FRIED FRANK

To Our Clients and Friends
Memorandum

June 10, 2022

The Digital Assets Bill: Lummis-Gillibrand Responsible Financial Innovation Act

On Monday, June 6, 2022, U.S. Senators Cynthia Lummis (R-WY) and Kirsten Gillibrand (D-NY) published a draft of their jointly sponsored Responsible Financial Innovation Act ("**RFIA**"), which would establish a comprehensive federal system of regulation for digital assets.[1] As a legal matter, the RFIA is notable for (i) providing a definition of "digital assets" and of various types of digital assets (*e.g.*, virtual currencies, payment stablecoins, ancillary assets); (ii) defining the regulatory treatment of each of these types of digital assets (whether subject to banking, securities or commodities regulation); (iii) addressing other significant related regulatory schemes (tax, cybersecurity and AML); and (iv) providing a very workable path for the development of digital asset businesses and the distribution of digital assets. As a political matter, it is notable for the participation of Senator Gillibrand, a Democratic Senator effectively espousing a position — *i.e.*, active support for the digital asset industry — that is very much in contrast to the positions taken by other Democratic Senators (particularly Senator Elizabeth Warren (D-MA) and Senator Sherrod Brown (D-PA)). In the same vein, the bill is also notable for its rejection of the policy positions taken by Securities and Exchange Commission ("**SEC**") Chair Gary Gensler (D) and its consistency with positions taken by SEC Commissioner Hester Peirce (R).

This memorandum analyzes the following issues as raised in the RFIA: (i) the definition of "digital assets" and the types of digital assets; (ii) the RFIA's division of authority between the SEC and the Commodity Futures Trading Commission ("**CFTC**") as to "ancillary assets" (as detailed further below, a new regulatory category of digital assets that under current law might be a "security," but that would not be regulated as a security under the RFIA); (iii) the RFIA's disclosure requirements, and other requirements imposed on the distribution and sale of digital assets; (iv) a number of CFTC, securities, and banking law issues; (v) the taxation of digital assets; and (vi) an assortment of other regulatory issues (AML, cybersecurity and sanctions). Finally, Section VII of the memorandum discusses the political implications of the RFIA. The Appendix to the memorandum compares certain of the requirements that the RFIA would impose on digital assets deemed not to be securities with the proposed treatment of such assets formerly put forth by SEC Commissioner Peirce.[2]

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[1]   The Responsible Financial Innovation Act, S. 4356, 117th Congress (2022). Note that where this memorandum cites to the RFIA, all citations are to the pagination in the bill's PDF, rather than the specific sections of the RFIA itself.

[2]   SEC Commissioner Hester Peirce, Public Statement, Token Safe Harbor Proposal 2.0 (April 13, 2021). Commissioner Peirce initially proposed the token safe harbor in February 2020 and revised it after receiving feedback from the cryptocurrency community, securities lawyers and the public. *See* SEC Commissioner Hester

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I. Definitions

The RFIA provides a broad definition of digital assets as well as definitions of different types of digital assets,[3] as set out below:

- *Digital asset*: essentially any asset on the blockchain that confers economic, proprietary or access rights or powers.

- *Ancillary asset*: an intangible, fungible asset that is sold "in connection with the purchase and sale of a security through a scheme that constitutes an investment contract" and that **does not provide rights** in a business entity similar to debt or equity issued by that entity, a share of the revenue or profits of that entity, or a right to any liquidation proceeds from the entity.[4]

- *Payment Stablecoins*: a digital asset that is redeemable on a one-for-one basis with a fiat currency (not limited to U.S. dollars), issued by a business entity, backed by financial assets (other than digital assets), and intended to be used as a medium of exchange or store of value.[5]

- *Virtual currency*: a digital asset that is intended to be used as money but is not backed by an underlying financial asset (other than digital assets).

II. Division of Authority between the SEC and the CFTC

1. *Ancillary Assets and the Howey Test*. The most important aspect of the RFIA is the definition of "*ancillary asset*" — an asset that is defined **not** to be a "security," but the issuers of which will nonetheless be subject to **limited** obligations to provide disclosures to the SEC and the public, as further described in Section III of this memorandum below. A digital asset that qualifies as an "ancillary asset" would be treated as a "commodity," and thus would not be subject to the full measure of requirements under the Securities Act of 1933 in connection with the distribution of the asset, nor would the issuer of the ancillary asset be subject thereby to registration under the Securities Exchange Act of 1934.

   According to the statement accompanying the RFIA, the definition of ancillary asset incorporates and is consistent with the "Howey Test"; *i.e.,* assets that would be securities under the Howey Test would not be ancillary assets under the RFIA. In fact, the Howey Test, as applied by the current SEC, is very broad and would include many "ancillary assets" that would not be treated as securities by the RFIA.[6] Essentially, the SEC currently interprets the Howey Test to treat as a

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Peirce Offers Update to Proposed Safe Harbor for Digital Tokens, Fʀɪᴇᴅ Fʀᴀɴᴋ Rᴇɢᴜʟᴀᴛᴏʀʏ Iɴᴛᴇʟʟɪɢᴇɴᴄᴇ (April 14, 2021).

[3]   The RFIA also defines a number of other terms such as decentralized autonomous organizations ("DAOs"), digital asset intermediary, distributed ledger technology and smart contract.

[4]   It is the second part of this definition that is key. The first part of the definition, that the ancillary asset must be sold in connection with an investment contract, is a condition that has appeared in other bills but seems needlessly limiting and should, we believe, be eliminated from any adopted version of the bill.

[5]   RFIA at 5.

[6]   SEC Chair Gary Gensler has repeatedly stated "most crypto tokens are investment contracts under the Howey Test," and thus securities for purposes of the U.S. securities laws. For a discussion of the current state of the law and application of the *Howey* and *Forman* tests, see our memorandum The Securities Law Treatment of

"security" **any fungible asset** that an investor purchases with the hope or expectation of monetary gain, including through resale of the asset. The RFIA definition is much more limited: a digital asset is deemed to be a security **only** if the return on the asset derives from payments that are to be made by the issuer; *e.g.*, interest on a loan, dividends, or a right to profit, revenues or distributions in the issuer's insolvency.

By way of further example, the SEC currently treats a digital asset as a security if there are individuals providing essential managerial efforts that impact the potential success or profitability of the digital asset.[7] In notable contrast, the RFIA starts with an assumption that the holders of the relevant digital assets may benefit from entrepreneurial and managerial efforts of others, but does not treat that fact as determinative of the asset's status as a security. Instead, the RFIA distinguishes ancillary assets from securities on the basis that such assets (1) are not debt or equity, (2) do not provide liquidation rights, (3) do not create an entitlement to interest or dividend payments and (4) do not create a financial interest in the issuing entity.[8] Neither the managerial efforts of others nor the potential for profits by resale of the digital asset are dispositive to the determination of whether the digital asset is a security.

2. *CFTC Authority Over Ancillary Assets.* The CFTC is given "exclusive jurisdiction" over transactions in digital assets, including the newly created category of ancillary assets, subject to carve-outs for (i) transactions settling within two business days and (ii) digital assets that are not fungible or that represent digital collectibles or other unique assets.[9] Further, the CFTC would not have authority over the custodial activities of entities that are otherwise governmentally regulated; *e.g.*, broker-dealers and banks.

The exclusive jurisdiction granted to the CFTC by the RFIA is likely broader than is really intended; read literally, it would include exclusive jurisdiction even over digital assets that are securities under the RFIA. Even leaving that issue aside, the RFIA's grant of exclusive jurisdiction to the CFTC is broader in scope than the CFTC's authority over other commodities, in that it generally includes all sales of digital assets with a delivery date of over two days, including those expected to result in physical delivery (legal ownership). As the CFTC is given this broad and exclusive jurisdiction, the jurisdiction of the SEC and the various States is inherently diminished.

III. Requirements Applicable to the Distribution of Ancillary Assets

1. *Disclosures*

Leaving aside the potential confusion arising from the definition of ancillary asset, which contemplates such asset being "offered, sold, or otherwise provided to a person *in connection*

Utility Tokens (or Why it is Past Time for the SEC to Engage with the Hard Issues), FRIED FRANK REGULATORY INTELLIGENCE (Jan. 11, 2022).

[7] *See* Strategic Hub for Innovation and Financial Technology, Securities and Exchange Commission, Framework for "Investment Contract" Analysis of Digital Assets (last modified April 3, 2019)

[8] RFIA at 13.

[9] RFIA at 23.

with the purchase and sale of a security through an arrangement or scheme that constitutes an investment contract,"[10] the RFIA clearly establishes the initial and ongoing disclosure obligations imposed upon issuers of ancillary assets.[11] Consistent with the spirit of the RFIA supporting the development of digital assets, the disclosure obligations are not imposed immediately upon any issuer of an ancillary asset, but instead are triggered based upon (1) the average daily aggregate value of all ancillary assets offered, sold or provided by the issuer being greater than $5 million and (2) the issuer (or a greater than 10% owner) engaging in entrepreneurial or managerial efforts that primarily determine the value of such ancillary asset.[12] Provided that these triggers continue to be met (and that the issuer has not terminated disclosures, as detailed below), the issuer would remain subject to ongoing semi-annual disclosure requirements. Required disclosures include information both as to the issuer itself, which are substantial but less burdensome than those imposed upon issuers of equity securities, and as to the ancillary asset.[13] As to the issuer, the disclosures focus on the issuer and its personnel generally but require more detail as to the issuer's activities in support of the relevant ancillary asset.[14] As to the ancillary

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[10] *See* RFIA at 13 (emphasis added). The press releases, speeches and industry discussion linked to the RFIA have presented the ancillary asset concept as encompassing a large number of digital assets that do not contemplate the sale of such "ancillary assets" as being necessarily conducted in connection with the offering of a security. While we understand that this particular phrasing may be intended to capture tokens issued under a token warrant sold in connection with a simple agreement for future equity ("**SAFE**") or similar offering common in the digital asset space, the proposed statutory definition should likely be broadened to capture the full range of intended products.

[11] It is not clear from the RFIA how situations involving an issuer of an ancillary asset that fails to meet all requirements would be resolved. While the RFIA does distinguish treatment of ancillary assets for purposes of the issuer (Section 41(b)(4)(A)) from treatment for all other non-issuer (or issuer controlled) persons (Section 41(b)(4)(B)), with a provision to account for potential recharacterization by courts, the process by which a recharacterization would occur and consequences for failing to satisfy obligations linked to ancillary asset status are not clear. Indeed, Section 41(g) provides that "[i]f an issuer fails to comply with a provision of this section, an ancillary asset provided by the issuer shall not be presumed to be a security under a provision of law described in subsection (b)(4)(A), solely because of such failure." Were disclosures to be not provided or inaccurate, or were the economics to change in a certain way, would the digital asset be recharacterized as a security? How and when would such recharacterization occur? What regulator or entity would perform the requisite analysis? Would the SEC be given notice by the CTFC or would the onus to provide notification fall upon the issuer?

[12] RFIA at 14. Initially, the test looks to the 180-day period immediately succeeding the date of first offer, sale or provision of the ancillary asset, while the test for ongoing disclosures looks to the immediately preceding fiscal year. These tests look to the value in spot markets. It is somewhat interesting that the initial test looks to "the average daily aggregate value of all ancillary assets offered, sold, or otherwise provided by the issuer in relation to the offer, sale, or provision *of the security* in all spot markets open to the public in the United States," [emphasis added] while the test for ongoing reporting obligations looks to "the average daily aggregate value of all trading in the ancillary asset in all spot markets open to the public in the United States." While this seems to further reinforce the idea that ancillary assets are initially linked to a security, before taking on a status of their own, it is not clear what this distinction is intended to accomplish.

[13] A fulsome review of these disclosures in comparison with those required by Commissioner Peirce's proposal is provided in Appendix 1.

[14] *See* RFIA at 16-17. These disclosures include information regarding other similar products or technologies being offered or developed by such issuer; activities the issuer has taken and projects to take regarding promotion of the ancillary asset, including costs of such activities and existing funding levels; backgrounds of the board, management and key employees of the issuer; descriptions of assets, liabilities and legal proceedings; general risk factors; and a statement as to the issuer's status as a going concern.

asset, the required disclosures relate to the asset's design, use, offering and market-related considerations.[15]

The RFIA permits an issuer to file a certification that the average daily aggregate value of all trading in an ancillary asset in spot markets during the prior 12-month period was under $5 million or that, during the 12-month period, neither the applicable issuer, nor any entity controlled by the issuer, engaged in entrepreneurial or managerial efforts that primarily determined the value of the ancillary asset.[16] Upon filing such certification, if not denied by the SEC, the obligations of the issuer to make the above disclosure would terminate 90 days after filing (or a shorter period if approved by the SEC).

2. *Consumer Protection*

In addition to the issuer focused disclosures discussed above, the RFIA establishes notice requirements for persons (or protocols) providing digital asset services before entering into certain transactions. Digital asset service providers would be required to give notice to customers regarding source code changes, asset segregation, bankruptcy treatment of the asset, fees, and dispute resolution procedures.[17] The RFIA also establishes disclosures for digital asset lending arrangements and disclosures specific to arrangements contemplating rehypothecation of customer digital assets.[18]

The RFIA also requires that customers and providers of digital asset services agree upon the source code version used for the relevant digital assets and that customers and persons providing digital asset services agree on terms of settlement finality for all transactions, including considering the legal and operational conditions as to transfer.[19]

IV. CFTC, Broker-Dealer and Banking Issues

1. *Custody by FCMs.* The CFTC is required to adopt rules regarding the holding of digital assets by futures commission merchants ("**FCMs**"). The requirements that the CFTC must adopt generally track the CFTC custodial rules that apply to margin for listed futures. Interestingly, the CFTC would allow an FCM to hold digital assets with a number of other types of regulated entities, including a broker-dealer. Further, RFIA would permit customers to opt out of the CFTC-provided protections (perhaps as a condition to custodying their assets away from an FCM).

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[15] *See* RFIA at 17-18. These disclosures include information as to the intended uses and functionality, market, services, supply, manner and rate of creation of the ancillary asset; general risk factors; related intellectual property rights; pricing and valuations; legal, regulatory and tax considerations; information as to custody and ownership; information about insider and related party transactions; and other factors impacting the asset's value.

[16] RFIA at 19.

[17] RFIA at 40.

[18] RFIA at 40-41. In addition to disclosures, the entity rehypothecating is also obligated to obtain affirmative customer consent and consider and mitigate risk of: (a) liquidity and volatility, (b) prior failures to deliver, (c) concentration, (d) an issuer or lender of last resort, (e) capital, leverage and market position of the person and (f) legal obligations of the person to customers and other persons in the market who provide digital asset services.

[19] RFIA at 42-43.

2. *Digital Asset Exchanges.* The RFIA would create a new Section 5i of the CEA that would provide for the creation of "digital asset exchanges" that are to be regulated by the CFTC. Such exchanges are those that that have as their business purpose the facilitation of **physical delivery** transactions in digital assets. A digital asset exchange could also offer trading in derivatives on digital assets provided that the exchange was also separately registered with the CFTC as a designated contract market or swap execution facility. The statutory requirements applicable to digital asset exchanges would generally track those applicable to designated contract markets, except that digital asset exchanges could hold customer margin and other assets without intermediation by an FCM.

3. *Broker-Dealer Custody.* The SEC would be required to adopt amendments to Rule 15c3-3 (the Custody Rule under the Securities Exchange Act) that would allow broker-dealers to keep digital assets in custody for customers.[20] This provision may be read as specifically in response to the SEC's having put forward an extremely narrow (and, as a practical matter, unworkable) concept release on the provision by a new special class of broker-dealers that would only be permitted to custody digital assets that are securities.[21]

4. *Bank Issuance of Payment Stablecoins.* A depository institution would be permitted to issue private-label payment stablecoins, provided that it must maintain segregated high-quality liquid assets of not less than 100% of the value of the stablecoins it has issued. Banks would also be permitted to engage in related activities in stablecoins, including making a market, trade support activities, and the provision of custody.[22]

V. Tax

1. *Exempt "de minimis" personal gain.* The RFIA would exempt personal virtual currency transaction gain from tax, up to $200 per transaction, adjusted annually for inflation. The exemption is designed to reduce the administrative burden to taxpayers of using virtual currencies in everyday retail transactions. It applies only to virtual currencies "used primarily as a medium of exchange, unit of account, store of value, or any combination of such functions," such as Bitcoin or Ether.

2. *Defer tax on mining and staking.* The RFIA would defer the taxation of mining and consensus-layer staking rewards until disposition. The IRS currently asserts that mining rewards are taxed at ordinary rates when received, and has not issued official guidance on staking rewards.

3. *Limit broker reporting.* The RFIA would revise the digital asset broker reporting rules introduced in 2021 by the Infrastructure Investment and Jobs Act (the "**IIJA**"). Under those rules, "brokers" are required to report information to clients and the IRS on Form 1099-B for digital assets transactions occurring after 2022. The IIJA definition of broker includes "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital

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[20] RFIA at 20.

[21] Request for Comment, Securities & Exchange Commission, Custody of Digital Asset Securities by Special Purpose Broker-Dealers (Dec. 23, 2022); *see also* SEC Requests Comment on Broker-Dealer Custody of "Digital Asset Securities", FRIED FRANK REGULATORY INTELLIGENCE (Dec. 23, 2020).

[22] RFIA at 44.

assets on behalf of another person," which potentially could include miners, consensus-layer stakers, wallet providers and developers. The RFIA would delay the implementation of the IIJA's broker-reporting rules to transactions occurring after 2024, and would revise the definition of broker to mean "any person who (for consideration) stands ready in the ordinary course of a trade or business to effect sales of digital assets at the direction of their customers."

4. *Expand trading safe harbor.* The RFIA would make it easier for U.S. asset managers to trade digital assets on behalf of foreigners without causing them to be subject to U.S. income tax. Foreigners generally are subject to U.S. tax on income from a "U.S. trade or business" (a "**USTB**"). The tax code provides safe harbors whereby trading stocks, securities or commodities through a U.S. asset manager generally is not a USTB. The RFIA would expand the safe harbors to digital assets of a kind customarily dealt in on a centralized or decentralized exchange if the transaction is of a kind customarily consummated on that exchange.

5. *Clarify non-taxation of crypto loans.* The RFIA would provide that a loan of digital assets in a transaction similar to a securities loan generally is not a taxable event to the lender.

6. *Charitable appraisals.* Under current law, taxpayers generally need to obtain "qualified appraisals" to deduct charitable contributions of property exceeding $5,000 in value unless the property is publicly traded stock. The bill would require the IRS to adopt guidance "relating to" eliminating the qualified appraisal requirement for digital assets traded on "established financial markets."

7. *Stablecoins as debt.* The RFIA would require the IRS to adopt guidance "relating to" the treatment of payment stablecoins as debt for U.S. tax purposes. Treating payment stablecoins as debt likely would cause U.S. taxpayers to recognize ordinary income or loss, instead of capital gain or loss, on dispositions of foreign currency backed stablecoins, which is consistent with the tax consequence of disposing of foreign currencies. The provision does not address crypto-backed or algorithmic stablecoins.

8. *DAOs as business entities.* The RFIA would treat decentralized autonomous organizations ("**DAOs**") as business entities by default if the DAOs are "properly incorporated or organized under the laws of a State or foreign jurisdiction as a decentralized autonomous organization, cooperative, foundation or any similar entity." The effect (if any) of this provision is unclear, because most DAOs likely are treated as business entities by default under current U.S. tax law, regardless of where they are incorporated. The RFIA also specifies that treasury management and fundraising for charitable purposes are not considered business activities in determining whether a DAO can qualify as a tax-exempt social club.

VI. Additional Digital Asset Related Proposals

1. *AML, Sanctions and Cybersecurity*

The RFIA addresses a number of digital asset related concerns that regulators and legislators have raised in the past relating to money laundering, sanctions and cybersecurity.

The RFIA directs the CFTC and the SEC, in consultation with the Treasury Secretary, to develop comprehensive guidance related to cybersecurity for digital asset intermediaries, addressing internal governance, organizational culture, cybersecurity, operations, risk identification and mitigation, auditing and testing, and sanctions avoidance within 18 months of the passage of the

RFIA.[23] In the context of Rule 15c3-3, the RFIA links regulatory guidance relating to satisfactory control locations for digital assets directly to the related cybersecurity practices protecting the asset.[24]

The RFIA establishes within the Financial Crimes Enforcement Network ("**FinCEN**") an "innovation laboratory" to study developments in financial technology and digital assets and work with the industry to enhance supervision.[25] With respect to digital asset activities of depository institutions, the Federal Financial Institutions Examination Council, in consultation with FinCEN, is required to publish final guidance and examination standards covering anti-money laundering, information technology, payment system risk, and customer protection within 18 months of RFIA's enactment.[26] The RFIA requires that, within 120 days of enactment, the Secretary of the Treasury adopt final guidance relating to sanctions compliance responsibilities and liability of a payment stablecoin issuer.[27]

2. *Regulatory Coordination and Market Studies*

The RFIA calls for a number of studies to be performed and directs various regulators to coordinate on a number of digital asset related topics going forward. Below is a brief review of these sections of the RFIA.[28]

▪ Section 701 requires the Federal Reserve Board of Governors to study opportunities for risk reduction through use of distributed ledger technology within 180 days of the RFIA's passage.[29]

▪ Section 803 requires the States, by way of the Conference of State Bank Supervisors and the Money Transmission Regulators Association, to adopt uniform standards for treatment of digital assets under money transmission laws within two years of the RFIA's passage.[30]

▪ Section 805 requires the Secretary of Treasury, SEC and CFTC to work with the private sector to study various decentralized finance related topics within one year of the RFIA's passage.[31]

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[23] RFIA at 66-67.

[24] RFIA at 20.

[25] RFIA at 51-52.

[26] RFIA at 55.

[27] RFIA at 48. The bill also specifically addresses the central bank digital currency of the People's Republic of China.

[28] In addition, the RFIA addresses some further regulator related points: Section 801 requires that federal regulators respond to requests for interpretive guidance within 180 days after the filing of such request. RFIA at 59. Section 802 permits companies operating under existing "State financial regulator sandboxes" to engage in interstate business upon obtaining approvals and subject to restrictions. Section 804 establishes privacy and confidentiality standards for information shared between financial regulators. RFIA at 63.

[29] RFIA at 52.

[30] RFIA at 62.

[31] RFIA at 64.

- Section 806 requires annual studies from the Federal Energy Regulatory Commission ("**FERC**") in consultation with the CFTC and SEC regarding energy usage relating to digital assets.[32]

- Section 807 directs the CFTC and SEC, in consultation with digital asset intermediaries and digital asset industry representatives, to study the potential for establishing a self-regulatory organization for the digital asset markets, and develop a related proposal, within six months of the passage of the RFIA.[33]

- Section 809 establishes the Advisory Committee on Financial Innovation, a bipartisan committee composed of regulators and industry participants, which is intended to study the digital asset market and make reports to regulators.

VII. The Politics. The politics of the proposed legislation are as interesting as the legal implications, if not more so, given that no one expects this bill to be adopted in this Congressional session. Prominent Democratic Senators, particularly Senator Warren[34] and Senator Brown,[35] have been largely negative, if not outright hostile, in their statements on digital assets. Democratic regulators (notably SEC Chair Gensler[36] and the DOL under the Biden Administration[37]), perhaps taking their direction in part from the Senators, have been equally skeptical of digital assets. The Congresspersons regarded as most supportive of the digital assets have been primarily Republicans (Representative Patrick McHenry (R-NC) and Senator Patrick Toomey (R-PA)), and the most supportive regulators have likely been Republicans (former CFTC Chair Giancarlo and current SEC Commissioner Peirce).

To the extent that there have been prior bills proposed as to digital assets, all of the liberalizing initiatives have been from the Republican side. The only Democrat-initiated bills have been to increase enforcement efforts.

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[32] RFIA at 64-65. The study is, in part, focused on the type and amount of energy used for mining, with a view towards other governmental climate and renewable energy related goals.

[33] RFIA at 65.

[34] For example, Senator Warren, along with Senator Tina Smith (D-MN), describing "investing in cryptocurrencies [as] a risky and speculative gamble," severely criticized a financial institution that provided retail customers the option of holding Bitcoin investments in their 401(k) plans. *See* Senators Deride Firm's Decision to Include Bitcoin in 401(k) Plans, FRIED FRANK REGULATORY INTELLIGENCE (May 5, 2022). By contrast, RFIA Section 207 would require the Government Accountability Office (GAO) to conduct an analysis of the potential opportunities and risks of retirement investing in digital assets.

[35] At a U.S. Senate Committee on Banking, Housing, and Urban Affairs hearing in March 2022, Senator Brown described crypto assets as tools that "can be used to make it easier to commit crimes - facilitating illicit finance, terrorism, and other forms of criminal activity, and threatening our national security." He asserted that digital assets are appealing to "crime rings and scam artists," and noted in particular FinCEN's warning that "Russian actors could even use crypto get around sanctions." *See* Senate Banking Committee Considers Implications of Digital Assets for Illicit Finance, FRIED FRANK REGULATORY INTELLIGENCE (March 18, 2022).

[36] *See* SEC Chair Gensler Highlights Gaps in Crypto Regulation, FRIED FRANK REGULATORY INTELLIGENCE (Aug. 4, 2021).

[37] *See* DOL Warns Plan Fiduciaries of the Substantial Risks of Cryptocurrency Investments, FRIED FRANK REGULATORY INTELLIGENCE (March 10, 2021).

As to the SEC, RFIA is, in effect, a repudiation of the agency's activities as to digital assets. RFIA materially narrows the SEC's interpretation of the Howey Test, gives the SEC only a limited role in regard to the sale of digital assets while providing the CFTC with very significant new jurisdiction, tells the SEC to get a move-on with regard to custody, and effectively suggests to SEC Chair Gensler that he should have been paying more mind to Commissioner Peirce's proposal on digital assets.

In light of the above, even if this bill is not passed in this session, as few expect it to be, Senator Gillibrand's break with the current Democratic party position on digital assets is significant. The fact that there is at least one Democratic Senator (and very likely more) that favor adopting a workable regulatory scheme for the oversight of digital assets makes it far more likely that something gets done in the next session. The fact that the bill would transfer so much potential authority from the SEC to the CFTC may cause SEC Chair Gensler to rethink the SEC's approach to digital asset regulation to the extent that would allow the SEC to play a larger role in that regulation going forward.

It should also be noted that the transfer of authority to the CFTC also indirectly increases the authority of the Agricultural Committee, which oversees the CFTC, and of which Senator Gillibrand is a member.

Appendix 1
Comparison of the Lummis-Gillibrand Responsible Financial Innovation Act
Against SEC Commissioner Peirce's Token Safe Harbor Proposal 2.0

As noted previously in the memo, the RFIA is largely consistent with the conceptual approach that Commissioner Peirce took towards digital assets. However, there are a number of distinctions in the proposals themselves. The Token Safe Harbor Proposal 2.0 addressed the sale of tokens to facilitate access to, participation on, or finance the development of a network, rather than addressing digital assets very broadly.[38] As such, it contemplated a three-year grace period to develop a network, during which time such network will be exempt from the federal securities laws, provided that the developer (i) complied with anti-fraud rules, (ii) provided semi-annual updates to the plan of development disclosure and a block explorer and (iii) made certain disclosures discussed below. Lastly, upon the cessation of the grace period, the developer would be required to create an exit report explaining why the network is sufficiently decentralized and the token is not a security or registering as security.

Commissioner Peirce's proposal would have left the general status quo intact, creating a clear and detailed process for developing a network and ensuring the related tokens were not characterized as securities. In contrast, the RFIA addresses digital assets broadly, and rather than creating a detailed and time-limited framework, essentially creates a new class of product to be treated as a commodity while granting substantial authority to the CFTC. Commissioner Peirce's proposal establishes disclosure requirements focusing primarily on the token and only the most salient facts for potential purchasers. Presumably because of the substantially broader scope, the RFIA requires far more detailed disclosures as to the issuer, in addition to information about the asset.

The following chart provides a comparison of the disclosures required by the RFIA against those required by Token Safe Harbor Proposal 2.0.

Token Safe Harbor Proposal 2.0	Lummis-Gillibrand Responsible Financial Innovation Act
Disclosures would be made prior to filing a notice of reliance on the safe harbor. Disclosures would also provide the information below, with disclosures of any material changes provided as soon as practicable after the relevant change.	Disclosures are required for the one-year period beginning on the date that is 180 days after the first date on which the security that is classified as an ancillary asset is offered, sold, or otherwise provided, subject to certain conditions.
Source Code. A text listing of commands to be compiled or assembled into an executable computer program used by network participants to access the network, amend the code and confirm	If applicable, information relating to any external audit of the code and functionality of the ancillary asset, including the entity performing the audit and the experience of the entity in conducting similar

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[38] Specifically, the proposal defined a "Token" as "a digital representation of value or rights (i) that has a transaction history that: (A) is recorded on a distributed ledger, blockchain, or other digital data structure; (B) has transactions confirmed through an independently verifiable process; and (C) cannot be modified; (ii) that is capable of being transferred between persons without an intermediary party; and (iii) that does not represent a financial interest in a company, partnership, or fund, including an ownership or debt interest, revenue share, entitlement to any interest or dividend payment."

Token Safe Harbor Proposal 2.0	Lummis-Gillibrand Responsible Financial Innovation Act
transactions.	audits.
	Description of the technology underlying the ancillary asset.
Transaction History. A narrative description of the steps necessary to independently access, search and verify the transaction history of the network.	The issuer must provide, if applicable, a description of the amount of assets offered, sold or provided, the terms of each such transaction, and any contractual or other restrictions on the resale of the assets by intermediaries. However, there is no requirement that information permitting independent access, search and verification of these transactions be provided.
Token Economics. A narrative description of the purpose of the network, the protocol and its operation, including: ▪ The number of tokens issued initially, the total number of tokens to be created, the release schedule and the total number of tokens outstanding, ▪ Methods of generating/mining tokens, burning tokens, validating transactions and consensus mechanisms, ▪ Explanation of governance mechanisms, ▪ Information for third-party transaction history verification tools and ▪ Block explorer.	Information relating to ancillary assets, including the following: ▪ A general description of the ancillary asset, including the standard unit of measurement with respect to the ancillary asset, the intended or known functionality and uses of the ancillary asset, the market for the ancillary asset, other assets or services that may compete with the ancillary asset, and the total supply of the ancillary asset or the manner and rate of the ongoing production or creation of the ancillary asset, ▪ Amount of ancillary assets owned by issuer,[39] ▪ Each third-party not affiliated with the issuer, the activities of which may have a material impact on the value of the ancillary asset, ▪ Risk factors, ▪ Average daily price for a constant unit of value of the ancillary asset during the relevant reporting period, as well as the 12-month high and low prices for the ancillary asset, ▪ If applicable, any third-party valuation report or economic analysis regarding the ancillary asset

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[39] This falls in the ancillary asset info portion of the proposal, despite looking to the issuer.

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	or the projected market of the ancillary asset, which shall include the entity performing the valuation or analysis and the experience of the entity in conducting similar reports or analyses, ▪ Information as to custody by owners or third parties, ▪ IP rights, ▪ Tax considerations, ▪ Legal/regulatory considerations and ▪ Other factors impacting the value of the asset.
Development Plan. The current state of and timeline for network development. This would also be updated every six months following the filing of a notice of reliance on the safe harbor, until the network is mature or the three-year safe harbor period expires.	For the one-year period following the submission of the disclosure, a description of the plans of the issuer to support (or to cease supporting) the use or development of the ancillary asset, including markets for the ancillary asset and each platform or system that uses the ancillary asset.
Prior Token Sales. Date of sale, number of tokens sold prior to filing a notice of reliance on the safe harbor, any limitations or restrictions on the transferability of tokens sold and the type and amount of consideration received.	As to the ancillary asset: ▪ If ancillary assets have been offered, sold or otherwise provided by the issuer to investors, intermediaries or resellers, then a description of the amount of assets offered, sold or provided, the terms of each such transaction, and any contractual or other restrictions on the resale of the assets by intermediaries. ▪ If ancillary assets were distributed without charge, then a description of each distribution, including the identity of any recipient that received more than 5% of the total amount of the ancillary assets in any such distribution. As to the Issuer: ▪ Information as to any similarly developed assets (noted in more detail below).
Initial Development Team and Certain Token Holders. Information including names and experience of developers; numbers of tokens	Basic corporate information regarding the issuer: ▪ Experience developing similar assets,

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owned by developers, current or future rights to tokens of developers or related persons, and restrictions on transferability of tokens held by such persons.	▪ History, including pricing of any previously provided ancillary assets, ▪ Activities that the issuer has taken in the relevant disclosure period, and is projecting to take in the one-year period following the submission of the disclosure, with respect to promoting the use, value or resale of the ancillary asset; the anticipated cost of such activities and whether the issuer has liquid funds equal to such amount, ▪ To the extent that the ancillary asset involves the use of a particular technology, the experience of the issuer with the use of that technology, ▪ Backgrounds of the board of directors, senior management and key employees of the issuer, ▪ Description of assets and liabilities, ▪ Information about legal proceedings, ▪ Risk factors and ▪ Going concern statements.
Secondary trading platforms on which the token trades.	Names and locations of markets in which the ancillary asset is known by the issuer to be available for purchase and sale.
Sales of 5% or more of tokens owned by members of initial development team and Any material (or proposed material) transactions involving the initial development team and any related person.	Ownership information relating to 10%+ holders of the ancillary asset and issuer's management, Information as to related person transactions and Recent purchases, sales or dispositions of ancillary assets by issuer and affiliates.
Warning of risks to token purchasers.	While risk factors need to be disclosed within the items noted above, but there is not an explicit warning required.

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Special thanks to Sebastian Souchet, Corporate Law Clerk, for his valuable assistance in the research and drafting of this client memorandum.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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