Democracy Defenders Action

The Hon. Tim Scott
Chairman, Senate Committee on Banking, Housing, and Urban Affairs
104 Hart Senate Office Building
Washington, DC 20510

The Hon. Elizabeth Warren
Ranking Member, Senate Committee on Banking, Housing, and Urban Affairs
311 Hart Senate Office Building
Washington, DC 20510

Re: Democracy Defenders Action Response to the Committee's Digital Asset Market Structure Legislation Request for Information

Chairman Scott, Ranking Member Warren, and members of the Committee:

Thank you for the opportunity to respond to the Committee's Request for Information ("RFI") on draft digital asset market structure legislation. Democracy Defenders Action ("DDA") is a nonpartisan, nonprofit organization dedicated to protecting our government from corruption and ensuring that its institutions and officials act on behalf of the people they serve. It's with this purpose in mind that we respond to the Committee's RFI.

DDA has included responses to questions posed in the RFI as an attachment to this letter. DDA writes separately to emphasize a single, overarching point that we encourage the Committee to consider when approaching this proposed legislation: it is crucial to include *common sense* ethics guardrails as a core element of any digital asset marketplace legislation. Congress has consistently included ethical safeguards in financial marketplace legislation, starting with the first Congress passing limitations on treasury officials abusing their authority in the Treasury Act in 1789. Given the immense powers that elected officials and cabinet members have over the digital asset marketplace, it is essential that the Committee protect against the inherent potential for decision-makers to abuse their positions for personal gain, including a comprehensive divestment requirement, increased transparency, and strong enforcement measures. Absent these measures, the officials who are responsible for adopting, implementing, and enforcing fair and objective rules might have a financial stake in the game; if Congress allows this to occur, it risks creating an unfair competitive playing field.

This is particularly concerning for the President of the United States, whose expansive crypto companies and investments call into question whether the burgeoning market will be subject to the even-handed administration of law, or to the private pecuniary interests of a single person. Since his inauguration, President Trump and his family members have made hundreds of millions of dollars from crypto ventures, and they stand to make millions more. These vast cryptocurrency conflicts of interest pose risks to the quality of our nation's crypto markets, threatening to undermine core enforcement actions and distort the marketplace in favor of those who do business with the President.

The discussion draft and bills like the House's Digital Asset Market Clarity (CLARITY) Act (H.R. 3633), both of which attempt to regulate these fast-evolving assets, do not establish strict ethical safeguards necessary to protect against the possibility that the President and other decision-makers may regulate out of financial self-interest as opposed to concern for the public welfare. These conflicts of interest pose an extraordinary threat to the stability of our markets and a broader threat to our nation's security and the quality of our democracy.

Put simply, it matters little if Congress provides regulatory "clarity" for digital asset innovators if the President and his appointees can manipulate the statutory framework to create a regulatory regime without any meaningful government oversight and promote enforcement policies that unfairly target their competitors. All other improvements will ring hollow if companies can woo the President with favorable deals and investments that undermine the progress of legitimate enforcement actions. The discussion draft therefore risks creating only an illusion of independent market oversight while surrendering significant congressional power to curb executive corruption.

To be clear: it is crucial that Congress creates a serious and comprehensive legal regime to bring the opaque market for digital assets into the light. A strong and clear market structure, regulated and enforced by neutral arbiters, with protections for retail investors, will ensure that American consumers can access the market with confidence. To achieve this goal the final legislation must:

1. **Ban the President, Vice President, members of Congress, senior officials, Supreme Court justices, and federal judges–and their spouses and dependent children–from owning or trading cryptocurrency, or from owning a company that issues cryptocurrency and crypto products.** The only way to be certain that corrupt or illicit actors or foreign governments are not able to abuse the crypto ecosystem to purchase influence with American policymakers is divestment and a blanket prohibition on transactions.
2. **Require all senior officials to report any cryptocurrency transactions or holdings, from any source, in any public financial disclosures they file, including those required under the Ethics in Government Act and the STOCK Act**. In addition to a divestment and prohibition requirement, it's critical that public officials disclose their interests and transactions in cryptocurrency assets or businesses, including stablecoins.

Timely disclosure will ensure that policymakers are complying with divestment requirements as well as protect against potential conflicts of interest that may arise from ownership of digital assets. Disclosure would also make it easier for ethics officials and law enforcement to hold filers accountable–both for violating the prohibition *and* their disclosure requirements.

3. **Create a clear and comprehensive criminal crypto anticorruption enforcement system that empowers independent supervising ethics bodies to investigate, review, and enforce divestment and disclosure requirements, and impose meaningful penalties that serve as a true deterrent for non-compliance.** Congress must enact legislation that empowers the supervising ethics office of each branch of government to effectively enforce this regime, including by independently investigating officials' finances. Independent investigators must be granted authority to audit members' finances and organizations for cryptocurrency compliance, including access to relevant blockchain data, such as public keys, and exchange records. This legislation should also strengthen protections, and provide incentives, for public and private whistleblowers, including government contractors, who report instances of possible noncompliance or the use of illicit cryptocurrency transactions to influence a government official in carrying out an official activity. In addition to banning policymakers and their families from owning, trading, and or issuing any crypto products, legislation should also ban campaign contributions in the form of cryptocurrencies.

Conclusion

Designing the legal framework to regulate the more than $1 trillion cryptocurrency market is one of the most important and far-reaching projects in the Committee's recent history. It is critical that you approach it deliberately and seriously. Rushing to pass digital market structure legislation will result in mistakes that could have grave consequences for the country.

If this Committee wants to provide true structure, protections, and space for safe innovation in digital assets, it *must* include ethical safeguards in its digital asset market structure legislation. These protections must be a *precondition* to any such legislation, as their absence will undermine every key element of the project, and likely lead to a market that is at once anti-competitive – where some participants are allowed to play by different rules than others – and harmful to everyday investors. We encourage you to include our three ethics pillars for an effective crypto policy in your next draft, and in any legislation that moves through the Committee.

Thank you for the opportunity to submit this statement and for your attention to this matter. We look forward to working with the Committee as you work to improve this discussion draft.

Attachment

ATTACHMENT A

Specific Suggestions

DDA offers the following answers to a number of the questions the Committee raises in its RFI.

4: Should legislation allow market participants the freedom to choose between being subject to SEC jurisdiction or CFTC jurisdiction? If so, how?

Answer: No. The absence of clearly-defined jurisdictional boundaries promotes forum shopping and incentivizes weaker regulatory oversight that undercuts the public interest. Failure to meaningfully address President Trump's conflicts of interest will further undermine regulatory oversight. This failure will enable President Trump to choose his own regulator and foster even greater instability into the market by further incentivising regulators to adopt not just industry-friendly regulatory and enforcement policies, but Trump-friendly regulatory policies and enforcement priorities that further his financial interests. This is not the recipe for a healthy market. Digital asset participants should be required to play by the same rules as everyone else, but that outcome is not remotely possible if the underlying statutory framework allows for President Trump to be both a crypto market participant and a crypto market regulator.

17: How should legislation address illicit finance and anti-money laundering issues as they relate to digital assets?

Answer: Given that President Trump's World Liberty Financial is estimated to have generated nearly $700 million in overseas token sales, it's critical that the Committee adopt legislation that includes the strongest possible anti-money laundering protections to ensure the American people that the government and the markets are both operating with the highest levels of integrity. The legislation *should* explicitly address the illicit finance and anti-money laundering issues that digital assets create. The discussion draft does not. Instead, it offers mere fact finding and information sharing. The proposed steps include an examination of general risk, a pilot information sharing program, a working group to combat terrorism and illicit finance, and a reiteration of existing sanctions compliance expectations. They do not provide for even the bare minimum requirements necessary to address the magnitude of crypto's illicit finance risks.[1] This is particularly important given the President's investment in the crypto market, the public corruption risks that arise from the market's overall lack of transparency, and from the President's executive authority, including his appointment authority over the heads of the regulators and

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[1] For key steps on stoppng illicit finance in crypto *see* https://us.transparency.org/resource/letter-from-counter-kleptocracy-groups-urging-amendments-to-the-genius-act/.

recent efforts by his Office of Management and Budget to consolidate its control over the rulemaking of independent agencies.

26: What action should market structure legislation take with respect to decentralized finance? a. How should an exemption for decentralized finance be structured? b. What changes, if any, should Congress make to prior legislative attempts to structure an exemption for decentralized finance?

Answer: The Committee must ensure that decentralized finance ("DeFi") activities are regulated the same way as other digital assets by ensuring that the Committee's legislation builds in appropriate protections against corruption, illicit finance, and money laundering.

Exempting DeFi activities would undermine our national security by making it harder to stop the flow of illicit money through digital asset channels. Decentralized services and platforms, including those developing or operating distributed ledger protocols like smart contracts, can be used to mix and launder funds. Exempting these platforms from regulation will open the door to a flood of dirty money into our markets.

Moreover, exempting DeFi activities from regulation will create significant opportunities for public corruption of both elected and appointed officials. Congress has a responsibility to prevent public officials, and those who seek to influence them, from being able to use market regulation loopholes as a means of accepting corrupt payments. Without appropriate know-your-customer, anti-money laundering regulations, and suspicious activity reports, DeFi protocols can be used to elicit and make illegal payments and bribes with impunity. The lack of regulation itself creates the uneasy appearance of corruption, even if no corruption exists. For example, President Trump's crypto company World Liberty Financial reportedly operates as a DeFi firm. World Liberty Financial has derived nearly $700 million from token sales, almost all of it is likely from foreign entities. Absent divestiture requirements, the President's business may lead Americans to lose confidence and question the legitimacy of the market. Congress has the opportunity to rectify the destabilizing effects of corruption and the appearance thereof through ensuring a fair marketplace exists for all market participants and that elected and appointed officials do not have the ability to hide financial transactions from public scrutiny.

35: Should federal legislation preempt certain state laws, and if so, how?

Answer: Any new legislation must not preempt state securities and commodities laws, particularly consumer protection laws that protect investors. It must also not preempt state banking laws, particularly those that allow state regulators to ensure the safety and soundness of financial institutions, and to ensure an orderly liquidation in the case of bank failure. If Congress enacts legislation that preempts state laws it would operate to exclude President Trump from an independent layer of regulatory scrutiny over his vastly expanding cryptocurrency empire.