House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

House Committee on Agriculture
1301 Longworth House Office Building
Washington, DC 20515

May 10, 2023

Dear Chairs McHenry and Thompson, Ranking Members Waters and Scott, Subcommittee Chairs Hill and Johnson, and Subcommittee Ranking Members Lynch and Caraveo,

We write today to provide a statement for the record for today's joint subcommittee hearing on digital assets entitled, "The Future of Digital Assets: Closing the Regulatory Gaps in the Digital Asset Ecosystem."

While we appreciate the efforts by both committees to create opportunities to discuss the need for robust regulatory oversight of and accountability for the crypto industry, we are concerned that the assumptions under-girding today's hearing are off target.

The resolution put before the committee today, "H. Res.________, Resolution Expressing Support for Blockchain Technology and Digital Assets," is a prime example; we would contest most of the assertions found within the resolution. In particular, those elements which assert that digital assets and blockchain will definitively be the building blocks of a new internet that improves lives, enhances transparency, and provide safeguards for consumers; that the SEC's current approach to crypto regulation is not 'fit for purpose'; and that Congress should enact a functional regulatory framework tailored to digital assets.

This rose-colored view of the digital asset industry and its purported potential stands in stark contrast to the reality of the industry today. It is a space where most activity is centered around speculative investment, using extractive business models, and one that is rife with criminal and predatory financial activity, with many players large and small facing enforcement actions and resisting compliance with basic financial regulatory requirements.

Many, perhaps most, consumers exposed to crypto have suffered losses.[1] Public skepticism of the industry is at its height. The industry struggles to highlight use cases that are viable and/or scalable, and consistently shifts the rationale for crypto as these use cases fail to launch. Meanwhile, actions by

[1] Raphael Auer, Giulio Cornelli, Sebastian Doerr, Jon Frost and Leonardo Gambacorta, Crypto Trading and Bitcoin Prices: Evidence from a New Database of Retail Adoption (Basel, BIS: 2022), accessed January 30, 2023, https://www.bis.org/publ/work1049.pdf.

federal regulators[2] – using existing regulatory tools and frameworks – while not perfect, in large part helped protect many more investors and consumers, who would have been at risk had they failed to act.

Despite these realities, the resolution before the committee today represents unquestioning support for the industry's claims regarding innovation and barely considers whether its proposed regulatory structure will truly provide consumers with adequate protections and recourse.

We hope to provide more detailed analysis in the future on how existing regulatory frameworks can be applied to crypto asset markets and market participants. For the moment, we urge committee members to oppose the resolution being considered today. Additionally, we offer the following broad principles for crypto regulation and urge policymakers to use them as a starting point for future discussions on legislation that seeks to address regulatory oversight of the crypto industry.

Principles for Crypto Regulation

1) There are widespread and systemic problems found throughout the crypto industry, which cannot be blamed on a few bad actors alone.

The crypto industry claims that by deploying a blend of cryptography and distributed ledger technologies, tech firms can create and offer digital asset-based products and services to consumers with little or no reliance on either regulatory agencies or traditional financial institutions. The logic is that this use of these technologies to 'disrupt' the financial sector will bring new opportunities and benefits. On the investment side, crypto has been marketed as a tool for wealth creation that lowers the barriers to entry for individuals often marginalized by the traditional financial system. On the consumer side, the industry claims crypto can support payment and banking services that are faster, cheaper, more reliable, and more secure than existing systems.

The main problem with these claims is that they generally don't match the reality of crypto markets as they largely operate today. Instead, crypto markets are largely vehicles for speculative investment, appear rife with scams and fraud, reward and incentivize predatory business models, and due to lack of adequate regulation, many crypto market participants lack the basic types of consumer and investor protection measures found in traditional finance.

- The FBI's Internet Crime Complaint Center (IC3), which receives reports of internet crime and analyzes related data, found that in 2022 cryptocurrency-related investment fraud reported to the FBI amounted to $2.57 billion in 2022, an increase of a whopping 183% from the previous year ($907 million), and amounted to more than **two-thirds of all internet investment scam losses reported in 2022** (a total of $3.31 billion), and more than **one-fifth of all reported online fraud losses** ($10.3 billion).[3]
- Meanwhile, according to crypto market data analysis, consumers and investors lost the equivalent of **$7.8 billion dollars to cryptocurrency scams alone in 2021**, up 82% from 2020. This same data

[2] See, for example, a record of SEC enforcement actions in footnote 15 below; see also the Fed/OCC/FDCI January 2023 statement on crypto asset risks: https://www.occ.treas.gov/news-issuances/bulletins/2023/bulletin-2023-1.html
[3] https://www.ic3.gov/Media/PDF/AnnualReport/2022_IC3Report.pdf

reported that the equivalent of $3.2 billion in crypto assets were lost to theft in 2021, a staggering **516% increase** compared to 2020.[4] These figures have only increased in 2022.

- Furthermore, Americans reported a record $1 billion lost to cryptocurrency scams to the Federal Trade Commission (FTC) in 2021, which is 60 times higher than the amount lost in 2018. Per the data, crypto-related scams accounted **for one-quarter of all dollars lost to fraud reported to FTC during this period, more than any other type of scam.**[5]
- Finally, for the year 2021 the Better Business Bureau (BBB) ranked cryptocurrency scams as the second riskiest type of scam reported to the bureau. Although they only made up 1.9% of scams reported to the BBB, the median victim lost $1,200, and 66% of people targeted by this scam reported losing money.[6]

These numbers are shocking on their own, but even they don't tell the whole story. To begin with, each figure above is based largely on data gathered from individuals self-reporting their losses. Additionally, the FTC and other authorities estimate that **less than 10% of all fraud victims report scams to regulators**, **entities like the BBB or law enforcement**.[7] Thus, we may vastly underestimate how much consumers and investors actually lose each year to crypto-related scams and fraud.

Furthermore, crypto can be employed in scams or fraud in several ways. It can serve as the means of payment for another crime (such as ransomware attacks), as an asset that is itself stolen (through hacks or physical theft of cold wallets), as a ruse for an related affinity fraud (such as romance scams), or as the core feature of a fraud scheme (e.g., such those investors who had assets in custody with FTX, only to find their deposits allegedly stolen by the platform's operators). These overlapping schemes, fueled by crypto's unique attributes (such as pseudonymity, wash trading, etc.) as well as lack of adequate regulatory oversight, suggest the footprint of harm is even larger than these figures indicate.

Lastly, these figures do not fully capture the loss of crypto assets through crypto's infamous volatility, instability, and significant market failures. We have some indication of the volume of that loss: at its height in early 2022, the market capitalization of crypto markets was estimated to be more than $3 trillion in value. Subsequent losses in value tied to the failure of Terra, Celsius, Voyager, FTX, crypto hedge fund 3AC and other crypto platforms are estimated to be more than $2 trillion.[8] And, the failure of additional firms this year seems likely as well.

Anyone not inundated with marketing and lobbying efforts by the crypto industry should see the examples above as a small illustration of the industry's thirteen-year track record – one which has done much more harm than good – and should begin with that takeaway in mind when crafting policy responses.

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[4] https://go.chainalysis.com/2022-Crypto-Crime-Report.html
[5] https://www.ftc.gov/news-events/data-visualizations/data-spotlight/2022/06/reports-show-scammers-cashing-crypto-craze
[6] https://bbbfoundation.images.worldnow.com/library/259c7333-0fb3-4bc0-a059-4b116594c473.pdf
[7] *Ibid.*
[8] https://www.cnbc.com/2022/12/23/bitcoin-lost-over-60-percent-of-its-value-in-2022.html. Note: estimates of crypto market values, market capitalization, etc., vary and are not well defined.

2) Congress should prioritize protecting consumers, investors, communities, and financial stability over promises of innovation from a technology that has yet to deliver on its promises, or provide lasting, widespread, scalable use cases.

Much has been made of Americans' interest in cryptocurrency. An NBC News poll from March 2022 found that one in five adults in America report having invested in, traded, or used cryptocurrency. and Subsequent polls have also captured similar figures, often noting that African American or Latinx consumers report having engaged in the crypto markets in numbers greater than their white counterparts.[9]

Yet, a poll conducted just months later by Pew Research Center in August 2022 showed that 46% of poll respondents reported their crypto investments performed worse than they expected – and this was before collapse of FTX and other platforms.[10] For example, one market research firm estimated that an investor that bought $1,000 worth of Bitcoin (BTC) just after the flurry crypto related Super Bowl ads in February 2022 would own $513.22 worth of BTC a year later – a loss of 48.7%.[11] Recent price increases in BTC notwithstanding, this example underscores the volatility and risk involved in crypto investing – risk that traditionally wealthy investors might be able to weather, but which is borne much harder by investors with low income and/or are from communities of color--who are more likely to lack wealth or other resources to absorb such losses.

Moreover, crypto platforms have largely failed to demonstrate lasting value in the payments space. Most crypto activity is focused on speculative investment activities. Crypto-derived payment platforms have struggled to demonstrate viable mainstream use. Stablecoins, which were initially created with the intention of being used to facilitate crypto payments outside crypto platforms, are still largely used for speculative investment, and rely on fiat currency and legacy financial institutions to facilitate off-chain transactions for goods and services. Stablecoins have also demonstrated real fragility; famously, in the case of the collapse of Terra, the algorithmic stablecoin whose collapse (and likely fraud) precipitated the larger collapse of crypto markets beginning in May 2022. But even stablecoins perceived as more 'stable' such as Circle and Tether have faced so-called 'de-pegging' events, which at a minimum suggest stablecoins operate more in a manner like loosely regulated money market funds than as an actual "currency" or "bank deposits."

Meanwhile, crypto platforms themselves often charge high fees for buying, selling, or exchanging crypto on or off platforms. The famed speed of cryptocurrency's clearing and settling abilities is belied by the fact that the consensus mechanisms used to verify blockchain transactions are infamously slow – processing a very small number of transactions per second, especially in comparison to existing

[9] https://www.cnbc.com/2022/03/31/cryptocurrency-news-21percent-of-adults-have-traded-or-used-crypto-nbc-poll-shows.html

[10] https://www.pewresearch.org/fact-tank/2022/08/23/46-of-americans-who-have-invested-in-cryptocurrency-say-its-done-worse-than-expected/

[11] https://www.benzinga.com/markets/cryptocurrency/23/02/30880044/if-you-invested-1-000-in-bitcoin-after-super-bowl-lvi-aka-the-crypto-bowl-heres-how-much-y

payments systems, which can process tens thousands of transactions per second.[12] Attempts to speed up these processes – by creating extra layers of code on top of an existing blockchain, or by creating off-chain software solutions – create significant security risks for individuals engaging in such transactions, and also defeat the purpose of using the blockchain's 'immutable' properties to provide security for such transactions.[13]

Blockchain proponents often argue that the technology is still in the "early days" of its development. This claim is used either offensively – to suggest that the technology offers significant unrealized potential benefits that will emerge soon – or defensively, to explain why the consistent failures of blockchain-based technology are not indicative of its enduring limitations but constitute "growing pains" that are a natural and necessary phase in the technology's development.

A well-known essay by Molly White, a software programmer and noted critic of crypto assets and blockchain, entitled, "It's not still the early days" lays out the basics of a rebuttal to this argument.[14] In summary, White points out that Bitcoin was launched in 2009; Ethereum in 2015. Many first generation and second generation blockchain applications are anywhere from 7-13 years old. During that same time range, numerous other technological products, and platforms (some new, some established) have been further developed and have demonstrated utility, scalability, and viability more rapidly. These products include major social media platforms, online ride-sharing apps and platforms, new computer processors, new database programs, programming languages, operating systems, payment apps, and more.

Given the degree of doubt and uncertainty regarding the use case of crypto as illustrated here, policymakers should not pursue policy proposals that elevate dubious claims regarding financial innovation at the expense of consumer and sound consumer protection.

3) **Policy makers should take a tech agnostic stance on crypto regulation, not pursue deregulatory carve-outs in favor of an industry that hasn't delivered on its promise of innovation.**

Fintech firms – not just crypto – often claim that the new technological innovations they offer require a soft touch from regulatory agencies to avoid stifling these new supposedly transformative offerings. Yet, in the experience of consumer advocacy organizations like AFR, the innovation that is being offered by these firms is all too often a form of regulatory arbitrage, rather than a product that offers meaningful benefit to consumers.

As such, we believe policymakers should treat regulation of crypto assets, actors, and activities as they would other regulated entities in the financial services sector. They should not create new, carved-out regulatory frameworks for crypto based on dubious industry claims that current rules aren't 'fit for purpose.'

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[12] https://crypto.com/university/blockchain-scalability#:~:text=The%20Transaction%20Speed%20of%20Cryptocurrencies&text=While%20Visa%20can%20process%20up,capability%20to%20achieve%20mass%20adoption.

[13] https://coingeek.com/the-unsecure-lightning-network-as-btc-layer-2-scaling-protocol/#:~:text=Inefficiency%20and%20noncompliance%20with%20the,is%20the%20pretense%20and%20untruth.

[14] https://blog.mollywhite.net/its-not-still-the-early-days/

Real innovation benefits from sound and robust regulatory standards, which rewards innovators who can meet such standards. Private sector firms have a role in producing products and services they believe can provide real value while generating returns for firms and investors. Regulators have a different role: ensuring that such firms, products, and services operate in a way that avoids harming consumers, investors, communities, and markets while providing real and lasting benefits to the same.

4) **Congress should bolster regulators' existing authority and capacity to oversee the digital assets industry, instead of pointing fingers. Any new policy efforts should first 'do no harm' to existing regulatory frameworks by creating loopholes or undermining regulators' existing authorities.**

Traditional financial regulatory frameworks require a set of minimum standards and protections for firms to operate. On the investing side, exchanges, broker-dealers, and issuers of securities must register with regulators and provide significant information about the nature of their business or product offering, managerial structure and composition, financial statements, potential conflicts of interest, and more. Once registered, these actors must provide disclosures on an ongoing basis to investors and regulators and must abide by a host of anti-fraud and market manipulation rules, as well as rules intended to ensure that such actors are operating in the best interests of their clients – such as fiduciary duty or best execution rules. Often, such standards require firms to disaggregate their operations to avoid perpetuating conflicts of interest and mitigate the possibility of insider trading or front running.

On the banking and payments side, banking and consumer financial protection rules require a host of regulatory measures, prudential supervision and examinations, anti-money laundering compliance standards, capital requirements, fair lending disclosures and policies, payment dispute resolution requirements, and many other measures that ensure the companies and actors in this space have some minimum standard of oversight and that depositors have both protections and recourse should plans go awry.

None of these regimes are perfect; regulators can still fail to adequately enforce these standards and bad actors are still able to skirt, evade or undermine them. However, they represent over a century of lessons learned from past financial crises and schemes and serve as a reliable means of preventing financial risk and harm and protecting consumers, investors, and markets when such harm occurs.

Unfortunately, little of the crypto industry is currently held to or meets even these standards. Most crypto firms register at the state level under money transmitter or money service business licensing regimes that, with some exceptions, usually do not offer the same level of consumer and investor protections as outlined above. Many crypto platforms are structured such that their services are aggregated, with the platforms providing their clients asset custody services, brokering, market making, and more – conditions which all too often can lead to exchanges misusing or abusing these overlapping roles to benefit at their clients' expense. Crypto firms have shown difficulty in providing safe and secure custody of their client's assets. These assets are generally not protected by either deposit insurance programs or securities investor protection programs.

Additionally, many firms have failed to segregate such assets to protect them in the event of insolvency. As a result, many of the clients of firms such as Celsius, Voyager and FTX are all ensnared in lengthy and complex bankruptcy proceedings, waiting in the back of the line behind other creditors with little hope

of reclaiming the full value of their assets. Meanwhile, stablecoin issuers who claim that the coins they issue are fully collateralized, redeemable in full on demand, have often either failed to meet these standards or have operated under a cloud of questions and uncertainty about the quality and quantity of their collateral and their ability to honor on-demand redemption agreements.

In response to this litany of basic failures, federal regulators (as well as some state regulators) have taken a number of recent actions to respond to the crypto crash and draw bright lines regarding the risks that crypto assets pose to consumers and investors. In January 2023, the Fed, OCC and FDIC issued a “Joint Statement on Crypto-Asset Risks to Banking Organizations.”[15] The statement laid out in clear detail how the unique properties and risks posed by crypto assets may be incompatible with the safety and soundness standards banking institutions must meet. Meanwhile, the Securities and Exchange Commission, after making many public statements indicating their clear view that most crypto assets are securities and those offering them should seek registration with the SEC, has ramped up enforcement of traditional securities laws. The SEC’s legal track record in this regard is sound – as of January 18, 2023, the SEC has brought 127 crypto-related enforcement actions without losing a single case.[16]

There are many other examples, but the pattern is clear – existing banking, securities and consumer protection regulations are relevant to crypto assets, activities, and actors, and should be applied consistently and robustly to provide consumers and investors with comparable levels of protection. These requirements are not sophisticated, esoteric regulatory mandates – they are bedrock elements of financial regulation. As the mantra goes, financial firms offering the same types of services or activities, with the same risks, should be subject to the same rules and same supervision.

Accordingly, policymakers should defend the regulatory tools, frameworks and authorities that currently exist and are best suited to provide consumers and investors with appropriate protections. They should avoid policy proposals that undermine existing regulatory frameworks for financial actors and markets and put all of us at greater risk.

We hope the principles and supporting content shared here can contribute to a reset or at the very least help refocus the objectives of these Committees’ policy discussions towards proposals that will build upon the existing tools and methods regulators have to protect consumers, investors, markets and communities. We would be happy to discuss how best to do this in greater detail with members of the Committee and their staff as well.

Thank you.

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[15] https://www.fdic.gov/news/press-releases/2023/pr23002a.pdf

[16] Cornerstone Research, “SEC Tightens Cryptocurrency Enforcement,” January 18, 2023, https://www.cornerstone.com/insights/press-releases/sec-tightens-cryptocurrency-enforcement/; John Reed Stark, “Why ‘SEC Regulation by Enforcement’ is a Bogus Big Crypto Catchphrase,” LinkedIn, January 23, 2023. https://www.linkedin.com/pulse/why-sec-regulation-enforcement-bogus-big-crypto-john-reed-stark/?published=t.