HOUSE FINANCIAL SERVICES COMMITTEE

"DIGITAL ASSETS AND THE FUTURE OF FINANCE: UNDERSTANDING THE CHALLENGES AND BENEFITS OF FINANCIAL INNOVATION IN THE UNITED STATES"

December 8, 2021 – 10:00 AM

OVERVIEW

On Wednesday, December 8, the House Financial Services Committee held a hearing titled, "Digital Assets and the Future of Finance: Understanding the Challenges and Benefits of Financial Innovation in the United States." During the hearing, Members and witnesses discussed: digital assets, including digital wallets, stablecoins, and the Infrastructure Investment and Jobs Act cryptocurrency provisions; cybersecurity; financial inclusion; financial stability; digital assets as securities; a central bank digital currency (CBDC); and the environmental impacts of cryptocurrency.

OPENING STATEMENTS

- Chairwoman Maxine Waters (D-CA)
- Ranking Member Patrick McHenry (R-NC)

WITNESS PANEL

- Jeremy Allaire, Co-Founder, Chairman and CEO, Circle
- Samuel Bankman-Fried, Founder and CEO, FTX
- Brian P. Brooks, CEO, Bitfury Group
- Charles Cascarilla, CEO and Co-Founder, Paxos Trust Company
- Denelle Dixon, CEO and Executive Director, Stellar Development Foundation
- Alesia Jeanne Haas, CEO, Coinbase Inc. and CFO, Coinbase Global Inc.

QUESTION AND ANSWER SUMMARY

Digital Assets

Rep. Blaine Luetkemeyer (R-MO) asked how Congress and federal regulators can ensure the dollar remains the world's reserve currency. Mr. Brooks noted the share of dollars in the European and Japanese central banks have decreased to 60 percent from 80 percent, adding that the "dollar cannot take its primacy for granted." He argued digital assets and blockchain will enable the dollar to "compete in the global marketplace." He asserted that because of the "highly inflationary environment, there will come a time where the attractiveness of the dollar relative to other currencies could change." Mr. Allaire advocated for increased partnerships among private companies and the federal government, in addition to utilizing the open internet to make dollar digital assets more attractive than other digital assets that are nationalized and used as surveillance mechanisms.

Rep. Luetkemeyer asked Mr. Brooks about concerns regarding private control of digital dollar trading platforms. Mr. Brooks claimed that large financial institutions have "deplatformed industries and customers for not sharing the right point of view," and he argued cryptocurrencies ("cryptos") provide a "true decentralized" payment system. He asserted successful cryptos will be the ones that are user controlled.

Rep. Andy Barr (R-KY) asked Mr. Brooks if Congress should pass legislation that provides clarity on the definition of a digital asset. Mr. Brooks responded when he was the Acting Comptroller of the Currency, the Office of the Comptroller of the Currency (OCC) provided clear answers to banks that approached the OCC with new activity proposals. However, he asserted the Securities and Exchange Commission (SEC) does not provide similar clarity to new crypto products. He advocated for legislation that defines a security or gives discretionary authority to federal regulators to decide what constitutes a security on a case-by-case basis.

Rep. Roger Williams (R-TX) asked Mr. Brooks about the potential negative consequences of "heavily" regulating digital asset technology. Mr. Brooks cautioned that only allowing accredited investors to access digital asset technology would be detrimental because it would restrict the advantages of trading digital assets to already wealthy individuals. Additionally, he advocated for permitting retail investors to diversify their crypto mutual funds, which is already permitted in Canada, Germany, and Singapore, among others. He concluded "the way to win is to bring more people into the system more safely."

Rep. Ritchie Torres (D-NY) asked Mr. Brooks how to regulate decentralized finance (DeFi). Mr. Brooks advocated for allowing stablecoin issuers to receive a bank charter so they can be regulated through traditional financial regulators. However, he noted that DeFi was designed to "solve problems that created the need for enforcement" in the traditional financial system. He asserted "the point of these decentralized systems is to take out human error and solve it algorithmically."

Rep. Bill Foster (D-IL) advocated for establishing anonymous tax identification numbers to allow regulators to identify individual transactions without needing personally identifiable information (PII). He then asked for Mr. Allaire's thoughts on this proposal. Mr. Allaire agreed this is a "critical area" that needs to balance security privacy and limit "leakage" of PII. He noted blockchain provides a "powerful way for auditability and transparency," but there is a risk of including "too much PII in transactions."

Rep. Ted Budd (R-NC) asked Mr. Brooks about "anti-innovation" regulations and regulation by enforcement. Mr. Brooks asserted some digital asset products are legal in other countries but illegal in the U.S., as the "SEC has refused to approve products that other G20 nations have approved." Rep. Budd asked about the SEC's regulatory authority over digital assets. Mr. Brooks argued the U.S.'s regulatory framework is "unique among developed countries" because of its "fragmented approach to regulations." He asserted it is unnecessary to create another financial regulator to oversee digital asset regulations, rather "we need parity for crypto activity that is similar to traditional finance." He stated crypto lending should be regulated by the Federal Deposit Insurance Corporation (FDIC), and crypto trading should be regulated by the Commodity Futures Trading Commission (CFTC) and SEC.

Rep. Alma Adams (D-NC) asked Ms. Haas how Congress and industry can collaborate to structure a "successful regulatory framework for crypto trading platforms." Ms. Haas explained Coinbase is not advocating for a new federal regulator, but is advocating for having one regulator responsible for oversight of the crypto industry. Additionally, she stated Coinbase also supports establishing a self-regulatory organization (SRO) in addition to the federal regulator because the industry needs a "nimble group that is constantly looking at the changes in crypto."

Rep. Madeleine Dean (D-PA) asked if it is necessary to create a new regulatory framework for digital assets, or if these assets already fit into the current regulatory system. Ms. Haas asserted non-fungible tokens (NFTs) and other new tokens "do not fit under existing frameworks." She advocated for "definition taxonomy, clarity of regulator, and SROs."

Digital Wallets

Chairwoman Maxine Waters (D-CA) asked Mr. Cascarilla about Paxos' digital wallet pilot program using Pax Dollar (USDP) with Meta, formerly Facebook. Specifically, Chairwoman Waters asked about the President's Working Group on Financial Markets' (PWG) recommendation to limit stablecoin issuers partnerships with private companies to ensure the U.S. dollar is not undermined as the world's reserve currency. Mr. Cascarilla explained Novi, Meta's digital wallet, is a "regulated money services business" and Paxos has conducted its "due diligence on its regulatory oversight" of Novi.

Chairwoman Waters then asked about the impacts to the dollar if Facebook's three billion active users begin using the Pax Dollar. Mr. Cascarilla responded Novi is better positioned to discuss any intention to expand this pilot program, as it is currently limited to the U.S. and Guatemala.

Rep. French Hill (R-AR) asked Mr. Brooks about the regulatory regime for digital wallets and if connecting these digital wallets to banks is necessary. Mr. Brooks argued if digital wallets had to be hosted by a bank, the ability of consumers to self-custody their own assets would become obsolete. He advocated for digital wallet identification protocols that allow for security and legitimacy without including self-identifying information.

Stablecoins

Rep. Sean Casten (D-IL) expressed concern that consumers purchasing stablecoins may perceive the stablecoins to be a currency, but "in reality [the consumer] is holding something more like a commodity." He then asked Mr. Allaire if Congress should regulate stablecoins like commodities. Mr. Allaire answered in the negative. He stated stablecoins, such as Circle's stablecoin, "operate under the same stored value of electronic money statutes." He asserted there are already reserve requirements and consumer protections in stablecoin trading.

Rep. Warren Davidson (R-OH) asked Mr. Brooks if Congress should provide more clarity around custody of stablecoins. Mr. Brooks explained cryptos are superior to the traditional financial system in terms of custody and self-custody of assets. He highlighted foreclosures during the 2008 financial crisis, stating "it was difficult for custodians to produce the original note that proved whoever was entitled to enforce that transaction because the paper had gone missing or custodians had merged." He asserted cryptos allow for self-custody and self-ownership of assets, in addition to increased financial privacy and affordability.

Rep. Josh Gottheimer (D-NJ) asked Mr. Allaire if it is necessary for stablecoins to be insured by depository institutions, or if partnering with insured depository institutions provides sufficient protections. Mr. Allaire responded Circle has decided to pursue a national bank charter and is "open to being a FDIC insured bank." However, he stated Circle's "full reserve digital currency model … is not the same as a bank deposit" institution because the digital currency model does not lend customers' assets. He explained it "can be powerful to have a federal bank charter as a stablecoin issuer for the ultimate form of safety and soundness," but FDIC insurance may be unnecessary for stablecoin issuers because they do not lend. He concluded the FDIC has been "examining the appropriate forms of insurance for stablecoin issuers."

Rep. Jake Auchincloss (D-MA) asked Mr. Bankman-Fried about "the most important thing Congress can do to regulate stablecoins." Mr. Bankman-Fried suggested ensuring stablecoin issuers have the reserves they claim they have, as "this is a large portion of the risk" if a trillion-dollar stablecoin has only a billion dollars backing it. He recommended "daily attestations and third-party audits to ensure stablecoins are backed one to one."

Infrastructure Investment and Jobs Act Cryptocurrency Provisions

Rep. Al Lawson (D-FL) noted the Infrastructure Investment and Jobs Act (IIJA) expanded the definition of a crypto "broker" to include any person who regularly provides a service that executes transfer of digital assets, and requires the broker to report those transactions to the Internal Revenue Service (IRS). He stated this expanded definition of broker would include crypto miners, validators, and developers. He then asked if this expanded broker definition is problematic because it would "require non-brokers to report transactions for people who are not even their customer." Mr. Brooks explained there is a "difference between centralized exchanges who agree they should be in tax reporting versus decentralized algorithms with no company involved and no one well situated to provide that kind of tax reporting." He explained the decentralized algorithms are what allows peer-to-peer transactions with no intermediary. Ms. Dixon emphasized this expanded definition of broker would include entities that do not have access to the necessary information needed to report transactions to the IRS.

Rep. Budd asked if the IIJA's crypto provisions are harmful to the industry. Ms. Haas stated the broker definition included in the legislation was "intentionally overly wide" and includes entities "that have no ability to comply with reporting regimes." She added this expanded broker definition adds "additional reporting risk to privacy and pulls in parties that do not need to be covered by this rule."

Cybersecurity

Rep. Carolyn Maloney (D-NY) highlighted a recent hack of 6,000 Coinbase customers. She asked Ms. Haas about Coinbase's consumer protections in the event of a hack or unauthorized withdrawals. Ms. Haas explained only two percent of Coinbase assets are held in a "hot wallet," and hot wallets are vulnerable to hacks. She claimed Coinbase protects customers from any hot wallet attacks through third-party insurers and using its own balance sheet to reimburse customers. She added individual Coinbase users' accounts have been subject to cyberattacks, not Coinbase's broader network. Rep. Maloney asked if these consumer protections are uniform across all crypto platforms. Ms. Haas responded she can only speak to Coinbase protocols. Rep. Maloney then asked if consumers would benefit from standardized protections across all crypto platforms. Ms. Haas agreed "there is opportunity there."

Rep. Pete Sessions (R-TX) asked Ms. Haas how to identify fraud and risk in the digital assets system. Ms. Haas explained Coinbase complies with Know Your Customer (KYC) regulation; completes a "robust assessment" of each asset listed on its trading platform by examining legal risks and ensuring they are not securities; and continually examines its exchanges for spoofing and wash trading. She added blockchains are easy to monitor because they are "extremely transparent."

Rep. Barry Loudermilk (R-GA) asked Mr. Brooks if blockchain enhances cybersecurity. Mr. Brooks responded blockchains "are as much about transparency as they are about security." He explained blockchains enhance cybersecurity of the digital asset payments system because they are based on a "consensus mechanism," meaning "there has to be thousands of computers agreeing that a change can be made" on the blockchain. He stated this structure makes blockchains more difficult to attack, and it is easier to identify a cyberattack faster than cyberattacks in the traditional banking system.

Rep. Gottheimer expressed concern about the use of crypto in illicit financing. He then asked Mr. Bankman-Fried how crypto exchanges ensure their consumers are protected from hacking and theft, and if these exchanges notify law enforcement when suspicious transactions are identified. Mr. Bankman-Fried explained FTX mandates all users have two factor authentication, in addition to conducting KYC "surveillance on all users." He added FTX works cooperatively with law enforcement in the U.S. and internationally because the "combination of KYC surveillance and transparency of blockchain can make it a tool for tracking funds from illicit activity."

Rep. William Timmons (R-SC) asked Mr. Bankman-Fried how centralized exchanges can retrieve ransomware paid through cryptos. Mr. Bankman-Fried responded FTX has assisted in retrieving $10 million of ransomware payments in cooperation with law enforcement. Rep. Timmons then asked why exchanges cannot retrieve 100 percent of the ransomware funds. Mr. Bankman-Fried responded "any asset on our platform can be retrieved," however FTX cannot retrieve assets "sent in another direction." Rep. Timmons asked about tools that could aid in greater recovery percentages. Mr. Bankman-Fried stated "speed" is essential for successful recovery. He suggested standardizing communication channels with law enforcement and exchanges.

Financial Inclusion

Rep. Ann Wagner (R-MO) asked how digital assets and blockchains can facilitate greater financial inclusion to underbanked or unbanked populations. Ms. Dixon explained because blockchain eliminates the need for intermediaries in financial transactions, it allows users without bank accounts to access this technology and participate in this simplified and expedited financial system. Mr. Allaire agreed financial inclusion is a "critical design goal" of digital assets, adding that UDS Coin (USDC) "enables users to transfer dollars in a fraction of a second with a very low transaction cost." He concluded the openness of digital currencies "creates an opportunity for anyone with a mobile device to access this system."

Rep. Gregory Meeks (D-NY) asked Mr. Allaire about Circle's partnerships with minority depository institutions (MDIs) and community development financial institutions (CDFIs). Mr. Allaire explained Circle launched a new broad-based initiative called Circle Impact, which will "take billions of dollars of deposits held behind USDC and place those with MDIs and CDFIs throughout the U.S." He explained Circle does not participate in lending, so this initiative is "an opportunity to work with banking institutions to benefit from strength in balance sheets to open up credit and lending in underserved communities." Additionally, he claimed Circle is coordinating with federal banking regulators on their own initiatives to support MDIs and CDFIs.

Rep. Torres asked Mr. Cascarilla how cryptos and blockchains can mitigate unaffordable remittance fees of the traditional financial system. Mr. Cascarilla stated an "important element" of cryptos and blockchains is these technologies remove intermediaries, which eliminates minimum bank account fees or balances. He also highlighted the instantaneousness of digital asset transactions.

Financial Stability

Rep. Al Green (D-TX) asked Mr. Brooks about the possibility of a "bubble" in the crypto market. Mr. Brooks asserted much of the price volatility of cryptos can be attributed to the early stages of the market and the "thinly traded nature of the asset" compared to other assets. He explained the U.S. equity and debt markets are stable because of "price discovery" mechanisms, such as regulated equity mutual funds, derivatives, and futures products that "provide the market with a forecast." However, he noted the U.S. has "not developed these price discovery tools for crypto," so "one person's unwinding position could have a massive effect on the price" of a crypto. He advocated for "more liquidity and price discovery to mitigate volatility" in the crypto markets. Mr. Bankman-Fried added blockchain technology allows for constant risk monitoring in real-time, in addition to FTX storing collateral from users to backstop their market positions. He noted one aspect that precipitated the 2008 financial crisis was "a number of bilateral, non-reported transactions between financial counterparties that got re-leveraged so that no one knew how much risk was in the system." He asserted this practice would not be possible with digital assets.

Rep. Dean asked Mr. Brooks how to ensure the crypto industry does not threaten financial stability. Mr. Brooks responded that at the "beginning of a revolution the early days will see turbulence," adding cryptos' "price volatility does not make it different from the U.S. equity markets."

Rep. Bryan Steil (R-WI) asked Mr. Brooks how the growth of DeFi can drive financial inclusion. Mr. Brooks explained fees associated with traditional bank accounts cause banks accounts to be unaffordable for certain consumers, however he highlighted the zero fees associated with digital assets. He argued the accessibility of digital assets can allow for greater wealth creation.

Digital Assets as Securities

Rep. Wagner asked Ms. Haas if additional guidance and clarity are needed for investors and market participants in crypto and other digital asset markets. Ms. Haas argued "existing laws, regulation, and legal precedent make it clear that blockchain tokens are not securities," asserting that blockchain tokens are "either digital property or a new way to record ownership." However, she agreed it would "benefit" the crypto industry to "have agreed upon definitions."

Rep. Ed Perlmutter (D-CO) asked Mr. Bankman-Fried if FTX is registered with the SEC. Mr. Bankman-Fried answered in the negative because FTX does not list securities. However, he claimed he is "excited to explore" the possibility of listing securities under the guidance of the SEC. He also recommended implementing a uniform regulatory regime between the SEC and CFTC.

Rep. Barr asked Mr. Brooks about the process that determines if a digital asset is a security. Mr. Brooks highlighted a test developed by the Crypto Rating Council (CRC) that developed an "objective, quantitatively based process that asks several questions about the asset across dimensions of the Howey Test." He noted the CRC cannot determine authoritatively what a security is, but it can determine how risky the digital asset is.

Rep. Cindy Axne (D-IA) expressed concern the CFTC does not have regulatory authority over spot trading securities. She then asked Mr. Bankman-Fried if this regulatory gap allows different companies to provide different levels of consumer protections. Mr. Bankman-Fried responded FTX has “much the same investor protections on our spot markets as our derivatives market.” However, he expressed support for instituting “a similar regime of spot and commodities as we see for the derivatives.” Rep. Axne then asked if FTX and Coinbase publicly report their order histories, and if there are regulatory standards to ensure these reports are accurate. Mr. Bankman-Fried responded FTX does report “all of our public market data,” and claimed he would “be supportive for that becoming a regulatory standard.” Ms. Haas also responded that Coinbase makes their data “available.”

Central Bank Digital Currency (CBDC)

Rep. Barr asked Mr. Allaire about the differences between stablecoins and a central bank digital currency (CBDC), in addition to the potential advantages stablecoins can offer over a CBDC. Mr. Allaire responded stablecoins are built on an “open-internet technology model,” while a CBDC would be built on a “closed loop technology administered by the government.” He added “most payment system innovations have been driven by the private sector.” Rep. Barr then asked if dollar stablecoins could address concerns surrounding China’s advances in its CBDC, including its ability to potentially evade sanctions. Mr. Allaire answered in the affirmative. He asserted the digital dollar is currently “winning the race,” as the experimental beta of the digital yuan has done $10 billion in transactions compared to the dollar stablecoins that have facilitated trillions of dollars in transactions. He argued the primacy of the dollar stablecoin infrastructure should be a strategic and national security priority.

Environmental Impacts of Cryptocurrency

Rep. Rashida Tlaib (D-MI) expressed concern with the amount of electricity needed for Bitcoin mining, claiming it consumes more electricity than Google, Apple, Microsoft, and Facebook combined. She then asked Ms. Dixon why Bitcoin mining is so energy intensive. Ms. Dixon explained Bitcoin’s “consensus is achieved through math equations that require a lot of energy.” However, she claimed Stellar’s protocols consume less energy than Visa transactions. She added the energy consumption of crypto mining depends on the mechanism, and agreed it “is important to consider the sustainability concerns.” Rep. Tlaib then asked if central banks should take a “more active role” in lowering carbon emissions from crypto mining. Ms. Dixon responded “we need to focus on this issue without regulation” by “minimizing energy consumption as much as possible” through collaborating with governments to achieve a carbon neutral status. Rep. Tlaib asked what tools policymakers can use to incentivize a transition from carbon-intensive crypto mining. Ms. Dixon responded Stellar has hired a third party to examine how its network “can be better,” and she suggested all exchanges conduct this research.

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Please click here for the archived hearing.