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June 20, 2023

The Honorable Patrick McHenry (R-NC)
Chairman
U.S. House Committee on Financial Services
Washington, D.C. 20515

The Honorable Maxine Waters (D-CA)
Ranking Member
U.S. House Committee on Financial Services
Washington, D.C. 20515

The Honorable Glenn Thompson (R-PA)
Chairman
U.S. House Committee on Agriculture
Washington, D.C. 20515

The Honorable David Scott (D-GA)
Ranking Member
U.S. House Committee on Agriculture
Washington, D.C. 20515

Re: NASAA Urges Congress to Preserve the Existing Securities Regulatory Framework as Congress Considers Digital Assets Market Structure Legislation

Dear Chairmen McHenry and Thompson and Ranking Members Waters and Scott:

On behalf of the North American Securities Administrators Association ("NASAA"),[1] I am pleased to share NASAA's preliminary comments on the Digital Asset Market Structure Discussion Draft dated June 1, 2023 (the "Discussion Draft").[2] Innovation is critical to the future of our capital markets, and we appreciate efforts to address regulatory concerns involving digital assets.[3] However, respectfully, we cannot support the Discussion Draft as we are concerned that

[1] Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA's membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, the U.S. Virgin Islands, and Guam. NASAA is the voice of securities agencies responsible for grassroots investor protection and responsible capital formation.

[2] *See* Digital Asset Market Structure Discussion Draft, 118th Congress, 1st Session.

[3] NASAA has not endorsed a definition of "digital assets." Like many involved in related policy discussions, we use the term as an aid for communicating. However, we recognize that this misleading marketing term has injected unnecessary complexity and confusion into our collective understanding of the law and regulation. Nearly all securities in the United States are issued and traded digitally (*i.e.*, using devices constructed or working by the methods or principles of electronics). Moreover, in the coming decade, more securities, including 'traditional securities,' probably will be issued and traded using blockchain or distributed ledger technology. *See generally* JP Morgan, Blockchain Brings Collateral Mobility to Traditional Assets (last accessed June 16, 2023); Depository Trust and Clearing Corporation, DTCC's Project Ion Platform Now Live in Parallel Production Environment, Processing Over 100,000 Transactions Per Day on DLT (Aug. 22, 2022). We use the term "digital asset securities" to refer to those digital assets that would be a security using the well-established tests developed through and in decades of common law.

it would unnecessarily undermine decades of well-established investor protections and further erode trust in our capital markets. We would welcome the opportunity to work with you and your staff on alternative legislation that preserves the existing securities regulatory framework and the authority of state securities regulators.

A. The Well-Established Securities Regulatory Framework in the United States Applies to All Products That Are Securities.

To begin, NASAA strongly opposes the effort to establish a new, redundant, and bespoke regulatory framework for self-titled digital assets that are securities ("digital asset securities"). In the United States, federal and state governments have long used our adaptable regulatory framework to maintain markets that are fair not only to veteran securities market participants but also to new or newer market entrants and products. To the extent regulators observe the same activities and risks to our markets presented by new practices, products, or professionals, they use the elasticity of existing regulations and rules whenever possible to regulate those new market elements. This approach promotes fairness and often can minimize the overall costs of regulation that ultimately are borne by investors and taxpayers.[4]

Importantly, the U.S. Securities and Exchange Commission ("SEC") has interpreted its existing authority to extend to the offer, sale, and trading of, and other financial services and conduct relating to, digital assets to the extent they are securities. Platforms on which digital asset securities are traded in the secondary market generally must register as national securities exchanges or operate pursuant to an exemption from registration, such as the exemption under SEC requirements for alternative trading systems ("ATSs") (*i.e.*, SEC Regulation ATS), and report information about their operations and trading to the SEC. Meanwhile, certain digital assets-related activities may trigger registration and other obligations with the SEC and a national securities association, primarily the Financial Industry Regulatory Authority ("FINRA").[5] For example, the securities laws would require an institution to register with the SEC as a broker if it were in the regular business of effecting transactions in digital asset securities at key points in the distribution chain. Such key points could include the solicitation and recruitment of investors, the regular advertisement of digital asset securities, and the receipt of transaction-based compensation for the trading of digital asset securities.[6]

State regulators similarly have interpreted their existing authorities to extend to the offer, sale, and trading of, and other financial services and conduct relating to, digital assets to the

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[4] *See, e.g.*, NASAA Letter to Congress Regarding Our Core Principles and Positions on Various HFSC Discussion Drafts Related to Digital Assets (Apr. 11, 2023).

[5] Presently, FINRA is the only national securities association registered with the SEC.

[6] Some firms are receiving registration approvals. For example, Prometheum Ember ATS Inc. is a FINRA member and SEC-registered ATS and broker-dealer approved to operate an ATS for digital asset securities. This entity is also registered with 53 U.S. states and territories. *See*, SEC, Alternative Trading System List (last updated May 31, 2023) and BrokerCheck Report for Prometheum Ember ATS, Inc. Prometheum Ember Capital LLC ("ProCap") is registered with the SEC, FINRA, and 15 U.S. states and territories. ProCap can serve as a special purpose broker-dealer for digital assets. *See* BrokerCheck Report for Prometheum Capital. FINRA also approved the application of OTC Markets Group to trade digital assets securities on OTC Link ATS. *See* OTC Markets Group, OTC Markets Group Reports First Quarter 2023 Results Delivering Continued Revenue Growth (May 9, 2023).

extent they are securities. By way of example, a person that facilitates the exchange of a digital asset security between persons or between a person and a platform, provides trade execution, and engages in the private placement of digital asset securities is a broker-dealer. State governments, the SEC, and FINRA regulate broker-dealers. Moreover, a person who, for compensation, advises others as to whether they should invest in digital asset securities or issues reports concerning digital asset securities must register as an investment adviser. Investment advisers are regulated by the SEC or one (1) or more states, depending on the assets under management (if less than $100 million, the adviser is regulated by one (1) or more state securities regulators). The SEC and state regulators have used this authority to protect investors in digital asset securities and play an important role in fostering trust in this newer market.[7]

In sum, the standard by which the Discussion Draft should be judged is whether it would encourage compliance with existing laws and, if needed, engagement with regulators on requests for limited relief. Under this standard, the Discussion Draft fails to meet the mark.

B. NASAA Strongly Urges Congress to Foster Innovation by Funding and Requiring Enhanced Regulatory Coordination.

Given that the SEC and the Commodity Futures Trading Commission ("CFTC") have the necessary and appropriate authorities to regulate the securities and derivatives markets, and amendments to the authorities of the SEC and state governments over a particular asset class would be anti-competitive, counterproductive, and unwarranted,[8] NASAA strongly urges Congress to abandon the Discussion Draft and similar measures. We urge Congress to instead pursue legislation that would require the SEC and CFTC to prepare joint rulemaking and host a joint advisory committee.

To those ends, NASAA generally supports the pursuit of joint rulemaking. If legislation were needed, Section 104 of the Discussion Draft would be a good start. Section 104 would require the agencies to define terms such as blockchain, blockchain network, decentralized

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[7] *See, e.g.*, Pennsylvania Department Of Banking And Securities Announces 2023 Priorities For The Bureau Of Securities Compliance And Examinations (Mar. 20, 2023) ("Digital Assets – The Bureau will review registrants' recommendations to purchase investments in digital assets. The Bureau will review transactions for suitability, and the Bureau will examine a registrant's [written supervisory procedures] and Form ADV disclosures. Furthermore, the Bureau will examine a registrant's due diligence prior to the recommendation of investments in digital assets."). For examples of state-federal coordination with respect to enforcement actions, see Written Testimony of 2021-2022 NASAA President Melanie Senter Lubin before the U.S. Senate Committee on Banking, Housing, and Urban Affairs Regarding Protecting Investors and Savers: Understanding Scams and Risks in Crypto and Securities Markets (July 28, 2022).

[8] *See* Statement of Dan M. Berkovitz, Former Commissioner, U.S. Commodity Futures Trading Commission and Former General Counsel, U.S. Securities and Exchange Commission before the Committee on Agriculture, U.S. House of Representatives, The Future of Digital Assets: Measuring the Regulatory Gaps in the Digital Asset Markets (June 6, 2023) ("The CFTC and the SEC have the necessary and appropriate authorities to regulate the derivative and security markets. Amendments to the SEC's authorities over one particular asset class, such as digital assets, would be unwarranted, unnecessary, and potentially counterproductive. Creating new authorities based on a particular technology or newly defined asset class could disrupt decades of securities law precedent, create additional uncertainty about the meaning and interpretation of both new and existing statutory terms and classifications, and generate opportunities for regulatory arbitrage in the capital markets based upon technology upon which the asset is created or distributed rather than the functional nature of the asset or instrument.").

network, and restricted digital asset, among many others. In addition, Section 104 would require the agencies to exempt persons dually registered with the SEC as an ATS and the CFTC as a digital commodity exchange from "duplicative, conflicting, or unduly burdensome" provisions of federal law and the rules thereunder. However, the exemption would still need to "foster the development of fair and orderly markets in digital assets, be necessary or appropriate in the public interest, and be consistent with the protection of investors."

When pursuing legislation related to any such joint rulemaking, Congress should address the following: Importantly, Congress should direct the SEC and CFTC to invite a representative of state securities commissions to contribute to and participate in discussion prior to seeking public comment. While NASAA likely would comment again once a proposed rule has been approved and published, permitting the states to comment earlier would reduce possible misalignment in the proposed rule between applicable state and federal laws. Moreover, Congress should not list terms for regulators to define. Instead, Congress should direct the regulators to develop a joint taxonomy and inform Congress of the need for legislation if any to create new terms in the federal securities or commodities laws. A joint taxonomy would make it even easier for all of us to communicate effectively regarding this policy area and help to show that a new, redundant, bespoke regulatory framework for digital asset securities would be anti-competitive, counterproductive, and unwarranted. Last, Congress should direct the agencies to, when completing joint rulemaking, preserve as much of the existing regulatory framework as possible. Ultimately, taxpayers and investors, as well as more seasoned market participants, would bear the costs of unnecessary changes to the U.S. regulatory framework.

In a similar vein, NASAA generally supports the pursuit of an advisory body that would help the SEC and CFTC. If legislation were needed, Section 503 of the Discussion Draft would be a good start. Specifically, this section would establish a "CFTC-SEC Joint Advisory Committee on Digital Assets" (the "committee"). The committee would have at least 20 nongovernmental, uncompensated stakeholders, including "digital asset issuers," persons registered with the SEC or CFTC and engaged in "digital asset related activities," academics, and "digital asset users." The Directors of LabCFTC and the SEC's FinHUB would be designated officers. In short, this committee would provide recommendations to the SEC and CFTC regarding their respective promulgation of related regulations, rules, and policies. The agencies would be required to provide a formal response to the committee's recommendations not later than three (3) months after the agencies receive them.

When pursuing legislation related to any such advisory body,[9] Congress should consider the following: To begin, the federal agencies should be required to invite a representative of state securities commissions to participate. Again, taxpayers and investors ultimately would bear the unnecessary costs of failing to give the states a seat at the regulatory table. Also, Congress should include a sunset provision for the advisory body. It appears unfair or anti-competitive for a financial regulator to indefinitely host an advisory committee dedicated to a single asset class.

[9] *See* NASAA Letter to Congress Regarding Our Core Principles and Positions on Various HFSC Discussion Drafts Related to Digital Assets (Apr. 11, 2023) at 8 (offering additional technical and other comments to the Financial Technology Protection Act or the Eliminate Barriers to Innovation Act).

Last, Congress should make funds available to compensate individuals who want to serve but cannot afford to do so without compensation. This will foster inclusion.

In conclusion, for these, as well as the reasons outlined below, we strongly urge Congress to abandon the Discussion Draft except for the sections that would foster regulatory coordination. Such coordination must include state representation as well.

C. NASAA Strongly Opposes Laws That Would Weaken Investor Protection and Preempt State Efforts to Promote Responsible Capital Formation.

NASAA strongly opposes efforts, including the one proposed in the Discussion Draft, to create new exemptions from federal securities laws for digital asset issuers with complementary preemptions of state securities laws. In short, Sections 201 and 307 of the Discussion Draft would be a gigantic step backwards in our collective efforts to support the next generation of American entrepreneurs and individual investors of all ages and backgrounds. This legislation is contrary to the purposes of the securities laws necessary for well-regulated capital markets and investor confidence. The bill also injects new, unnecessary complexity into an exemption framework that is complex already.

As context, state securities regulators regularly witness firsthand the value that comes from having entrepreneurs and small businesses engage directly with state regulators about capital raising generally and the securities offerings they will make or have made to investors in their states. This engagement helps issuers better understand their options for raising capital and avoid or mitigate compliance mistakes. It also deters fraud and other misconduct that can harm business owners and investors alike. For example, state securities regulators facilitate networking opportunities for businesses to raise capital, attend venture capital or entrepreneur fairs (*e.g.*, the MIT Entrepreneur Forum), collaborate on outreach efforts with other regulators, and support trainings conducted by nonprofit organizations (*e.g.*, venturecapital.org). The engagement similarly helps state securities regulators better understand the educational and compliance needs of the business community in their states, including rural and other hard-to-reach community members. State securities regulators use this information to enhance their education and outreach programming for entrepreneurs and small businesses.

As further context, to the extent any product is a security, issuers presently can offer and sell securities through many types of offerings *without* registering those securities with the SEC. For example, issuers can use any of the following 10 types of offerings up to the stated limits: (1) Section 4(a)(2) (no offering limit); (2) Rule 506(b) of Regulation D (no offering limit); (3) Rule 506(c) of Regulation D (no offering limit); (4) Regulation A: Tier 1 ($20 million); (5) Regulation A: Tier 2 ($75 million); (6) Rule 504 of Regulation D ($10 million); (7) Regulation CF, Section 4(a)(6) ($5 million); (8) Intrastate: Section 3(a)(11) (no federal limit but states usually have limits between $1 and $5 million); (9) Intrastate: Rule 147 (no federal limit but states usually have limits between $1 and $5 million); and (10) Intrastate: Rule 147A (no federal limit but

states usually have limits between $1 and $5 million).[10] If issuers or their representatives have questions or concerns on how to raise capital in a compliant way, they should engage with regulators on those questions and any requests for limited relief.[11]

Ignoring the many available pathways for raising capital, Section 201 of the Discussion Draft would amend the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act") to establish a new, unnecessary exemption from registration under the federal securities laws for the offer or sale of units of a digital asset by a digital asset issuer. Issuers would have to satisfy enumerated conditions to use and maintain the exemption. For example, the digital asset issuer's total sales of the units of the digital asset during the 12-month period preceding the date of the transaction, including the amount sold in such transaction, could not be more than $75 million.

Sections 201 and 307 of the Discussion Draft would also amend Securities Act Section 18(b)(4) to preempt state regulation of securities meeting the conditions of the new federal exemption. Specifically, Section 201 would add the new federal exemption as a new type of exemption that, if used, would trigger the classification of the securities as a "covered security" for purposes of preempting state registration.[12] Section 307 seems to create a preemption provision that would be redundant of the one in Section 201. By adding a new subsection (5) to Securities Act Section 18(b), Section 307 would treat all digital assets qualifying for the new exemption established by the bill as a "covered security" if they are "brokered, traded, custodied, or cleared by a broker or dealer registered under section 15 of the Securities Exchange Act of 1934; or traded through an alternative trading system".[13]

Again, state securities regulators understand the need for entrepreneurs and small businesses to raise capital efficiently and the role strong investor protection plays in facilitating this goal. Naturally, it is disappointing for the states to watch certain federal lawmakers praise the important work of state securities regulators, scold the federal government for not supporting small businesses and investors enough, and then support legislation that takes away the very authority that state securities regulators need to achieve our common goals.

Thank you for your time and consideration of the preliminary concerns we have expressed above. Should you have any questions or wish to seek NASAA's technical feedback

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[10] See SEC Overview for Exemptions to Raise Capital (last updated Apr. 6, 2023) (setting forth a chart that provides certain regulatory information and requirements that govern 10 different avenues for raising capital under existing exemptions from federal securities laws).

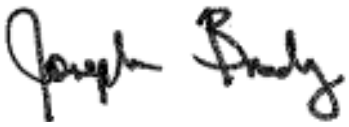
[11] *See, e.g.*, Washington State Department of Financial Institutions, Virtual Currency, Cryptocurrency, and Digital Assets Primer. To find your state securities regulator, use NASAA's Contact Your Regulator interactive map.

[12] In 1996, the federal government enacted the National Securities Markets Improvement Act ("NSMIA"). This legislation preempted much state regulation of securities offerings. Among other changes, NSMIA preempted state registration of "covered securities" such as nationally traded securities and mutual funds. However, NSMIA still permitted state review and registration of non-covered securities and requirements to submit notice filings to state securities regulators of covered securities. In subsequent years, Congress repeatedly added to the list of covered securities and thereby further restricted the ability of state governments to decide whether and how to regulate certain securities offerings. *See* 15 U.S.C. § 77r.

[13] *See* Section 307 of the Discussion Draft.

on any legislative proposals, please do not hesitate to contact me or Kristen Hutchens, NASAA's Director of Policy and Government Affairs, and Policy Counsel, at khutchens@nasaa.org.

Sincerely,



Joseph Brady
NASAA Executive Director