

Summary of the Digital Commodity Exchange Act of 2021

The Digital Commodity Exchange Act (DCEA) is legislation to fill the regulatory gaps between the U.S. Commodity Futures Trading Commission (CFTC) and the U.S. Securities and Exchange Commission (SEC) in digital asset markets. It creates a framework to regulate trading venues that list emerging digital commodities for public trading, such as Bitcoin, Ether, their forks, and other similar digital assets. Additionally, it provides a regulated process for pre-sold digital commodities to become publicly available for trading without sacrificing protections for retail consumers of digital commodities. Finally, it provides a regulatory regime to verify the integrity of asset-backed stablecoins.

New Framework for Digital Commodity Exchanges and Custodians

The DCEA builds on and extends the existing commodity markets framework, which has served participants in futures markets for decades. It provides authority for the CFTC to register and regulate Digital Commodity Exchanges as a new type of registered entity with requirements that closely parallel existing requirements for existing intermediaries in commodity derivatives markets.

The law simplifies the spot market for digital assets by providing trading venues an alternative to the cumbersome state-by-state money transmitter regulations. It also builds on the work done in many states by relying on state and federal banking regulators to license and supervise custodians.

Digital Commodity Exchanges

A registered Digital Commodity Exchange (DCE) would be subject to comprehensive CFTC oversight and regulations. Similar to how Designated Contract Markets (DCMs) and Swap Execution Facilities (SEFs) are regulated by the CFTC, a registered DCE would be required to comply with regulations regarding monitoring of trading activity, prohibition of abusive trading practices, minimum capital requirements, public reporting of trading information, conflicts of interest, governance standards, cybersecurity, and more. Exchanges would also be subject to limitations on which digital commodities they would be permitted to offer for trading.

Additionally, the proposed legislation builds on the existing commodity market practices required of Futures Commission Merchants (FCM) to protect customer assets held by third parties. DCEs would be required to segregate customer assets and be incorporated into the existing commodity broker bankruptcy process. These two tools have proven to be resilient and trusted by market participants throughout the derivatives markets.

Registration with the CFTC would preempt the existing state-based money transmitter licensing regime trading venues are currently subjected to, which are not fit-for-purpose when applied to a spot trading market. The current regime is cumbersome, requiring separate licensing in each state of operation, and insufficient, failing to provide oversight of the trading and market activities on the platform.

Voluntary Registration

The registration regime is voluntary but with strong incentives for properly placed trading venues to seek registration.

Trading venues would opt into the CFTC Digital Commodity Exchange regime or remain regulated under individual state money transmitter licenses. Trading venues will be incentivized to choose CFTC regulation to reduce their regulatory burdens by facing only one regulator, be eligible to offer leveraged trading, and be the point of entry for new digital commodities to the retail public.

Qualified Digital Commodity Custodians

A registered Digital Commodity Exchange would be required to hold customer digital commodity assets in a *Qualified Digital Commodity Custodian*, an entity regulated by a state, federal, or international banking regulator. The CFTC would establish minimum standards for supervision and regulation a regulator would have to impose for an entity regulated under the regime to be “qualified.”

Improving the Process to Create Digital Commodities

The DCEA simplifies the process in which new digital commodities are brought to market by creating clear jurisdictional lines between the CFTC and the SEC and establishing a more collaborative, flexible process to evaluate the appropriateness of making digital commodities available for public trading.

Compliance with Existing Securities Law

The DCEA would continue to require entities raising money to fund a digital commodity project to follow securities laws to accept funds from investors. This activity would continue to be subject to the jurisdiction of the SEC, under the existing rules for that activity.

However, if participation in a securities offering results in the promise or delivery of an asset that meets the definition of a digital commodity, transactions involving the promised or delivered digital commodity would be subject to the regulatory regime provided in the DCEA.

Pre-sold Digital Commodities

The DCEA defines the delivery or promise of a digital commodity in exchange for participating in a securities offering or investment contract as a “digital commodity presale.” Participants in digital commodity presales would be subject to the new trading restrictions on the assets received through the presale until a DCE lists the asset for trading.

The proposed trading restrictions serve a similar customer protection function as trading restrictions in securities laws, but are tailored more appropriately to digital commodities. Most importantly, the DCEA establishes a clear process for lifting the trading restrictions.

Specifically, the DCEA would only permit the sale or transfer of a digital asset in limited instances:

- to another person who would have been eligible for the relevant securities offering;
- on a registered digital asset exchange;
- to utilize the digital asset for its intended purpose; or
- under a limited CFTC-provided public interest exemption.

A DCE would be required to evaluate the digital commodity to determine it is “not readily susceptible to manipulation” before it could be listed for trading and before the participants in the presale would be able to sell their holdings to the public. This process is intended to be similar to the existing process undertaken by DCMs in determining what contracts are available for trading on their exchanges but focused on examining the mechanics of the digital commodity itself, including its purpose, functionality, governance structure, distribution, and participation.

Once a unit of a digital commodity is sold through a registered DCE, all trading restrictions on the asset are removed, and it becomes freely usable by any market participant for any purpose.

Protecting Customers Utilizing Stablecoins

A digital commodity whose value is based on an underlying pool of assets is an asset-backed digital commodity. Integral to the value of these digital commodities are the assets available to support the value of all the outstanding digital commodities tokens issued.

The DCEA provides a new regulatory regime for certain stablecoins, based on the CFTC’s successful regimes to protect customers and customer assets across the wide range of commodity market intermediaries.

Registering Asset-Backed Digital Commodity Issuers

The DCEA permits stablecoin operators to register with the CFTC. Registration requires a stablecoin operator to meet certain obligations, including publicly sharing essential operational information about the stablecoin, protecting the assets backing the stablecoin, mitigating and disclosing conflicts of interest, and retaining books and records for examination by the CFTC.

Registration provides a simplified path for stablecoins to be utilized on registered digital commodity exchanges, encouraging compliance.

Full Accounting of Stablecoin Assets and Liabilities

The DCEA also provides the CFTC with authority to require those registered issuers to be subject to a comprehensive reporting and auditing regime to ensure assets backing the stablecoin are fully accounted for, and there are sufficient resources available to fully meet all redemption obligations.