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LXR Group

Policy 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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LXR Annual Book List (P.7)

Top Developments:

House Committees Advance Major Crypto Legislation Over Opposition of Waters, Democrats, Setting up Floor Vote

The House Financial Services Committee (HFSC) and House Agriculture Committee voted last week to advance a landmark bill to overhaul cryptocurrency regulation in the United States. The votes, which occurred despite strong opposition from HFSC Ranking Member Maxine Waters (D-CA) and most democratic lawmakers, were a striking victory for the crypto industry and the underlying blockchain technology. The vote was also a clear rebuke of SEC Chairman Gary Gensler, whose perceived hostility to crypto has eroded his credibility with key House lesiglators and blunted the impact of the SEC Chair's continued strong support from Waters. The HFSC voted 35-15 to advance the bill last Wednesday, with six of the panel's twenty-three Democrats joining all the HFSC's Republicans in voting for the bill...

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HFSC's "ESG Month" Culminates in Nasty Full Committee Markup.

On July 27, the HFSC ended its divisive "ESG month" with a predictably contentious markup that advanced partisan bills targeting the Biden Administration's recent policies on ESG. As we discussed in the previous Bulletin , throughout July, HFSC Republicans have consciously targeted the Biden Administration's ESG policies. Whereas hearings in early July focused on the SEC, recent hearings focused on federal banking regulators. On July 18, the Subcommittee on Financial Institutions held a hearing on banking regulators' "improper" focus on climate change risks over other "real" risks impacting banks. Republican members seized on Fed Chair Powell's recent statements, stating that the Federal Reserve Board is not a climate regulator but then pointed to activities by federal banking regulators that seemingly did not line up with that statement. Additionally, many Republicans criticized US bank regulators' participation in international policy forums, questioning whether these groups have an undue influence on US policy. Democrats focused on recent state laws targeting ESG regulations, arguing such policies prevent state regulators from acting to reduce risk. It was clear from this July 18 hearing that the discussion and debate would lead to proposed legislation.

On July 27, the HFSC marked up four bills targeting ESG policies, in addition to two bills on Stablecoins (discussed elsewhere in this bulletin), and one House Joint resolution disapproving the CFPB rule on Small Business Lending, which Republicans asset imposes "overly burdensome" requirements on certain covered financial institutions, specifically with respect to data collection and reporting. The four "ESG" bills were hotly debated and received no bipartisan support.

The first bill, HR 4760, the *Guiding Uniform and Responsible Disclosure Requirements and Information Limits (GUARDRAIL) Act of 2023*, would limit SEC-required disclosure to "material" information, require the SEC to report justifications for non-material disclosure requirements, and create an SEC Advisory Committee on Public Companies to advise the Commission on its rules and regulations. A second, HR 4767, the Protecting Americans' Retirement Savings from Politics Act, would require significant reforms to the shareholder proposal process to limit proposals on ESG and require proxy advisory firms to register with the SEC, creating liability for material misstatements under the federal securities laws. While largely concerned with the shareholder proposal process as it relates to ESG, some of its provision would also impact investment advisers, asset managers and pension funds. A third bill, HR 4823, the *American Financial Institution Regulator Sovereignty and Transparency Act*, would create a series of reports and requirements regarding US bank regulators' involvement with international governance groups, especially those involved in climate policies, and attempt to limit what Committee Republicans are calling "executive capture" of US banking regulations. This legislation was a direct reaction to one of the themes of the hearing on July 18, regarding international NGOs' impact on US bank regulators. A fourth bill, HR 4655, the Businesses Over Activists Act, also targets the shareholder proposal process, barring the SEC from requiring an issuer to include or discuss any shareholder proposal on the issuer's proxy statements.

Gensler Testifies before Senate Appropriations. On July 19, 2023, the Senate Appropriations Committee's Subcommittee on Financial Services and General Government (FSGG) held a hearing to review the Fiscal Year 2024 Budget for the U.S. Securities and Exchange Commission. The only witness to testify was SEC Chair Gary Gensler. The dominant themes of the hearing were (1) the pace of SEC rulemaking; (2) cryptocurrency policy and cryptocurrency fraud; and (3) ESG. Other topics receiving significant attention included (4) the SEC OIG's 2022 report on SEC management; (5) recently proposed amendments to the SEC's custody rule; (6) SEC telework policies; (7) the adequacy of the SEC's responses to Congressional inquiries; (8) the SEC's failure to proactively detect rampant fraud at FTX. Topics that were mentioned but did not feature prominently at the hearing included (9) China; (10) proxy advisors; (11) swing pricing. Dogs that might have barked but didn't include: (12) investment adviser examinations; (13) FINRA; (14) Reg. BI; (15) RIA arbitration abuses ; (16) SEC market structure proposals; (17) MiFiDD II. A detailed look at the key takeaways from the hearing is available on the LXR Group's website.

(**House Committees Advance Crypto, continued from P.1**) ... The Democrats who voted for the bill include Reps. Josh Gottheimer (NJ), Jim Himes (CT), Steven Horsford (Nev), Wiley Nickel (NC), Brittany Pettersen (CO) and Ritchie Torres (NY). The following day, July 27, the House Agriculture Committee approved the legislation by voice vote.

Formally known as the *Financial Innovation and Technology for the 21st Century Act*, the House bill creates a new exemption from the registration requirement under the Securities Act for offers and sales of digital assets by issuers if certain conditions established by the bill are met. The bill specifically gives the CFTC primary jurisdiction over digital asset markets, while establishing a process for market participants and regulators to follow in allocating oversight of digital assets between the SEC and CFTC. Under the bill, a digital asset is classified as a "Digital Commodity" and is regulated by the CFTC if the blockchain network to which the asset relates is both "functional" and "decentralized" (with each term defined in the bill, and incorporated into the securities laws and Commodity Exchange Act).

The bill establishes an exception for "Restricted Digital Asset," which under the bill are required to be registered with the SEC. The assets that the bill deem "restricted" include (1) digital assets held by the issuer of the digital asset, related persons, or affiliates of the issuer before the networks to which the assets relate are functional and certified as decentralized; and (2) digital assets held by persons other than issuers, their related persons, and their affiliates before the networks to which the assets relate are functional and certified as decentralized unless the digital assets are distributed through an "end user distribution" or acquired on a CFTC-regulated exchange.

The bill also defines and provides for the regulation of "Digital Commodity Exchanges," "Digital Commodity Brokers," and "Digital Commodity Dealers," requiring each to register with the CFTC.

Notably, the legislation does not authorize or appropriate any additional funding for the CFTC, nor authorize the agency to assess "user fees" to defray its operating costs, as has been suggested by some proponents. Thus, even as the bill enhances the CFTC's responsibility and authority, the question of how the CFTC would implement them in the face of resource constraints remains unanswered.

The markups are significant because they represent the first and second times that Congressional committees have taken a vote on crypto regulatory legislation. A vote on similar legislation by the Senate Agriculture Committee was widely anticipated last December, but ultimately postponed due to the collapse of cryptocurrency exchange FTX. While the bill's long-term prospects remain entirely uncertain, the markups represent a remarkable and solely needed victory for the crypto community and its lobbyists, who have for several years pushed Congress to consider legislation to afford "regulatory clarity" for the industry, but until now have had nothing to show for their efforts.

While the committee votes theoretically clear the way for the full House to take up the legislation, the question of when that will happen and what that might look like have yet to be answered. Further complicating the outlook are the striking differences between the HFSC's markup and the Agriculture Committee's markup. Indeed, where the former saw Democrats devote an entire day to criticizing the bill and arguing that more time was required, the Agriculture Committee worked through various amendments, adopting proposals from both Democrats and Republicans, and approving the bill by voice vote. Thus, the politics of the bill within the Democratic Caucus are mirky and possibly very fluid.

Congressional Developments:.

Senate Proposals Would Subject Crypto to AML/BSA Rules

On July 19, a bipartisan gang of four Senators introduced the *Crypto Asset National Security Enhancement and Enforcement Act*, or CANSEE Act. The new bill would end special treatment for DeFi by applying the same national security laws that apply to banks and securities brokers, casinos and pawn shops, and even other cryptocurrency companies like centralized trading platforms. According to a public statement released by its primary authors, the bill reflects an effort to "prevent money laundering and stop crypto-facilitated crime and sanctions violations." The CANSEE Act specifically requires decentralized finance (DeFi) services to meet the same anti-money laundering (AML) and economic sanctions compliance obligations as other financial companies, including centralized crypto trading platforms, casinos, and even pawn shops. It also modernizes key Treasury Department AML authorities and sets requirements to ensure that "crypto kiosks" don't become a vector for laundering the proceeds of illicit activities. The bill's primary Senate sponsors include U.S. Senators Jack Reed (D-RI), Mike Rounds (R-SD), Mark Warner (D-VA), and Mitt Romney (R-UT).

One week later, on July 26, a second group of bipartisan Senators introduced a separate yet related bill. The so-called Digital Asset Anti Money Laundering Act of 2023, sponsored by Senators Elizabeth Warren (D-MA) and Roger Marshall (R-Kan.), Joe Manchin (D-W.Va.) and Lindsey Graham (R-S.C.), seeks to "mitigate the risks that digital assets pose to our national security by closing loopholes and bringing the digital asset ecosystem into greater compliance with the anti-money laundering and countering the financing of terrorism (AML/CFT) frameworks governing the greater financial system." Specifically, according to a short summary of the bill released by the sponsors, the legislation will (1) extend Bank Secrecy Act (BSA) responsibilities, including Know-Your-Customer requirements, to digital asset wallet providers, miners, validators, and other network participants; (2) require FinCEN to finalize and implement its December 2020 proposed rule requiring banks and money service businesses (MSBs) to verify customer and counterparty identities; (3) direct FinCEN to issue guidance to financial institutions on mitigating the risks of handling, using, or transacting with digital assets that have been anonymized; (4) require Treasury to establish an AML/CFT examination and review process for MSBs and other digital asset entities; (5) extend BSA rules regarding reporting of foreign bank accounts to include digital assets by requiring United States persons engaged in a transaction with a value greater than $10,000 in digital asset; and (6) require that digital asset ATM owners and administrators regularly submit and update the physical addresses of the kiosks they own or operate and verify customer and counterparty identity.

Senate Votes 86-11 to Approve NDAA. At the end of July, and in the nick of time to start the August recess, the Senate reached a deal to advance its version of the National Defense Authorization Act (NDAA) off the Senate floor by a vote of 86 yeas to 11 nays. The legislation advanced out of the Senate Armed Services committee in a bipartisan fashion, but after over 1,000 amendments filed on the Senate floor the Majority and Minority were able to reach agreement on which amendments would either end up in the managers package or get a floor vote. The process this year was relatively drama free, a change from recent years when Congress approved the bill days before the new year.

Update on Appropriations. In a shocking update for skeptics on the Hill that doubted the Senate would finish moving all 12 appropriations before the August recess, miracles do happen. Moreover, the Senate Appropriations Committee also advanced its 12 bills out of committee in a bipartisan fashion, for the first time in five years. It was notably one of the smoothest appropriations seasons for the Senate. The House Appropriations Committee advanced 10 of the 12 bills in partisan fashion, with significant policy riders, and perhaps more notably, funding levels that were significantly lower than the Senate and do not meet the agreement reached with the Biden Administration during the Debt Ceiling negotiations. When back in session, the House will need to move the final two bills out of committee first. All of these bills will need to pass the House and Senate floor before September 30 to avoid a government shutdown, which means that a short-term funding deal is likely on the horizon. The House and Senate are significantly far apart on top-line funding numbers as well as on policy-riders that are serious non-starters for many Democrats.

Bipartisan Deal on Stablecoins Slips Away. On Thursday, July 27, the HFSC's second markup of the week opened on a low note. Chair Patrick McHenry (R-NC) and Ranking Member Waters alike had hoped to come to a bipartisan agreement on stablecoin legislation that began in the last Congress and has been in the works now for more than fifteen months. Up until Thursday, both McHenry and Waters had been hopeful and as McHenry stated at the markup "closer than ever" to arriving at an agreement on this legislation. Instead, McHenry decided to abruptly move forward with a version of the bill that was published in June 2023 due to apparent reservations from the Whitehouse about the bipartisan version of the bill. In doing so, McHenry effectively reversed months of bipartisan negotiations and agreement.

> ***"Important legislation takes time, but the Chair is impatient and has decided to abruptly end our negotiations and move forward with a bill that is deeply problematic,"***
>
> -Rep. Maxine Waters (D-CA)

Waters delivered a fiery opening statement in which she made her disappointment about McHenry's decision to halt negotiations clear. Waters also received jeers from the committee's Republicans after calling them the "extreme MAGA wing of the Republicans Party," and criticizing them for their continued focus on anti-ESG disclosures and striking the words "diversity" and "inclusion" from bills' texts. The rest of the markup stalled as Waters and other Committee Democrats tried and failed to postpone the consideration of the bill. It was also revealed that Committee Democrats had been blindsided by Republicans who only revealed the final version of the bill for markup earlier that morning, forcing Democrats to offer amendments "on-the-fly."

> ***"We each represent about 800,000 people in the United States, and they would like to have a voice in this hearing,"***
>
> -Rep. Stephen Lynch (D-MA)

Regulatory Developments:

SEC Releases Updated Regulatory Agenda. The SEC published the Chair's agenda of rulemaking actions required by the Regulatory Flexibility Act (RFA). RFA requires each Federal agency, twice each year, to publish in the Federal Register an agenda identifying rules that the agency expects to consider in the next 12 months that are likely to have a significant economic impact on a substantial number of small entities (5 U.S.C. 602(a)). The Chair listed two new rules that are in the proposed rule stage, as well as several other notable rules in the final rule stage or completed actions. Comments to the agenda are due by August 28, 2023.

SEC adopts Cybersecurity Disclosure Requirements for Public Companies. On July 26, 2023, the SEC adopted final rules that require public companies to report material cybersecurity incidents within four days. Specifically, the final rules require a company to file a Form 8-K within four business days of a determination that a cybersecurity incident it has experienced is material. Specifically, the new Form 8-K 1.05 line-item requires disclosure of the (1) nature, scope and timing of the incident and (2) its impact or reasonably likely impact on the company. The new rules also require annual disclosure of a company's processes to assess, identify and manage material cybersecurity risks, management's role in assessing and managing material cybersecurity risks, and the board of directors' oversight of cybersecurity risks. Foreign private issuers will be subject to similar reporting requirements in Forms 6-K and 20-F. The SEC's adoption of a final rule marks a win for U.S. Sen. Jack Reed (D-RI), who has for nearly a decade been pushing for the Commission to adopt more stringent requirements related to the disclosure of data breaches and similar cyber events. Nevertheless, in a press release, Senator Reed made clear that he considers the victory incomplete. "While this approach is an improvement, it does not provide appropriate incentives for companies to proactively address cyber risk. It also leaves investors without critical information about cyber expertise at the highest level of public companies. I consider today's announcement a starting point. I will continue to press the SEC and public companies to take cyber risk more seriously and continue pressing for legislative fixes to protect investors and our economy."

Federal Reserve Launches "FedNow" Instant Payment Service. The Federal Reserve announced last week that its new system for instant payments, the FedNow® Service, is now live. Banks and credit unions of all sizes can sign up and use this tool to instantly transfer money for their customers, any time of the day, on any day of the year. "The Federal Reserve built the FedNow Service to help make everyday payments over the coming years faster and more convenient," said Fed Chair Jerome Powell. "Over time, as more banks choose to use this new tool, the benefits to individuals and businesses will include enabling a person to immediately receive a paycheck, or a company to instantly access funds when an invoice is paid." Initially, 35 early-adopting banks and credit unions, as well as the Treasury's Bureau of the Fiscal Service, are ready with instant payments capabilities via FedNow. In addition, 16 service providers are ready to support payment processing for banks and credit unions. When fully available, instant payments stand to provide substantial benefits for consumers and businesses, such as when rapid access to funds is useful, or when just-in-time payments help manage cash flows in bank accounts. .

CFPB Closes Public Comment on PACE Loan Proposal. Last week marked the end of the public comment period on a CFPB proposal intended to enhance consumer protections for residential Property Assessed Clean Energy (PACE) loans. Specifically, the CFPB proposal, announced on May 1, would require lenders to assess a borrower's ability to repay a PACE loan and would provide a framework for how these loans will be treated under the Truth in Lending Act.

Other Developments:

Biden to Sign Order Curbing China Investments by Mid-August. President Joe Biden is planning to sign an executive order to limit critical U.S. technology investments in China by mid-August, Bloomberg News reported on Friday, citing people familiar with the internal deliberations. The order would focus on semiconductors, artificial intelligence and quantum computing, Bloomberg reported, adding that it would not affect any existing investments and would only prohibit certain transactions.

Rep. Abigail Spanberger (D-Va.) to Run for Virginia Governor. According to reporting on Friday by Politico, Rep. Abigail Spanberger, a centrist Democrat from Virginia who sits in a must-win seat for her party in 2024, has told multiple people she will run for governor in 2025. A former CIA Officer and political moderate, Spanberger has represented Virginia's 7th District since she flipped the seat in 2018 as part of a Democratic wave that retook control of the U.S. House.

SEC Charges Richard Heart with Misappropriation and Fraud. On July 31, the SEC brought a complaint against Richard Heart, a content creator and entrepreneur who controls Hex, PulseChain, and PulseX. Heart began marketing Hex in 2018 and claimed it was the first blockchain certificate of deposit. PulseChain was then created by Heart as a supposed crypto asset network, and PulseX as a crypto asset trading platform. Through these entities, Heart has raised more than $1 billion in crypto assets from investors on his unregistered platforms. The SEC also found that Hart spent over $12 million of investor offerings on luxury goods including sports cars, watches, and what is possibly the largest black diamond in the world at 555 carats.

CFPB Sues Snap Finance for Consumer Offenses. On July 19, The Consumer Financial Protection Bureau (CFPB) brought action against the lease-to-finance company Snap Finance for deceptive business practices, hidden terms in finance agreements, and false threats to customers. Snap Finance is a Utah-based consumer finance company partnered with thousands of merchants across the nation that offers financing agreements to consumers on the purchase of goods and services. Since January 2017, Snap Finance has sold over three million of these finance agreements.

Upcoming Events:

- ·National Conference of State Legislatures 2023 Legislative Summitt August 14-16, 2023. Indianapolis, IN

Summer Recess Reading List, 2023

It's another August Recess, so LXR is again putting on our annual fall reading list fundraiser, where we will donate to a DC charity while our readers help us put together a book list. *We hope to* ***c****reate a reading list that will help power us all through the fall while helping improve the city we call home. As before, we ask that friends, subscribersers, and clients recommend high-quality books—fiction or non-fiction, finance-related or not—that we can include in a reading list we circulate later in the month. And as before, for each recommendation, LXR will donate $5 to charity. This year, however, we're doing something different: Each recommendation will also count as a vote that will decide which charity LXR donates to. The three potential charities that LXR will give to are:*

- **Thrive DC** is a one-stop shop committed to preventing and ending homelessness in Washington, DC by providing vulnerable individuals with comprehensive services. It is a safety net for people experiencing housing instability, food insecurity, and economic crisis, with the goal to support and equip Washingtonians on their journey of achieving greater self-sufficiency.

- **DC Central Kitchen** is a nonprofit and social enterprise that combats hunger and poverty through job training and job creation. It provides hands-on culinary job training for individuals facing high barriers to employment while creating living wage jobs and bringing nutritious, dignified food where it is most needed.

- **Humane Rescue Alliance** is dedicated to ensuring the safety and welfare of all animals in addition to bringing people and animals together. It is the largest animal services provider in our region, touching the lives of tens of thousands of animals annually through direct rescue, care, and community-based services.

Please send Mike an email with up to 10 book recommendations, and a sentence or two for each about why you are recommending them, and which of the three charities receives your votes.

Recommended Reading and Podcasts:

1. "A New Generation of Robots Seems Increasingly Human," — The New Yorker
2. "Will Biden's Meetings with A.I. Companies Make Any Difference?" — The New Yorker
3. "Big tech's dominance is straining the logic of passive investing," — The Economist
4. "America's battle with inflation is about to get trickier," — The Economist
5. "Deflation is delaying China's rise to economic superiority," — The Economist
6. "Could a Recession Still Be Years Away? Steady Growth, Moderating Inflation Improve Odds of Extended Expansion," — The Wall Street Journal
7. "Why Businesses Can't Stop Asking for Tips," — The Wall Street Journal
8. "Soft Landing Optimism Is Everywhere. That's Happened Before," — The New York Times