

LXR Group

Policy Bulletin

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

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Top Developments: Big Crypto Catches a Big Break.

On July 13, a U.S. District Court judge [ruled](#) that sales of Ripple's "XRP" token directly from Ripple to institutional investors constituted an unregistered offer and sale of investment contracts," thus in violation of federal securities laws. At the same time, the court found that Ripple's offer of \$757 million worth of tokens to retail purchasers via "programmatic sales" of [XRP](#), or sales on crypto exchanges, did not violate the securities laws, because the purchasers in that instance were secondary market buyers who "did not know to whom or what it was paying its money."

The long and medium-term significance of the court's split decision remains entirely unclear; however, with [committee votes](#) on major House [crypto legislation](#) looming, the timing could not have been better for crypto industry.

As Congress enters its last two weeks of legislative work prior to the August recess, a key question is whether Republicans will be able to capitalize on the ruling as a way to overcome Democrats [refusal](#) to engage in the legislative process surrounding digital assets legislation.

House, Senate Appropriations Committees Approve FY 2024 FSGG Spending Bills. On Thursday, July 13, 2023, the House Appropriations Committee held a Full Committee markup of the House version of the FY 2024 Financial Services and General Government ("FSGG") Appropriations [bill](#). The bill provides a total of \$25.279 billion in non-defense discretionary spending for agencies and programs under the subcommittee's jurisdiction, including \$2,039,321,000 for the SEC. The House figure represents a roughly \$170 million cut to the SEC's current FY 2023 funding and falls \$436 million short of the SEC's requested funding for FY 2024. The bill also includes a provision prohibiting the use of funds to finalize or enforce the SEC's [proposed](#) Climate Disclosure rule, among other riders targeting the Biden Administration's regulatory efforts. According to the accompanying [House Committee report](#), of the SEC's total appropriation, \$1,999,663,000 for SEC Salaries and Expenses; \$25,243,000 for costs associated with the SEC's District of Columbia headquarters facilities and \$14,415,000 for costs associated with the SEC's Atlanta regional office, to be fully derived from offsetting fee collections. Other specific issues addressed in the Report include: (1) *Digital Asset Accounting Standards*; (2) *Economic Analysis*; (3) *Reporting on Influence of Public Companies*; (4) *Private Fund Advisers Rule Analysis*; (5) *Reforming the Registration Process for Registered Index Linked Annuities*, and (6) *the Consolidated Audit Trail (CAT)*. .

Later in the day, the Senate Appropriations Committee [met](#) to consider that body's [version](#) of the FSGG bill. The Senate bill would provide \$2.403 billion for the SEC, as well as \$1.884 billion for the Department of Treasury (excluding the IRS). It also allocates \$450 million to the Federal Trade Commission—a \$20 million increase from 2023 FY, which will assist in protecting America's most vulnerable population from fraud. The Senate's version of the FSGG bill passed the Appropriations Committee 29-0. Among other issues, the [Senate Committee Report](#) (1) *encourages the SEC to use its authority to promote "retail-friendly disclosures for SPACs,"* (2) *requires the SEC to brief Congress on implementation of the Holding Foreign Companies Accountable Act,* and (3) *urges the agency to maintain its "longstanding position that mandatory arbitration clauses violate the anti-waiver provisions of securities laws."* The Senate Report also includes a fairly lengthy paragraph on the SEC Investor Advisory Committee ([IAC](#)) which among other things *"encourages the Chairman of the Commission to establish a transparent process for identifying candidates that: (1) incorporates the perspectives of each member of the Commission; (2) ensures that a wide array of market and investor perspectives are represented; and (3) reflects the Commission's commitment to expanding diversity, inclusion, and opportunity for all Americans in our capital markets."* Also, as discussed on page 6 of this Bulletin, the Senate Report – like the House Report - calls for the SEC to do more to address [unpaid broker-dealer arbitration awards](#).

Consumer Advocates Spell Out Opposition to House "Capital Formation" bills. In a 10-page letter sent to the Senate Leadership and Senate Banking Committee last week, Americans for Financial Reform (AFR) sought to make the case for why the Senate should oppose "a series of legislative proposals that have recently been approved by the relevant House committee, HFSC , and, in some cases, by the full House of Representatives, that seek to amend the federal securities laws in ways that would be harmful to investors."The AFR [letter](#), which comes on the heels of a sweeping [letter of opposition from state securities regulators](#), addresses 20 specific proposals - many of which have bipartisan support - that have been approved this year by the HFSC and in some cases the Full House. Also last week, the Consumer Federation of America (CFA) in a [letter](#) outlined its opposition to "19 separate bills, most of which would reduce transparency, integrity, and accountability in U.S. securities markets."

(Big Crypto, continued from P.1) In the broadest sense there are two major impediments to advancing legislation that would establish a regulatory framework for digital or crypto assets. The first problem is jurisdictional: the federal government's two major market regulators, the SEC and the CFTC, are under the jurisdiction of different authorizing committees. The second is political: the fate of the multi-trillion digital asset ecosystem will not be set in statute without bipartisan consensus and the stability it conveys.

In May, House Republicans solved one of these vexing obstacles when House Financial Services (HFSC) Chair Patrick McHenry (R-N.C.) and House Agriculture Chairman GT Thompson, (R-Pa.), announced that their panels would [work together](#) on cryptocurrency legislation in what remain the most substantial cross-committee collaboration on the issue to date.

The remaining obstacle to legislative progress on crypto policy has been HFSC Ranking Democrat Maxine Waters' and other key Democrats unwillingness to [engage](#) in the cross-committee process.

Despite Republican efforts [to prod Democrats](#) to engage, as recently as late last week, the likelihood of that happening appeared remote: Republicans were on the verge of coming up short on the second key goal. Indeed, prior to Thursday's ruling, the HFSC and Agriculture committees seemed on the cusp of moving forward with a markup an almost completely partisan bill. In other words, conceding defeat.

Then, late last Thursday, a judge of the U.S. District Court of the Southern District of New York's issued a [ruling](#) in the high-profile case of *SEC v. Ripple Labs Inc. et al.* Specifically, the court agreed with Ripple Labs' argument that roughly half of its sales of XRP didn't violate investor-protection laws.

The Ripple vs. SEC legal battle has been a closely watched [case](#) in the crypto ecosystem, with implications for the industry as a whole and the SEC's [approach](#) towards other cryptocurrencies. Thursday's ruling was trumpeted as a victory by Ripple, and crypto enthusiasts of all stripes, including House Republicans. [In a joint statement](#) released Friday, Reps. McHenry and Thompson cast the ruling a tipping point: "The decision underscores the need for Congress to provide clear rules of the road for the digital asset ecosystem [and] recognizes what Republicans have said all along: there is a limit to the SEC's reach. Outcomes like this are what happens when regulators force courts to make policy instead of Congress. Our digital asset market structure bill is essential to filling the regulatory gaps highlighted in this decision. We look forward to advancing this legislation out of our respective committees this month."

Rep. Tom Emmer (R-MN), the House Majority Whip, leaned into this framing in a [tweet](#) over the weekend: "The Ripple case is a monumental development in establishing that a token is separate and distinct from an investment contract it may or may not be part of. Now, let's make it law."

It's still too early to evaluate the political implication of the ruling. Nevertheless, Republicans may be correct in sensing opportunity.

The basic position of House Democrats throughout this year has been to back the SEC, and put on the onus on the industry to comply with securities laws, while conceding that if actual regulatory gaps exist, they need to be addressed. As Rep. Waters [explained](#) at a hearing in April:

"Despite what those across the aisle may say, we do not need to create an entirely new and special framework for crypto—we already have one. Rather, crypto firms...need to comply with the laws of the land. To the extent there are actual gaps in our laws, such as limitations on the SEC's reach overseas, we should focus on those, and not on creating more complexity through a whole new regulatory framework."

The court's apparent affirmation that the same exact token can be a security sometimes, and not a security at other times, may or may not be problematic from a legal standpoint. But from a policy standpoint, this kind of ambiguity seems confusing, unnecessary, and ultimately untenable.

To the extent the ruling is seen as affirming the idea that "actual gaps" exist, this could provide moderate Democrats on the HFSC with the opportunity to break with Waters and negotiate with Republicans.

Congressional Developments:

Bipartisan Senators Introduce Revised Crypto Oversight Bill. On July 7th, Senators Kirsten Gillibrand (D-NY), a member of the Senate Agriculture Committee, and Cynthia Lummis (R-WY), member of the Senate Banking Committee, re-introduced the [Responsible Financial Innovation Act](#). According to a [summary](#) of the legislation, "the consumer protection title of the new bill has nearly doubled since the 2022 version, and includes provisions designed to prevent another FTX, including disclosures, proof of reserves, advertising standards and limits on lending." Unlike the 2022 version of the legislation, the new bill would require firms to segregate client assets.

The Gillibrand-Lummis [bill](#) aims to create a complete regulatory framework for digital assets "that encourages responsible financial innovation, flexibility, transparency and robust consumer protections while integrating digital assets into existing law." The new bill would give the CFTC more authority to oversee certain tokens and addresses everything from sanctions compliance and taxes to stablecoin regulation and impose third-party custody requirements, according to a document detailing the updates to the legislative proposal. It would also create new advertising standards for marketing crypto and require exchanges to show proof that they have enough assets to cover customer balances. The bipartisan nature of the bill gives it a promising veneer; House committees are days or weeks away from marking up [crypto legislation](#) that few if any Democrats are likely to support. Nonetheless, the Senate crypto legislation would have to overcome significant hurdles to get enacted this year. Prominent Democratic senators on the Banking Committee have [expressed](#) serious concerns with the validity of cryptocurrency generally, and the negative impact it has had on investors recently. Without more broad-based support, the legislation is likely to stall in the Senate.

House Republicans Launch ESG Blitzkrieg. On July 12th the House Financial Services Committee (HFSC) held a Full Committee [hearing](#) to examine environmental, social, and governance (ESG) policy in financial regulation, and specifically, "the Biden Administration's weaponization of financial regulators to push climate and social goals." The hearing was the first in a remarkable set of four hearings held in under 48 hours in the HFSC, all aimed at undermining the SEC's [climate disclosure rulemaking](#) and discourage similar climate conscious rulemakings contemplated by [other](#) agencies. Subsequently, on July 13, the HFSC's Subcommittee on Capital Markets held a morning [hearing](#) focusing on "*Reforming the Proxy Process to Safeguard Investor Interests*," which included no less than [13 draft legislative proposals](#). Later that day, the HFSC Subcommittee on Oversight and Investigations held its own [hearing](#) on

"*Oversight of the Proxy Advisory Industry*," featuring testimony from executives representing the two proxy advisory firms [Glass Lewis](#) and [Institutional Shareholder Services \(ISS\)](#).

“**Today, Republicans are giving the term 'investor protection' new meaning by pushing legislation that would protect investors from their own ideas.**”

-Rep. Maxine Waters (D-CA)

A final [hearing](#) – held in the Subcommittee on Housing and Insurance and entitled "*How Mandates Like ESG Distort Markets and Drive Up Costs for Insurance and Housing*" was held Friday, July 14.

The Republican's legislative assault on ESG comes amidst [polling](#) showing that, despite the sharp increase in attention ESG has received inside the beltway in recent years, the general public is no more familiar with ESG today than two years ago. Conspicuous in their absence from any of this week's hearings were the nation's top asset management firms: BlackRock, Fidelity and Vanguard. Proxy advisors were a prominent topic of discussion at the first three hearings of the week, culminating in last Wednesday's oversight hearing, which saw witnesses from both members of the proxy advisor "duopoly" testify before Congress for the first time.

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on extensive research and review. Supporters of the current proxy process on the HFSC – mostly Democrats - also frame the discussion in terms of "corporate democracy," and criticized the GOP's legislative proposals as efforts to limit shareholder rights and empower corporate boards. In recent years, the political divisions over proxy advisors have come to be mirrored by Commission, to the point that SEC policy has oscillated back-and-forth according to which party chairs the agency.

Regulatory Developments:

New SEC Investor Advocate Submits First Report to Hill. On June 29, the recently appointed SEC Investor Advocate, Cristina Martin Firvida, submitted her Office's first Annual Report to Congress. The statutorily mandated report - 48-pages – detailed the Office of Investor Advocate's (OIAD) principal objectives for FY 2024. The report largely adhered to familiar issues and themes. Among the areas of focus the report specifically identified as priorities were: (1) *Broker and Adviser Conduct, (explicitly including Reg. BI and questions about whether digital engagement practices evade Reg. BI)*; (2) *Private Markets (including the accredited investor definition)*; (3) *Equity Market Structure*; (4) *Outsourcing by Investment Advisers*; and (5) *Mutual Fund Transaction Costs and Dilution*.

SEC Approves Money Market Rule Change. The SEC voted 3-2 last Wednesday along party lines, to adopt changes to the rules governing money-market funds (MMFs), which the Federal Reserve has had to backstop with emergency lending facilities in 2008 and 2020. Two previous MMF overhauls undertaken by the SEC failed to stop investors from fleeing certain MMFs when financial markets faced extreme stress early in the pandemic. The new rules increase minimum liquidity requirements for MMFs, prohibit the temporarily suspension of redemptions, and enhance reporting requirements allowing the SEC to more easily monitor and access money market fund data.

States Secure \$13 Million in Settlement with Raymond James. On July 11, the North American Securities Administrators Association (NASAA) announced a \$13 million settlement with Raymond James & Associates, Inc. and Raymond James Financial Services, Inc. resulting from an investigation into the company's practices of charging unreasonable commissions to retail customers on small dollar transactions. The cost of the violations to the firm's customers over the 5-year period the practice occurred was estimated at \$8.25 million. Under the settlement, Raymond James agreed to compensate consumers in participating states through restitution plus interest, in addition to fines and other costs associated with the investigation.

SEC Proposes Rule Amendments to the Broker-Dealer Customer Protection Rule. On July 12, the SEC voted to propose amendments to Rule 15c3-3 (the Customer Protection Rule) to require certain broker-dealers to increase the frequency with which they perform computations of the net cash they owe to customers and other broker-dealers (known as PAB account holders) from weekly to daily. The proposal would require "carrying broker-dealers" with large total credits to increase the frequency of their customer and PAB reserve computations from weekly to daily. Specifically, the proposal would require carrying broker-dealers with average total credits equal to or greater than \$250 million to make the relevant computations daily, as of the close of the previous business day. Additional information about the proposal is available on the SEC website.

Other Developments:

Push For Bitcoin ETF Refuses to Relent. BlackRock and Valkyrie refiled their application for an exchange-traded fund that invests directly in Bitcoin (an ETF that invests in Bitcoin futures already exists), shoring up their filings after the Securities and Exchange Commission indicated that the recent wave of requests seeking to launch such a product were insufficient. Both firms said via new documents filed with the SEC that Coinbase Global Inc. will provide market surveillance in support of their proposed ETF, which could significantly reduce fraud and market manipulation. The new filing comes two weeks after the SEC reportedly told Nasdaq and Cboe Global Markets, which filed

the applications on behalf of BlackRock and Fidelity Investments, that their filings are insufficient. Blackrock's application for a Bitcoin spot ETF last month sparked a new wave of optimism around the crypto market which led other major firms such as ARK Investment, Valkyrie, and Fidelity to file their own applications for a Bitcoin ETF.

Bank of America Hit with Numerous Enforcement Actions. On July 11, the Consumer Financial Protection Bureau (CFPB) ordered Bank of America to pay more than \$100 million to customers for systematically double-dipping on fees imposed on customers with insufficient funds in their account, withholding reward bonuses explicitly promised to credit card customers, and misappropriating sensitive personal information to open accounts without customer knowledge or authorization. The Office of the Comptroller of the Currency (OCC) also found that the bank's double-dipping on fees was illegal. BofA will pay \$60 million in penalties to the OCC.

House, Senate FSGG Reports Agree on FINRA's "Failure" to Address Unpaid Awards. It comes as a little surprise that the Republican controlled House Appropriations Committee and the Democratic controlled Senate Appropriations Committee have found a great deal about which to disagree. That makes it all the more notable that both Committees approved FSGG bill reports last week that singled out FINRA's failure to take steps to reduce or eliminate unpaid awards arising from the arbitration forum that it administers for member broker-dealers. Specifically, the Senate FY 2024 FSGG Report, approved last Thursday, registers frustration that "*FINRA has failed to undertake steps to address unpaid arbitration,*" and calls for the SEC to "*to engage with FINRA to identify ways to reduce and eliminate the occurrence of unpaid award.*" Meanwhile, the House version of the FY 2024 FSGG Report, as amended, goes a step further, directing the SEC to "*submit to Congress a report summarizing FINRA's ongoing and planned efforts to reduce and eliminate the occurrence of unpaid judgements.*"

Senate Banking Committee Democrats Urge CFPB to Act on A.I. Scams. On July 6, Senators sent the CFPB a letter that raises concerns about AI's role in complex fraud, including voice cloning. The letter asks that the CFPB take action to govern AI and machine learning in consumer financial products. In the letter, committee members point out that with banks and many peer-to-peer payment apps, there is no safeguard or repayment in the event a consumer suffers from fraud. The letter states that "Voice cloning add a new, threatening dimension to these scams." The letter also raises concerns about the vulnerability of financial institutions themselves to AI breaches.

Upcoming Events:

- House Financial Services Subcommittee on Financial Institutions and Monetary Policy —Hearing: "*Climate-Risk: Are Financial Regulators Politically Independent?*" July 18, 2023 10:00 AM
- House Financial Services Subcommittee on Capital Markets — Hearing: "*Oversight of the SEC's Division of Corporation Finance*" July 18, 2023 10:00 AM
- House Financial Services Subcommittee on National Security, Illicit Finance, and International Financial Institutions — Hearing: "*Potential Consequences of FinCEN's Beneficial Ownership Rulemaking*" July 18, 2023 2:00 PM
- Senate Appropriations Financial Services and General Government Subcommittee — Hearing: "*AF Review of the Fiscal Year 2024 Budget for the U.S. Securities and Exchange Commission*" July 19, 2023 2:45

Recommended Reading and Podcasts:

1. [“Meta's Threads is More of the Same Social Networking”](#) — The New YorkerE
2. [“Why people struggle to understand climate risk”](#) — The Economist
3. [“The world is in the grip of a manufacturing delusion”](#) — The Economist
4. [“New Mark Zuckerberg Dropped”](#) — The Atlantic
5. [“When Will the Southwest Become Unlivable?”](#) — The Atlantic
6. [“Looming U.S. Investment Restrictions on China Threaten Diplomatic Outreach”](#) — NY Times
7. [“U.S. Takes Third Shot at Shoring Up Money-Market Funds”](#) — The Wall Street Journal
8. [“Big Tech’s Love Affair With Low-Tax Nations Is Under Threat”](#) — The Wall Street Journal
9. [“Cracking the Proxy Advisor Duopoly”](#) – The Wall Street Journal
10. [“Ripple ruling threatens SEC’s crypto regulation push”](#) – The Washington Post
11. [“Jared Bernstein on the Next Stage of Bidenomics”](#) – The Odd Lots Podcast