

LXR Group

Biweekly Bulletin

Bringing our clients and subscribers exclusive policy updates and analysis from the world of capital markets, fintech, investor protection and more.

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Investor Advocates to Senate: Digital commodity legislation "must guarantee investors' ability to access the state and federal court system to resolve cases."

On December 9th, a coalition of consumer and investors advocacy organizations sent a letter to the Senate Agriculture Committee voicing "strong concern" about the fact that bipartisan digital commodity legislation now emerging in the Senate "does not contemplate any safeguards with respect to injured investors' ability to hold digital commodity issuers, brokers, and affiliated entities, accountable for misconduct."

Although the [letter](#) addresses a specific [bill](#) pending in the 117th Congress, it also puts down a marker for future legislation, including legislation related to SEC authorities and responsibilities that is likely to [emerge](#) from the Banking and Financial Services Committees next year. Organizations signing the letter include: *The American Association for Justice (AAJ)*, *Americans for Financial Reform (AFR)*, *Consumer Action*, *Consumer Federation of America (CFA)*, *Consumer Reports*, *Institute for Agriculture and Trade Policy (IATP)*, *National Association of Consumer Advocates (NACA)*, *Public Citizen*, *Public Investors Advocate Bar Association (PIABA)*, *Public Interest Research Group (US-PIRG)* and *20/20 Vision*.

Analysis: 8 Key Takeaways from Tuesday's FTX Hearing

On December 13, 2022, the U.S. House Committee on Financial Services (HFSC) held a Full Committee Hearing entitled, "Investigating the Collapse of FTX, Part I." The only witness to [testify](#) at the hearing was John J. Ray III, a bankruptcy expert who has since Nov. 12 served as Chief Executive Officer, FTX Group. Former FTX CEO Sam Bankman-Fried, who goes by SBF, was [expected](#) to testify as part of a separate panel at the same hearing, but in a shocking turn of events, he was instead [arrested](#) on Monday night by authorities in the Bahamas, where he was residing, after the filing of charges by the U.S. Attorney for the Southern District of New York.

Here are the main takeaways from the hearing.

1. Digital Asset Policymaking on the HFSC Next Year will be #BIPARTISAN.

From the outset of Tuesday's hearing, through the Committee's final gavel, Chair Waters and Ranking Member McHenry took pains to underscore the "bipartisan" nature of the hearing – with McHenry explaining that "we worked together to get this hearing on the books," and calling it "the first bipartisan hearing this Committee in the last four years." This message was reiterated by McHenry and Waters repeatedly, on Tuesday, and [again](#) at a separate hearing on Wednesday.

While there is much Waters will miss about being in majority next year, we think that having the final say on a bipartisan crypto deal is unlikely to be one of them. In fact, after spending the better part of two years jumping through hoops and using her considerable talent and influence [to prevent](#) any serious tangible legislative action on crypto, we expect Waters to embrace the opportunity to legislate and negotiate from the minority if given the opportunity.

2. Rep. Brad Sherman (D-CA) has been waiting years for Tuesday's hearing.

It has been 3 years since Rep. Brad Sherman took over as Chair of the HFSC Subcommittee on Investor Protection and Capital Markets – a plumb perch through which to influence conduct of regulators, industry and all things market related. But Sherman has been effectively barred from using his gavel as a platform to scrutinize (and criticize) the industry. While it remains to be seen whether incoming HFSC Chair McHenry will greenlight subcommittee hearings on digital assets, Sherman is not waiting to [train his fire](#) on the industry and its apologists in Congress. (Cont. P. 3)

According to Sherman, the use cases for crypto [primarily involve](#) “drug dealers, human traffickers, sanctions evaders who find [its lack of regulation] a good feature,” or “tax evasion.” After reminding the HFSC that “for five years, I've been trying to ban American investments in crypto,” and that “I'm the only member of the House to get an F from the only crypto promoting organization that rates members of Congress,” Sherman proceeded to use his time at the hearing to make a critical point: “My fear is that we will view SBF as just one big snake in a crypto Garden of Eden. The fact is, crypto is a garden of snakes. For my colleagues: *Don't trash Sam Bankman-Fried and then pass [his bill](#).*”

Sherman also pointedly used the hearing to defend the SEC, and to call out specific members of the HFSC who have until very recently been among crypto’s biggest proponents and beneficiaries. **You can continue reading this blog post on the LXR Group’s website, [here](#).**

Top Policy Developments

CFTC Chair Behnam Before the Senate Agriculture Committee...Again

The Senate Agriculture Committee [held an oversight hearing](#) on December 1st about FTX’s blow-up. Titled “Why Congress Needs to Act: Lessons Learned from the FTX Collapse” with CFTC Chair Rostin Behnam as the sole witness, the hearing was perhaps more of a call for crypto legislation than any hearing on the topic we’ve seen.

If nothing else, the hearing made very clear that Agriculture Committee Chair Debbie Stabenow (D-MI) and Ranking Member John Boozman (R-MI) want to get their bipartisan Digital Commodities Consumer Protection Act across the finish line. Stabenow’s [opening statement](#) explained how the White House and the Financial Stability Oversight Council have recognized that federal law does not provide for sufficient oversight of commodities and have called for legislation “to close this gap,” and that the DCCPA “does exactly that.” Boozman’s [opening statement](#) was even stronger, explaining that the purpose of the hearing was “to explore how the CFTC would have used the [DCCPA] in a situation and to flesh out what regulatory gaps we need to fill to prevent such occurrences from happening again.”

Chair Behnam appears keen to help them with the bill. Although he never explicitly called for the bill’s enactment – preferring instead to [discuss the regulatory gap](#) and how “the SEC does not have authority to regulate or oversee any commodity and we, the CFTC do not have any authority to regulate cash commodity markets” – when asked by Chair Stabenow whether the DCCPA would have stopped FTX’s failure had it been in place, Behnam replied that “the DCCPA ... would have prohibited those [consequential] actions from occurring at FTX.” He did also say that, if legislation were enacted to give the CFTC rule-writing authority, he thought regulations could be drafted within 12-18 months.

No Senators came out in direct opposition to the bill, though Sherrod Brown (D-OH), who chairs the Senate Banking Committee, discussed the need to create “a framework that safeguards the traditional financial system that protects consumers, that doesn't put the crypto companies first,” and mentioned his letter to Treasury Secretary Janet Yellen that calling for “whole-of-government legislation” to address crypto (more below).

As for what occurred at FTX, the hearing did not shed much light. We learned about customer money at [Ledger X](#), FTX's US derivative clearinghouse regulated by the CFTC ("safe and ... where it's supposed to be") , but also that the CFTC could not examine FTX beyond that CFTC-regulated subsidiary. We learned the state of Ledger X's [non-intermediated clearing proposal](#) at the time of FTX's collapse ("As of the withdrawal date... there was no decision" and "there was no decision or recommendation from staff") , and also of FTX's lobbying of the CFTC (officials met with FTX 10 times over the past 14 months, all about the Ledger X proposal) .

The impression given by the hearing is that the Senate Agriculture intends to move forward with the DCCPA. The Senators intend to do a top-down review of the bill to examine whether anything should be changed, but they plan on moving legislation to give the CFTC increased authority over crypto commodities. The bill will likely face resistance from members on the Senate Banking Committee, and is likely to be revised significantly prior to reintroduction,

Senate Approves one-week government funding patch on Thursday night, averting a government shutdown until Dec. 23.

The measure, which passed in a 71-19 vote, gives top appropriators more time to hash out a \$1.7 trillion year-end spending package. Democrats and Senate Republicans earlier this week struck a deal on an outline for the omnibus appropriations bill. That measure will fund defense activities at roughly \$858 billion, a \$76 billion increase from current levels. An impasse over spending for domestic agencies was broken when Democrats agreed to limit increases to those Biden requested. House Republican leaders decided not to participate in the negotiations. Kevin McCarthy, the chamber's GOP leader, has urged Congress to delay action on the bills until Republicans take over the House on Jan. 3.

McHenry Cleared to Chair Financial Services.

On December 7, 2022, the House Republican Conference elected Rep. Patrick McHenry (R-NC) to serve as Chair of the House Financial Services Committee for the 118th Congress. McHenry's nomination will next be ratified by a vote of the full House Republican Conference on a date to be announced.

Minor Financial Services Provisions Added to FY 2023 NDAA

Negotiators last week unveiled legislative text for the [National Defense Authorization Act \(NDAA\)](#) for Fiscal Year 2023, the final "must pass" policy bill this Congress. The final bill includes a number of provisions relating to banking and financial regulation. Some include section 5705, the "[Fair Hiring in Banking Act](#)" which reducing barriers to employment opportunities based on past minor criminal offenses at insured banks and credit unions; section 5708, which requires the Federal Reserve to create and maintain a public, online, searchable database of institutions that have access to a Federal Reserve Bank master account and services; and title LVIII, the "[Financial Transparency Act](#)," which requires federal financial regulatory agencies to adopt data standards with respect to format, searchability, and transparency. Not included in the final bill was the SAFE Banking Act, which would have expanded banking access to marijuana-related businesses, ([although this bill could still pass this year as part of the omnibus legislation presently being negotiated.](#)) Also excluded from the final version was a House-passed provision that sought impose AML requirements on so-called "gatekeeping" activities such as legal and accounting services,

Top Regulatory Developments

SEC Votes to Propose Market Structure Rules.

On December 14th, the SEC voted to propose a [package of market structure reforms](#) that, if adopted, would mark biggest changes to American equity market structure in nearly two decades.

- The first [proposed rule](#) would update Rule 605 under Regulation NMS for order executions in national market system stocks to expand the scope of entities subject to Rule 605, modify the information required to be reported under the rule, and change how orders are categorized for purposes of the rule. Rule 605 requires market centers, such as exchanges, alternative trading systems (ATs), and broker-dealer internalizers, to make monthly disclosures of standardized information concerning execution quality for orders in National Market System (NMS) stock. Since its adoption 20 years ago, the scope and content of Rule 605 reports have not kept pace with changes in the markets.
- A second [proposed rule](#) would update SEC Regulation NMS to adopt variable minimum pricing increments for the quoting and trading of NMS stocks, reduce access fee caps, and enhance the transparency of better priced orders. The proposal has three main components: (1) varying and lowering the minimum pricing increments, or “tick sizes,” for quotes and trades in certain NMS stocks; (2) reducing the access fee caps and increasing fee transparency for exchanges, and (3) improving the dissemination of information about smaller orders.
- A third proposed rule is designed to promote competition in retail order flow. Under current SEC rules, certain common industry practices favor large, sophisticated market participants at the expense of retail investors.

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The Bulletin is published every other week, when one or both chambers of Congress are in session. It provides a comprehensive snapshot of the key developments in financial services legislative and regulatory policy; detailed analysis of certain legislative and regulatory proposals; a calendar showing key events, on and off Capitol Hill during the next work period; podcast and reading recommendations; curated job postings; and more. Subscribers to the Bulletin are also entitled to receive certain other LXR Group publications, including Legislative Analysis and Election Analysis.

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