diffuse*tap*
Virtual Event Series

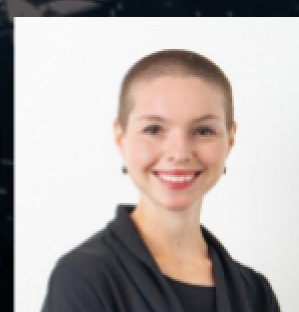
Self Regulation in Crypto

Guest Speaker:

Gabby Kusz
CEO
Global DCA

Hosts:

Kenny Estes
CEO & Founder
Diffuse



Ayla Kremb
COO & Co-Founder
Diffuse

DiffuseTap: Self-Regulation in Crypto

Last time on DiffuseTap, Gabriella Kusz, CEO of Global DCA, talked to us about what self regulation means in the digital asset space and how it works, how SROs work alongside authorities such as FINRA and the SEC, and whether the U.S. is ready to take on self regulation in the wake of FTX.

Want to make friends from the Diffuse Fund Ecosystem? Email contact@diffusefunds.com.

DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)… straight from your armchair like a boss.

Meet the Speaker

GABRIELLA KUSZ is a strategist, policy maker, and thought leader in financial services and sustainable programming innovation. She is the CEO of the Global Digital Asset and Cryptocurrency Association (or Global DCA), a self regulatory organization in the digital asset and cryptocurrency industry, and also an Emerging Leader at the Chicago Council on Global Affairs.

LinkedIn: @gabriella-kusz

About Diffuse®

We are an alternative fund platform offering differentiated investment products. From digital assets to VC funds and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information, visit www.diffusefunds.com.

KENNY ESTES: Gabby, would you mind telling the folks a little bit about your background and what you're up to over at the GDCA?

GABBY KUSZ: It's a pleasure to be here, thank you very much for having me. Just to introduce myself, as mentioned, I am Gabriella, CEO of the Global Digital Asset and Cryptocurrency Association. We are an emerging self regulatory organization association at this point and our focus is on three core areas. That includes standards and guidance, education and certification, and globally sensitive advocacy.

We started roughly three years ago, and today we represent over 80 member firms. That includes small and medium, as well as some of the largest names in the digital asset space. We have definitely seen a lot of interest around the concept of self regulation in the wake of FTX, and we're looking at how and in what way we could minimize or mitigate some of the negative aspects around centralized financial digital asset enterprises, and the behaviors, both ethical as well as technical, that perhaps have been underpinning some of what we've seen with FTX.

In this vein, I'm happy to share a little bit about what self regulation is, how it functions, and also to share a little bit about what our take on it is. Because, again, there are different ways of structuring, forming, and engaging. We can talk about all of that, and I think we could have some really exciting and dynamic dialogue on the subject.

AYLA KREMB: Awesome. I will toss you into the deep end right away. Someone from the chat is asking, was FTX a member of the global DCA? You might want to answer that one.

GABBY: Oh, no. They weren't.

AYLA: But you did talk to them a few times, right?

GABBY: Yeah, we did. But they were not a member.

AYLA: Okay. Maybe we could back up a little bit. What is an SRO, and how does that show up in the existing financial world? Who else is an SRO that we would know of? And how do they usually work?

GABBY: Sure. I'll orient it in two different ways. There are some SROs like exchanges that exist, but I'll focus more on those that are association oriented. An SRO is a self regulatory organization. By definition, it is an entity that creates rules or requirements. It works to build capacity to ensure that its members or adherents are able to comply with those. And then, over time it usually develops a system of inspection and then enforcement. Many times, the ways that it seeks to resolve member disputes are through, for example, the development of an arbitration system.

You can see that they're active. Some of them have legal mandates. Some of them have what we call, colloquially, an industry mandate, meaning that it's just generally accepted to operate in this space. Those that have legal mandates that you might see are the National Futures Association and the Financial Industry Regulatory Authority. NFA and FINRA.

And then, those that maybe don't have that level of legal mandate include the National Grain and Feed Association or NGFA. There is also the National Association of Realtors. That's another example that is not legally mandated, but operates in a self regulatory or self disciplining approach. That's a little bit about what self regulation is, how it functions, and how it exists in its form in the U.S. today.

KENNY: I've always been curious about the dynamics there. Maybe we could go a little bit deeper on that. I took my Series 7 about 20 years ago, and I remember a lot about FINRA and the SEC. The SEC, I gather, is not an SRO. It's a regulatory body. And then, FINRA is an SRO. So, what does that dynamic look like? Where is the line between them drawn? And then, how are you trying to position yourself with Washington and other regulatory aid organizations?

GABBY: Sure. I think that because what we're doing is a modern approach on self regulation, I think the digital asset industry has certain unique aspects that need to be taken into consideration. I'll focus less on the history or dynamics of FINRA and the SEC, and more on what we see as the evolution of a self regulatory organization or SRO in this space.

I think it's important to look at and understand that the digital asset space is at an early stage of development. The idea is that a formal regulatory entity and something like the Global Digital Asset and Cryptocurrency Association should be able to fit together like two puzzle pieces. It is not meant to be a substitute for the other. It's a complement for the legal and regulatory coverage that would be needed for the industry.

I always say SRO is such a wonky term. A lot of people don't understand it. So I always say, “well then, let's talk about a term that makes more sense to people.” And that's usually a public-private partnership, or like a P3. In this instance, it would be a recognition that regulators probably aren't going to have the expertise, the speed, the proximity, or the ability to appropriately attract, retain, or maintain highly qualified staff in this space.

And then, from the side of industry, we would need help around some of the enforcement and oversight. That component of it. Given the way that the industry is developing so quickly and so globally, neither one of us is really able to independently, appropriately regulate and support the development of good standards and practices from such a point of technological sophistication.

What needs to happen is that those two pieces come together, and then the people that are looking to build and want comfort and confidence in their investments here at home in the U.S., and potentially even abroad, will have that clarity from a legal and regulatory perspective that allows them to grow their business responsibly.

When we talk about the defining lines between the two, it's usually that the regulator has what we call "ultimate authority" over the self regulatory organization. This would be the thing that would actually do the regulating. This is the check on that. And then, you move forward and you evolve over a period of years from standards to then capacity internally within firms, then creating a system or a methodology for inspection. And then finally, a system of enforcement.

This would be the entity that would be the backstop on that and would help ensure that if there are issues or challenges, then those can be raised up to an ultimate authority.

AYLA: There's an interesting question in the chat here, which is, how do we take what might already be working in the federal universe and apply it to what we might need in crypto? For example, they could have specific kinds of exams where you could get licensed or approved to operate. Is that something that we will be considering, as well FINRA-type exams in future for the GDCA?

GABBY: From our side, we're looking at a whole host of options. Some of them would be based on learning or taking lessons learned from other self-regulatory movements. But I think the other piece that's important to recognize is that there may be better, more efficient and effective ways to provide that regulatory coverage without being as invasive, given the transparency that you have around blockchain. And also, the ability to track and trace much more nimbly and flexibly.

We're taking these on piece by piece. We've just completed phase one, which is the outline of what the structure of self regulation could look like. The next piece that we're going to look at is what the functions are. That would be phase two of that. And then phase three would be the operations.

This question relates a little bit more to the function and operation component of that. But all of these options should be, and are at this point, on the table, and would be considered as part of a next wave of how you would design and develop this.

I think one piece to recognize is that at this point, part of the reason that we are so aggressively inviting firms to the table, especially those that have built well and are looking to align from a high degree of regulatory compliance, is that because we want them to be part of the conversation. We want them to be part of the decision making process around what that structure looks like, what that function looks like, and what those operations look like.

KENNY: That makes sense. You want the industry to weigh in, and you don't want to just get blindsided by politicians who don't necessarily know what Bitcoin is. You have to be proactive to make that happen. So, what are the stakes here? If we, the U.S. as a country, flubbed this and we don't do this properly, what's the downside? What are we trying to protect from?

GABBY: Okay, that's a really good question. We had a really interesting guest speaker, Tim Massad, who was the former CFTC chair, and also Howell Jackson who's over at Harvard Law. Both of them shared their perspective on self regulation as part of one of our Global DC webinars. They pointed to the fact that if the industry hasn't at this point, post FTX, understood some of the value and importance of coming around and self-policing or self-disciplining, then I don't really know what more you need.

In the beginning, usually, self regulation is a way to try to create this very strong balance between innovation and consumer protection and market integrity. Now, normally, self regulatory movements can time out. So when you have a giant collapse like you had with FTX, sometimes that means that there's just no choice. Now you have to move towards a formal regulatory model.

Now, that being said, that would be true in an established industry. The difference here is that in some ways, self regulation is also about self preservation. What I mean by that is this industry has been hit so hard even though there is government regulatory intervention. The degree to which that will perhaps dampen or quash some of the innovation in this space is yet to be seen.

But the reality is that your credibility has been hit so hard that you now have no other choice. We need to come together in order to try to preserve the development of the crypto and digital asset space, because legal and regulatory requirements may be too little, too late to save the evolution of this space.

What really needs to happen is good industry actors need to come around the table, and not just themselves, and they need to start to, in a positive way, peer pressure colleagues who own, operate, and lead firms to understand how they need to engage, self regulate, and start to bring forward a system by which we can re-instill credibility, re-instill trust, because that trust has been broken. And if it isn't rehabilitated in some way, why would anyone trust digitally native firms again?

AYLA: Interesting. A follow up question to that is how to make a decision. Let's say it's not an SRO that ends up in the driving seat at the moment. Maybe it'll take a little bit longer. Currently, the SEC and the CFTC are fighting about who should be in charge. Do you have a view of who might be a better fit? Or is the answer none of the above?

GABBY: Sure. I can share with you my analysis on it, and I'm happy to take comments or questions as well. I took it less about what personalities are leading the organizations, because that's never really a strong indicator of the better fit organizationally. Instead, I looked at it as if I were making an assessment for a World Bank project for legal and regulatory reform or for financial sector reform. And when I took a look at it, I saw a few things come forward.

One is, I always look at the origination of the institution, because a lot of the regulatory approach or philosophy that's embedded in those organizations stems from the birth of that entity. You have the CFTC, which was born out of innovation. It helped come from a sleepy farm bureau into an entity that could truly lead the movement of moving off of the gold standard and onto the US dollar, helping to advance sound practices in the futures industry.

I think that those pieces of it are very important because that trickles through heads and political appointees. They rotate, they move. But those staff who stay internally, many times, are for life or for significant periods of time, even decades. And that organizational culture, that approach that it takes to regulation is very important.

Now, contrast that to the SEC, which came out of the stock market crash. They've focused very heavily on regulation by rules-based enforcement. You can see that differentiating piece of nurturing, enabling, building, and still regulating and enforcing, versus regulating, enforcing, and shutting down. And so, I think those two organizational cultures are one piece.

The next piece that I look at is the approach or the degree to which you have a principles versus rules-based approach with each of the different regulators. From the CFTC side, you have a more principles-based approach, which I think allows for a greater degree of coverage, and also is more flexible with regards to keeping pace on an emerging space. Versus a rules-based approach, which is very much "tick the box, don't do this, don't do that". But then, what happens if something occurs that's outside of that very narrowly defined scope?

Lastly, if you're looking at this, the reality is that you're looking at the degree to which the majority of some of these entities are coming forward, and the degree to which they're going to be classified or should be classified as a commodity versus as a security. I won't go into all of the factors that I look at, but if you look at even just those three factors, that's where I would believe that it would be better positioned under the Commodities and Futures Trading Commission.

KENNY: That's fascinating. I never really thought about the roots before. It totally makes sense. One is more on innovation, one's more defensive, and one's more likely to potentially stifle an industry for better or worse. That brings us to the world stage question, and you hinted about this being a U.S. issue. Where do we stand relative to other countries? Are other countries doing this better and being more progressive, or just being more lackadaisical? What are your thoughts there?

GABBY: Sure. I think that the United States is definitely behind. You have EU MiCA that's coming forward. And again, they may not be perfect. You may disagree with pieces of it. But in terms of taking the first steps forward, sometimes, something is better than nothing. This at least gives some level of clarity. We're even seeing that some of our own members are looking to expand operations into the EU based on the fact that yes, they don't agree with everything, but they have a certain degree of expectation that they can meet their stability in terms of what will be forthcoming.

That is not the case here in the United States. I think you've seen the creation in other jurisdictions based on the country context of SROs, or self regulation, as well as the creation of independent or new regulators or regulatory entities. You can also see the expansion of powers, in some instances, with existing regulators. I think all of these are important steps.

The truth is that in this country, because we have a democratic process that values differing opinions, and brings forward and tries to leverage compromise in order to create and moderate towards the medium, we're never going to have a piece of legislation that everyone, even in this virtual room, will agree with. But I think one of the things that is crucially important is to start moving in some direction.

That's why I've been very pleased with each of the lummis-Gillibrand Bill, the Digital Commodity Exchange Act, and the Digital Commodities Consumer Protection Act. Each of these I have my questions and issues with, but I think these are at least stepping in the right direction to put this country on track.

Thank you for downloading this DiffuseTap event transcript.

Sign up for upcoming sessions and check out past features and event transcripts.

Dennis Chookaszian

Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

Sharing his decades-long expertise on corporate governance, Dennis talked about how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on

Susan Brazer

CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan described the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on

Raj Mukherjee J.D.

VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

JOIN US