Fintech industry wants guidance as lawmakers focus on risks

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Financial technology innovators are hoping there's no such thing as bad press when it comes to cryptocurrencies.

As Congress focuses on risks and volatility, the fintech industry is touting the technology's benefits as they urge lawmakers to clear the runways that will make it easier to launch products without fear of violating the law.

"Congress is starting to pay more attention to crypto," Linda Jeng, an adjunct professor at Georgetown University Law Center and former Securities and Exchange Commission lawyer, said in an interview. That attention may be good or bad.

Jeng, who also heads global policy at the fintech startup Transparent, wants lawmakers to consider ways they can leverage technology for benefits such as promoting financial inclusion.

"Technology could transform financial services and provide more equitable access to consumers and businesses," Jeng said. Although many lawmakers are concerned about fraud and criminality involving cryptocurrency, Jeng stressed that many of the vulnerabilities to illicit activity also apply to cash.

Recent attention comes as regulators uncover fraudulent digital token issuers that were engaged in misconduct to swindle investors. Cryptocurrencies also experienced wild price swings this year that concerned some on Wall Street and in Washington about a lack of oversight.

"Bitcoin's value fluctuates at the drop of a tweet. Yesterday, it plummeted 30 percent. This kind of market volatility is not what our economy needs," Senate Banking Chairman Sherrod Brown, D-Ohio, tweeted in May.

Sen. Elizabeth Warren, D-Mass., this month wrote to SEC Chairman Gary Gensler on the need for investor and market protection from these risks. Warren also sits on the Banking Committee and is active in consumer and financial policy.

In a July 7 letter, Warren asked Gensler what the agency can do to protect investors amid rapid growth in the sector, price volatility, and thousands of cryptocurrency-related scams. She also said Congress may need to close "regulatory gaps."

"While demand for cryptocurrencies and the use of cryptocurrency exchanges have skyrocketed, the lack of common-sense regulations has left ordinary investors at the mercy of manipulators and fraudsters," Warren wrote. "These regulatory gaps endanger consumers and investors and undermine the safety of our financial markets."

Jeng called Warren's letter a reasonable response, in that the SEC's mandate is to protect investors. She acknowledged that some digital assets called "cryptocurrencies" are actually mislabeled investment contracts, and many investors don't fully understand the volatility and risk of what they're investing in.

Digital asset innovators who want to comply with the rules need more guidance, according to Jeng.

Kayvan Sadeghi, a securities litigator at Schiff Hardin LLP in New York, said Warren's letter doesn't address the other side of the coin: The industry yearns for more prescriptive guidance from federal policymakers.

"Warren's letter raises a lot of good questions about digital assets, including how to regulate decentralized organizations operating on a public blockchain," Sadeghi said. "But the tenor of the letter suggests the focus is on bad actors, and tools to address fraud and other misconduct already exist."

While there are ways to launch digital assets, the paths to legal compliance are still too ambiguous, expensive and much too slow for the rapid pace of innovation, he said.

"The problem isn't a need for more authority to pursue bad actors; we need to provide a clearer path for the good actors," Sadeghi said. An environment that makes compliance too difficult, slow and uncertain allows those who don't care about the rules to race ahead, he said.

"The desire to protect consumers and investors is important and shared by most in the industry," Sadeghi said. "The U.S. has a chance to be a leader in this area, and we shouldn't lose sight of that."

Stakeholder group

The fintech industry is tracking a bipartisan proposal by Rep. Patrick T. McHenry of North Carolina, the ranking Republican on the House Financial Services Committee, and co-sponsored by Rep. Stephen F. Lynch, D-Mass., who chairs the committee's Financial Technology Task Force.

The bill would establish a working group for digital assets under joint oversight by the SEC and the Commodity Futures Trading Commission, and made up of fintech and traditional financial industry stakeholders. It passed the House in April with bipartisan support and is now before the Senate Banking Committee.

Kate Goldman, who tracks fintech at the Washington-based nonpartisan think tank the Milken Institute, said in an interview the legislation would benefit an industry clamoring for more guidance. The institute is considered center-left by Influence Watch, which assesses organizations' political leanings.

Goldman touted the proposal for including a wide range of stakeholders to consider issues such as digital asset classification rules, custody and cybersecurity standards, and best practices to combat fraud and money laundering and to protect investors.

"There is a certain level of maturity in the industry, so I think it's timely for Congress to be taking a hard look at the legal and regulatory authorities for digital assets," Goldman said.

If the Senate passes it, the law would allow 90 days to prop up the panel of digital asset stakeholders from large and small fintechs, firms regulated by the SEC and CFTC, academics and investor protection organizations. That group would have an additional year to deliver its policy recommendations to both agencies and some congressional commttees.

"I think the industry would have liked clarity two or three years ago," Goldman said of the timeline. But it's a reasonable tradeoff to gather input from all stakeholders on these complex issues, she said.

Sadeghi also said he was pleased to see Congress push to assemble a group of industry stakeholders to gather more input.

"There is a need for more clarity in regulation so any efforts in that direction are positive," Sadeghi said. Although regulators have already been working together on these issues and gathering broad stakeholder input, a formal process could provide more transparency and ideally would offer an opportunity for all voices to be heard, he said.

While supportive of the proposal to form a stakeholder working group to help the agencies and Congress understand complexities underpinning digital assets, some experts noted that it's only the first step, as it excludes other necessary regulators.

Jeng said the SEC and CTFC will focus on legal classification, but bank regulators will need to eventually set rules for stablecoins, which are tied to fiat currency such as the dollar, and for the capital treatment of digital assets.

Goldman suggested the proposed stakeholder group could benefit from input from the Treasury Department's Financial Crimes Enforcement Network. She said she supports the bill and hopes it can gain bipartisan support in the Senate.

"Overall, industry is expressing positive sentiments about the general attitude of Congress to move forward to develop rules that allow digital assets to flourish," Goldman said.