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Take Two: The Lummis-Gillibrand Crypto Assets Bill 2.0

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On July 12, Senator Kirsten Gillibrand, a Democratic senator from New York who sits on the Senate Banking Committee, and Senator Cynthia Lummis, a Republican senator from Wyoming who sits on the Agriculture Committee, joined forces again to propose a comprehensive bill that seeks to organize and operationalize the Federal Government's response to crypto activities in the United States. In a press release announcing the legislation, the two senators acknowledge working with many stakeholders (including Cadwalader) to obtain "substantial feedback" to improve their previous legislation (Summer 2022) and describe the 2023 bill as greatly expanded legislation that "adds strong new consumer protections and safeguards to further strengthen the industry against fraud and bad actors, while giving American innovators the chance to thrive." The Lummis-Gillibrand bill runs 274 pages and addresses many crypto-related topics, including registration of cryptocurrency exchanges, improved anti-money laundering provisions, and updated directives regarding tax treatment of various crypto activities, and establishes a path for depository institutions to be able to issue payment stablecoins.

Most importantly, however, a key challenge of comprehensive crypto legislation to date has been to identify when the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC") have jurisdiction over the crypto activity – mainly codifying the Howey test while recognizing that not all crypto activities may or should be subject to SEC and/or CFTC jurisdiction. The updated Lummis-Gillibrand bill is significantly improved in this respect, providing a clear definition for crypto assets that should be governed by each agency (and, in some cases, by both agencies), and exempting tokenized assets as well as payment stablecoins from that definition.

As in the previous version of the bill, the CFTC gets an expanded grant of exclusive jurisdiction over "fungible crypto asset" spot markets and the authority to register "crypto asset exchanges" and regulate "decentralized crypto asset exchanges." "Crypto assets" are included within the definition of a "commodity"; however, some provisions in the amended Commodity Exchange Act would only apply to "commodities" that qualify as "crypto assets." Futures commission merchants are included in the definition of "crypto asset intermediary" and are authorized to transact with "crypto assets" but must adhere to mandatory segregation, third-party custody arrangements and prevention of conflicts of interest with affiliates. A lot of revisions in this version of the bill address the matters that have caused the "crypto winter," and are addressed in CFTC's and SEC's complaints and enforcement actions involving FTX, Alameda, Binance and others.

The bill also involves a broader swath of agencies, including the federal banking regulators, state bank regulators, the Office of Foreign Asset Control ("OFAC"), the Financial Crimes Enforcement Network ("FinCEN") and the Federal Trade Commission ("FTC"), directing them variously to take actions addressing consumer protection concerns, which include everything from adopting a uniform money transmission law for the regulation of crypto market participants at the state level to educating consumers about the crypto market to creating advertising standards for the marketing of crypto products and services.

Finally, for purposes of this brief note regarding the bill, the SEC is provided with something that the section-by-section overview claims "resolves a long-standing issue with SEC custody requirements" such that when a crypto asset is being held in custody, the SEC's requirement to maintain a satisfactory control location "may be fulfilled by protecting the [crypto] asset with commercially reasonable cybersecurity practices for a private key."

Due to the comprehensive nature of the bill, this summary only hits a few highlights of the bill, but we will provide more in-depth analysis as the legislative process continues.