirements to fall under their jurisdiction.

## SECTION TWO

## Analog Laws in the Digital World

A major hurdle to enticing blockchain-focused businesses to headquarter and operate in the United States stems from old laws being used to govern new assets. This issue has been raised before with the boom of credit cards and digital banking, which led to [the creation of several new laws](#). Yet, many regulators insist that it's possible for digital asset regulation to work within the current regulatory framework used by traditional financial institutions. [In their view, crypto is simply a digital version of traditional products](#); if it can loosely fit the classification of a security or commodity, it must be held to those same regulatory standards.

However, crypto and digital assets, in general, greatly differ from these traditional products in a myriad of ways: the fundamentally new [technology](#), the [decentralization](#), and the [pseudonymity](#). Current laws simply do not account for many capabilities — and expectations — that are central to virtual currencies. For example, the 1980 Paperwork Reduction Act [can't keep up with crypto's pace](#), rendering any information it obtains outdated. Relatedly, the [1966 Freedom of Information Act](#) can be a hindrance to virtual asset firms due to its reporting obligations. A crypto firm may hesitate to inform a regulator of key proprietary information out of fear that a competitor could also obtain that information.

While several of these old laws provide direction to virtual asset businesses, many were created far prior to the existence of the digital infrastructure that is vital to the new economy we've cultivated over the past 40 years. This shoehorning of new technologies into an antiquated paradigm has proven to be fruitless and stifles innovation. Furthermore, attempts to update and adapt these laws to better fit crypto have been met with skepticism. In the case of the Lummis-Gillibrand bill, which calls for [lighter disclosure requirements](#) for certain digital token issuers, regulators have argued that such changes could disrupt the greater financial market.

Even with additions, amendments, and updates, these pieces of legislation fall short when applied to our [internet-reliant banking and investments systems](#). Lawmakers over the years have proposed legislation and amendments to enable the digital economy to reach its potential, but they alone cannot fix the multiple issues we see today. Until a cohesive, modern solution is proposed, these impediments will continue to prevent businesses from bringing in billions of dollars from the digital economy into local markets, missing the chance on tax revenue that could fuel vital initiatives that lack funding.

## SECTION THREE

## Misconceptions Among Lawmakers Still Run Rampant

Though significant efforts have been [made to educate legislators](#), myths continue to abound. The most notable misconceptions are that digital assets are the primary method to facilitate criminal activity that can take place anonymously without restriction. This is [simply not true](#) due to the transparency and traceability of the blockchain. In fact, in 2021, only [0.15%](#) of activity on the blockchain was related to criminal activity. This is a continued drop from 2020 which saw a total of 0.62% illicit transactions.

Crypto and other digital assets run on blockchain technology, which is a shared, immutable ledger that records transactions between individuals. Those taking part in a transfer are assigned an alphanumeric code known as a “public key.” Using specialized tools, law enforcement can investigate suspicious transactions, and through due process, subpoena personal identifiable information (PII) from virtual asset service providers in order to identify an individual. This transparency makes cryptocurrencies one of the worst means for criminals to transfer or wash funds.

Yet, even academics have perpetuated this criminal activities myth. On March 17, the [Senate Committee on Banking, Housing, and Urban Affairs](#) held a hearing titled [“Understanding the Role of Digital Assets in Illicit Finance.”](#) Among the witnesses was [Shane Stansbury](#), a Senior Lecturing Fellow at Duke University’s Center for Law, Ethics, and National Security. In his [testimony](#), Stansbury held the position that cryptocurrency was “the perfect vehicle for anonymous, illegal transfers.” He went on to say, “Cryptocurrency is now used in connection with a broad array of illicit activity, ranging from child exploitation and human trafficking to extortion and fraud.”

But again, the transparency of these transactions have enabled law enforcement to successfully prosecute these crimes again and again. A prime example of this is the Bitcoin Fog case. In early 2021, the [DOJ arrested and charged](#) Roman Sterlingov for the alleged operation of the bitcoin mixing service on the darknet. Analyzing the blockchain, law enforcement was able to monitor and tag the movement of 1.2 million bitcoin — which amounted to approximately \$335 million at the time of transactions — to illicit services and marketplaces. Using transparency of the blockchain and advanced forms of [block explorers](#), agencies can more easily identify, investigate and prosecute crimes using cryptocurrency as opposed to those committed with traditional fiat.

Unfortunately, Stansbury's argument has been a point central to lawmakers who believe in harsh DeFi regulations. Many in the House and Senate continue to reinforce this misleading messaging.

Educating legislators remains a top priority for the industry.

SECTION FOUR

## Signs of Improvement

Though the DeFi space continues to face pushback from legislators, several signs call for optimism. Crypto has proven to be a non-partisan issue, with legislators on both sides of the aisle coming together to draft regulations, converse about key industry issues, and speak with leaders in the space. Crypto-informed professionals continue to be chosen for critical positions in the Cabinet.

When asked about the industry's relationship with lawmakers, Tom Pageler, CEO of Prime Trust, had this to share:



Tom Pageler  
CEO, Prime Trust

"The government's appointment of knowledgeable industry professionals to important seats at the table is cause for optimism. The digital asset space has long worried about constraining regulatory oversight that could reduce their ability to quickly innovate and move adoption forward. We've seen an increased focus from lawmakers on collaborating with the industry in a meaningful way. While this attitude changes from time to time, we always land in a position of achieving mutual interests for the industry and constituents. I'm fortunate to have a team at Prime Trust, who is actively working to comply with existing regulations while helping lead the charge with the next generation of crypto-minded legislatures."

## 03 Overview

In order to keep pace with these changes and support DeFi's evolution, the industry must move from speculation to application. Already, [some Web3 approaches are nearing interoperability](#), mostly through [self-regulatory organizations \(SROs\)](#), a non-governmental organization which has the power to create and enforce stand-alone industry and professional regulations on its own. Additionally, there has also been increased adoption in retail use, from [Chipotle to Shake Shack](#) and credit cards. These changes represent huge strides forward for DeFi and will help crypto make the jump to daily use. However, a sustainable DeFi future requires simplifying the process for the end user, which in turn requires a more explicitly defined framework for regulatory oversight.

A prominent example of a successful SRO is the Payment Card Industry Data Security Standard (PCI DSS), which began in the early 2000's. The major players in the credit card industry came together to fight fraud as the consumer demand for electronic payments rose. In 2004, Visa, Mastercard, Discover, American Express and JCB Global formed the Payment Card Institute and put security standards in place for all merchants accepting credit cards. Failure to comply with PCI mandates would leave merchants vulnerable to data breaches including fines, fees, and loss of business.

The crypto industry should look to the Payment Card Institute and the success of its industry-wide PCI DSS standards as a model to emulate. In Washington, D.C., the crypto industry speaks as a unified voice through the [Blockchain Association](#) (BA)<sup>1</sup>, a trade association representing more than 100 companies working together to support a future-forward, pro-innovation national policy and regulatory framework for the crypto economy. While BA's focus is public policy, it is also dedicated to ensuring consumer protections and addressing security concerns to create a digital future that's more transparent, inspiring, secure, and equitable.

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<sup>1</sup> Prime Trust is a member of the Blockchain Association. To view other members, please visit <https://theblockchainassociation.org/members>

## 04 The Three to Watch: A Deep Dive into Crypto Legislation

With multiple prospective bills in progress or introduced by lawmakers, we've highlighted the three most important that the industry and regulators should have top of mind. Should any of these bills be enacted, the ways in which digital assets are issued, used and transacted will change.

This section will provide an overview of each bill, notable key features, and expert commentary and analysis from Jeremy Sheridan, Prime Trust's VP of Regulatory Affairs.

# Federal crypto regulations explained

## A snapshot of current regulations

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Bills introduced in Congress that affect the digital asset and blockchain industries.

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Different state-level regulatory frameworks.

1

Executive order and White House Digital Assets Framework.

## Drivers of regulatory purgatory



No singular governing body designed to oversee virtual assets.

Application of decades-old laws that govern traditional financial institutions to decentralized assets.

Myths and misconceptions of blockchain's use for illicit activity.

### Lummis-Gillibrand Responsible Financial Innovation Act

- Defines BTC, ETH as commodities
- Stablecoin guidelines
- Clear delineation between a commodity and a security
- SRO, cyber security studies
- Creates taxation rules and IRS requirements
- Creates regulatory sandbox for collaboration with private sector

### Three Bills to Watch

- Environmental & Energy use study
- Defines digital commodity broker, dealer, custodian, trading facility

- Segregation of funds
- Requires financial resources and system safeguards
- CFTC has the most regulatory power

- Bankruptcy guidelines and protections
- Some disclosure requirements

- Exchange registration requirements
- Reporting requirements

### Digital Commodities Consumer Protection Act of 2022

- Designates Chief Compliance Officer
- Preempts state laws
- Consumer protection
- Platform core principles for risk management, antitrust considerations

### Digital Commodity Exchange Act

- CFTC has exclusive jurisdiction
- Defines digital commodity, custodian, and exchange
- Rules governing margined or leveraged trading
- Custodian qualification requirements



## Digital Commodity Exchange Act of 2022 (DCEA)

**INTRODUCED:** April 28, 2022

**SPONSOR:** Rep. Thompson [R-PA]

**CO-SPONSOR(S):** Rep. Khanna [D-CA], Rep. Soto [D-FL], Rep. Emmer [R-MN], Rep. Donalds [R-FL], Rep. Swalwell [D-CA], Rep. Johnson [R-SD-At Large]

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### Overview

The Digital Commodity Exchange Act or [H.R.7614](#) is an updated version of the [H.R.8373 bill](#), which was originally introduced in 2020 by former Rep. Michael Conaway. Based on a previous bill, the DCEA has acted as the starting point for other bills like those mentioned in this report.

The updated bill works to effectively provide the CFTC with majority control for regulating cryptocurrencies, though any digital assets that fall under the definition of securities would remain within the SEC's purview. The main update to this bill concerns [stablecoin providers](#), who will now be able to register as "fixed-value digital commodity operators." Said operators will be expected to retain records concerning how their stablecoins operate and are secured.

One of the main criticisms of this bill is that [it would create loopholes that digital asset-related businesses could exploit](#). Detractors also argue that the bill does not create proper frameworks for regulation and leaves too much leeway to the industry. Still, others view the bill as a giant step toward innovation and a key influence behind more recent legislative proposals.

### Key Features

The DCEA builds upon existing commodities laws and frameworks, which provide an attractive point of reference for regulators who have posited that newer, more extensive crypto laws aren't necessary and that [current frameworks](#) remain relevant. In building upon these frameworks, the bill would expand the jurisdiction of the CFTC to spot markets in digital commodities and would preempt state law. This is notable as it would go further than most proposals in establishing the CFTC's oversight.

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### Digital Commodity Exchange Act of 2022 (DCEA)

The bill would not bar exchanges from operating in the United States without registration, though [a few specific exchanges would be required to register](#) and demonstrate that their crypto could not be easily manipulated. The DCEA would provide a definition for “digital commodity.” This addition is significant, as it would offer compliance teams clearer, more purposeful direction for their programs. Recently proposed bills like Lummis-Gillibrand and the Digital Commodities Consumer Protection Act (DCCPA) build off of the major principles found within H.R.7614.

#### Take-Away

Of the regulations outlined in this report, H.R.7614 has the lightest touch on the industry. Depending on an investor’s feelings toward regulation, this could be seen either as a positive or negative feature of the bill.

The digital asset space evolves quickly, and in the short time since the DCEA was proposed, crypto has become much more prevalent in the public’s schema. This increased interest has forced lawmakers to learn more about blockchain-enabled assets. Given this new understanding, the DCEA may be less favorable to lawmakers and investors alike as it lacks the robustness of Lummis-Gillibrand or the DCCPA.

#### Jeremy’s Take

The most commonly cited mantra regarding digital asset legislation is the “need for regulatory clarity.” While there is an element of truth to that, I think there is a greater need for regulatory efficiency. Perhaps there are some semantics involved and they are asking for similar goals, but I find there is no shortage of regulatory clarity; in some instances, there is too much. The volume of state, federal, and international regulatory requirements make business operations and compliance activities cumbersome, burdensome, and redundant. The DCEA will be a significant reduction of these inefficiencies by preempting state laws that have overlapping industry mandates.

That said, having a clearly defined federal regulatory agency will greatly benefit the efficiency approach. The DCEA is a major step in that direction in identifying the CFTC as the primary regulator for spot market digital asset commodities. This authorization will foster innovation and enable investors and developers to build a viable infrastructure that will help banks, payments providers, and fintech companies improve their customer experience, make settlements faster, reduce costs, and allow for rapid product improvement and customization. This will ultimately lead to

## 04 The Three to Watch: A Deep Dive into Crypto Legislation

### Digital Commodity Exchange Act of 2022 (DCEA)

increased adoption, greater consumer familiarity, deeper end user understanding of the market, and, as a result, increased consumer confidence, security, and protection.

This bill's focus on consumer protection is its greatest strength. Creating a consumer-friendly environment will be paramount to the industry's success, and the DCEA seeks to achieve this through a collaborative, open market approach. This is reflective of the "spectrum" concept related to the digital asset industry. Often, concepts of CeFi and DeFi, or regulation and deregulation, are presented as binary, mutually exclusive concepts. In reality, the market does and will reflect a wide range of applications for all of these concepts. Market participants will engage in products in accordance with their respective risk calculus based on where that product falls on the spectrum. The DCEA will facilitate that range of offerings based on its permissive and voluntary regulatory framework.

It is important that the SEC continues to have its justifiable role in securities regulation. The SEC has been harshly criticized for its enforcement-first approach to digital assets and there certainly are concerns with the agency's tactics. However, the SEC plays an important role in protecting consumers and investors, ensuring fair markets, preventing market information asymmetry, and fostering capital formation.

Some areas of the bill require further development. Greater specificity is required on how an asset will be deemed a security and on the requirements and definitions for what constitutes a broker, dealer, or custodial activity. Similarly, the digital commodity definition must have a functional distinction between a commodity and a security. Also, it must exclude fungible, tangible, decentralized ledgers that do not convey voting rights. It will be important to establish clearer definitions in these areas that are currently too broad to avoid "line drawing exercises" between assets.

Further, while the permissive structure of this bill offers a very beneficial voluntary element, it will be important to guard against the natural tendency to drift towards mandatory registration requirements. Additionally, as the custody considerations are further refined, provisions must be clear and strong to protect and enable lending and staking.

Lastly, while there are many benefits and protections provided in this bill, it is also a great sign that numerous considerations were deliberately excluded. Primarily, the bill does not seek to regulate decentralized platforms. Also, as it relates to stablecoins, the permissive reporting framework shows an encouraging disclosure perspective.

## Lummis-Gillibrand Responsible Financial Innovation Act (RFIA)

**INTRODUCED:** June 7, 2022

**SPONSOR:** Sen. Lummis [R-WY]

**CO-SPONSOR(S):** Sen. Gillibrand [D-NY]

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### Overview

Introduced to the Senate Finance committee, [S.4356](#), often colloquialized as the “Lummis-Gillibrand Bill,” has caught the attention of lawmakers, media outlets, and crypto-detractors alike. The bill aims to provide a more robust, understandable framework for digital asset businesses that allows them to update their compliance programs in a meaningful way. S.4356 is also designed to facilitate innovation in the financial ecosystem and provides guidance for future legislation. An example of this is the establishment of the “Advisory Committee on Financial Innovation,” which would include industry leaders, policy experts and regulators to research the structure of securities and commodities markets in relation to digital assets and make recommendations on how to best delegate oversight.

### Key Features

[S.4356 preserves much of the SEC’s function](#) while expanding the CFTC’s authority. For example, the bill grants the CFTC exclusive jurisdiction over digital assets, but certain exclusions would still remain with the SEC, such as assets that provide debt or equity interest, liquidation rights, interest or dividend payments, and profit or revenue shares. Additionally, the bill divides authority between the SEC and CFTC with respect to “ancillary assets,” generally understood as intangible, fungible assets provided in connection with the purchase or sale of securities through an investment contract. While the CFTC controls these types of assets, the SEC would still have jurisdiction over disclosure requirements imposed on issuers.

Lummis-Gillibrand also provides tax guidance and clarification by better defining who is and is not a “broker.” The new definition would encompass any person who (for consideration) stands ready in the ordinary course of a trade or business to effect sales at the direction of their customers. For income tax purposes, miners and validators would thus not be considered brokers. In this manner, the bill expands the

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### Lummis-Gillibrand Responsible Financial Innovation Act (RFIA)

trading safe harbor for non-citizens to include digital assets as long as the asset is normally traded on an exchange.

Though the bill has generally been welcomed by the crypto community, skeptics fear it lacks the ability to uphold and protect innovation. Specifically, they have called for the bill to include an updated definition of securities in order to clarify, and mitigate, the SEC's reach. Furthermore, though the bill provides better insight into digital asset taxation, it has [failed to raise the reporting threshold for tax gains and losses](#), which must be tallied on a transaction-by-transaction basis and, at \$200, is considered quite low.

#### Take-Away

The importance of S.4356 lies in the simple fact that it has been drafted, let alone introduced. The thoroughness, thoughtfulness, and generally pro-crypto nature of the bill is a stride forward for the industry, offering a look into what comprehensive legislation could look like.

The bill has sparked insightful conversations from both sides of the aisle, and its co-sponsors represent [a possible political middle ground](#) between not only Democrats and Republicans, but also the SEC and CFTC. However, in its current state, the bill is unlikely to pass. Industry leaders know this, and many view it as an opportunity for the private sector, particularly DeFi policy experts, to [voice feedback](#) to help edit the current bill or rewrite a new one entirely.

#### Jeremy's Take

The strength of the RFIA, its comprehensiveness, may prove to be its greatest weakness. The bill has numerous accomplishments for the industry, but its broad scope may not only be difficult to achieve, but also result in a degree of generality that may not be appealing for passage.

Similar to the DCEA, the distinction between securities and commodities and the subsequent authorization of the CFTC over spot markets are huge benefits to the industry.

The bill's approach to stablecoins could greatly facilitate the mass adoption of these tokens and thereby lead to industry growth. While it would be ideal to make greater distinctions between stablecoins and authorize wider use, the industry needs to

## 04 The Three to Watch: A Deep Dive into Crypto Legislation

### Lummis-Gillibrand Responsible Financial Innovation Act (RFIA)

embrace the [consequences of Terra](#) and realize the conservative approach is the most realistic way to deal with a skeptical audience. The RFIA's framework for banks and credit unions to issue stablecoins is an opportunity for the industry to regain the confidence of regulators and the public and will establish a foundation for future growth.

The bill does an exceptional job of leveraging industry guidance and appropriate entities to frame future action on consumer protection, consumer education, financial literacy, financial inclusion, cyber security, and energy consumption. Its nod to reasoned and objective counsel in these areas is highly encouraging and presents an opportunity to grow into effective regulation as lessons are learned from the industry's exposure to oversight.

In this vein, I think the development of a regulatory sandbox is one of the bill's greatest strengths. The joint structure established between state and federal regulators to collaborate with fintech companies and facilitate limited market exposure under regulatory requirements will be instrumental in the growth and learning for both regulatory agencies and individual companies. This environment will further strengthen the relationship between those entities and consumers to drive financial literacy, confidence in the industry, and mass adoption.

There are some areas for improvement, most notably the "crypto burrito" problem. As the current de minimis exemption amount is \$200. The metaphor is that crypto could only be used to buy a burrito, and nothing more expensive, without incurring a taxable event. On the positive side of taxation, the bill provides great benefits by clarifying tax rules, IRS requirements, and tax treatments of different actors, notably that miners and other validators are not brokers for tax purposes. Additionally, the staff from Lummis and Gillibrand have been vocal about their recognition of the "crypto burrito" concern and their willingness to work with the industry to address it.

## Digital Commodities Consumer Protection Act of 2022 (DCCPA)

**INTRODUCED:** Aug. 3, 2022

**SPONSOR:** Sen. Stabenow [D-MI]

**CO-SPONSOR(S):** Sen. Boozman [R-AR], Sen. Booker [D-NJ], Sen. Thune [R-SD]

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### Overview

Introduced by the Senate Agriculture Committee, the [Digital Commodities Consumer Protection Act of 2022](#) proposes stark changes to digital asset regulation. Namely, S.4760 goes further than Lummis-Gillibrand in that it explicitly states that Bitcoin and Ether would fall under the CFTC's regulatory power. In this respect, DCCPA gives close to exclusive jurisdiction to the CFTC to regulate digital commodity trading, except for situations in which they are being used for the purchase or sale of a good or service.

### Key Features

The DCCPA refers to digital commodities as “fungible digital form(s) of personal property that can be possessed and transferred person-to-person without necessary reliance on an intermediary.” The bill goes on to state that “the term ‘digital commodity’ includes property commonly known as cryptocurrency or virtual currency, such as Bitcoin and Ether.” In this way, the bill is achieving two goals: First, it provides a clear definition of “digital commodity,” something the industry has long asked for. Second, it designates most cryptocurrencies as falling under this definition.

DCCPA would also expand the CFTC's oversight to include spot markets for non-securities exchanges, better define cybersecurity standards for digital asset intermediaries, and outline the disclosure and registration requirements of digital commodity brokers, which would be similar to those in traditional finance. However, perhaps the most notable change would be the requirement for digital commodity organizations to register with the CFTC, which would enable regulators to impose fees on these platforms. Until this bill, the CFTC only had enforcement jurisdiction, not registration jurisdiction.

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#### Take-Away

The lines between the CFTC's jurisdiction and that of the SEC, while more clearly defined, do leave room for interpretation. For example, [altcoins are not explicitly mentioned in the bill](#), and it's uncertain how DEXs and NFTs would be covered under its proposed policies. Furthermore, [disagreements concerning these newly proposed definitions continue](#), and the bill's fate remains in limbo as legislators attempt to reach a consensus.

#### Jeremy's Take

As with the DCEA, the definition provided for digital commodities could be considered too narrow, and the divisions between the CFTC and SEC authorities are not definitive enough. Without specificity in authorities, legislation that allows continued regulatory ambiguity about who is the true regulatory agency will not significantly improve current circumstances.

For example, the bill expressly excludes securities from the digital commodity definition and doesn't address the current definition of securities in any way. It fails to provide a definition of a digital asset security and the case-by-case determination process it establishes is not scalable for future innovation. This leaves the Howey test in place, allowing the SEC to continue its current approach despite the bill's designation of the CFTC as the primary regulator. Additionally, there is a need for greater detail and clarity regarding the definition of a digital commodity trading facility versus brokers and dealers.

This bill unfortunately also does not provide enough protection to decentralized platforms in general and provides potential avenues for all digital commodities platforms to be regulated entities. As such, under this bill the regulatory pendulum could swing too far towards over-regulation and could potentially stifle innovation, while damaging the soul and lifeblood of the industry. Specifically, the bill's definition of trading facilities is too broad, relying on existing language, and could be interpreted to include all decentralized exchanges. Similarly, the bill's definition of a broker/dealer could be interpreted to capture all liquidity providers, meaning they would need full KYC platforms and be subject to regulatory regimes.

Along with the other bills, the DCCPA's identification of the CFTC, although allowing for interpretation, is a welcome factor. Despite this benefit, the bill does provide a concerning amount of authority to the CFTC. Specifically, it allows the CFTC to regulate non-US transactions and play a role in the surveillance of all digital commodity



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platforms under The Bank Secrecy Act (BSA) authorization. In order to ensure a limit on these authorities, it would be preferable to limit discretion for CFTC rule-making, narrow the scope of covered actions and actors, and create “carve-outs” for market participants below certain thresholds. These lower-level actors could be covered by notice and disclosure practices instead of outright regulatory oversight. Also, protections could be provided for intermediaries who trade a digital commodity that is later determined to be a security, so long as they are properly registered and acting in accordance with the bill.

## 05 Closing Thoughts

Encapsulating the regulation conversation is a massive task. As of this writing, there have been [50 bills introduced in Congress](#) that affect the digital asset and blockchain industries. There are 53 different state-level regulatory frameworks if you include Puerto Rico, the District of Columbia, and the Virgin Islands. The intent of this report was not to pick legislative winners, predict the future, or poke holes in the laudable efforts to achieve comprehensive, sound, and supportive law. Rather, the report strives to be a resource to those searching for connective tissue between various legislative efforts, a tool for market participants to better understand the operating environment, and a humble suggestion to the legislative minds crafting much-needed guidance for the industry.

The path to legislative efficiency and a finalized bill still have a long journey ahead. Opportunities to ensure the final product meets all objectives start with deeper relationships between the industry and legislators. We at Prime Trust hope to continue to establish and foster these connections. Within that context, we opine that regulatory sandboxes present an unmatched potential for exploring market implementation under close supervision and protective guardrails and hope to see them grow in adoption and implementation.

It must be recognized that this report was drafted in the heart of the 2022 crypto winter, at the time of the publication of the [White House Digital Assets Framework](#) and the hundreds of pages of supplemental reports to that executive order. All of these have, and will continue to have, a deep impact on the industry and the regulatory frameworks discussed in this report. There is no doubt that the macroeconomic factors and the Biden administration's approach to the industry will shape its makeup now and for years to come. Just as those reports and frameworks were undoubtedly formed by the events that occurred immediately before their publication – issues with [stablecoins](#), [the Merge](#), and more – so too will they impact the legislative efforts discussed here. As with the rest of the industry, these bills will change, evolve, and be shaped quickly by a great number of factors.

A significant factor in the process of change will be the social protocol layer. Beyond any legal or technological advancement, the industry will need to come to a determination about where on the collaborative spectrum it wants to be. In the wake of the above-mentioned government reports, there are already calls for a “war” against

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centralized institutions, “the establishment,” or regulatory engagement. Will the industry decide to work with the government or against it? Will it prioritize profit or decentralization? Collaboration or combat?

As stated earlier, it is our belief that the core ideas of the digital asset space don’t have to be mutually exclusive from those of traditional finance. We feel it is possible to have harmony between privacy and identity, between decentralization and regulation. There are vast opportunities within the technology to achieve AML, KYC, and BSA objectives without intrusion. Regtech, Supertech, and embedded supervision all provide exceptional potential for such goals.

The fact that the whole of government responded to the Digital Assets Framework confirms the strength of this industry. While many focus on the constrictive and limiting nature of the reports associated with the framework, we feel it is important to focus on the areas that enable the industry and present opportunities. We look forward to working with those constructs and agencies. Most notably, the [Department of Commerce](#) will “help cutting-edge U.S. financial technology and digital asset firms find a foothold in global markets for their products” and “will examine establishing a forum to convene federal agencies, industry, academics, and civil society to exchange knowledge and ideas that could inform federal regulation, standards, coordinating activities, technical assistance, and research support.” Prime Trust is prepared to work with lawmakers and integrate upcoming regulatory guidance in order to create a better blockchain-enabled economy.

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