

BILL ANALYSIS

C.S.H.B. 1666
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Pensions, Investments & Financial Services
Committee Report (Substituted)

BACKGROUND AND PURPOSE

Many Texans have invested in cryptocurrencies and other digital assets, the vast majority of which are held by third-party custodial account holders that facilitate trading and maintain custody of the digital assets. These companies are often referred to as digital asset service providers. Recently, multiple digital asset service providers betrayed the trust of their consumers by commingling investor funds with corporate assets, leading consumers to lose billions of dollars of investments. Currently, the state only regulates digital asset service providers as it relates to their usage of government-issued currencies and stablecoins, which requires them to obtain a money transmission license. C.S.H.B. 1666 seeks to regulate digital asset service providers' digital currency holdings to ensure consumer funds are secure and protected.

CRIMINAL JUSTICE IMPACT

It is the committee's opinion that this bill does not expressly create a criminal offense, increase the punishment for an existing criminal offense or category of offenses, or change the eligibility of a person for community supervision, parole, or mandatory supervision.

RULEMAKING AUTHORITY

It is the committee's opinion that rulemaking authority is expressly granted to the Finance Commission of Texas in SECTION 1 of this bill.

ANALYSIS

C.S.H.B. 1666 amends the Finance Code to set out provisions relating to the commingling of funds by digital asset service providers doing business in Texas that hold a money transmission license and either serve more than 500 digital asset customers in Texas or have at least \$10 million in customer funds.

C.S.H.B. 1666 prohibits a provider from doing any of the following:

- commingling customer funds with funds belonging to the provider;
- using customer funds to secure or guarantee a transaction other than a transaction for the customer contributing the funds; or
- maintaining customer funds in such a manner that a customer may be unable to fully withdraw their funds.

C.S.H.B. 1666 requires a provider to maintain reserves in an amount sufficient to fulfill all obligations to customers and authorizes these reserves to be held in any of the following:

- separate accounts for obligations to each customer;
- in an omnibus account that only contains digital assets of customers and in which digital assets of customers are not strictly segregated from each other; or
- in the digital asset corresponding to the customer's obligations or obligations issued or guaranteed by an applicable governmental entity.

C.S.H.B. 1666 requires a provider to create a plan that allows each customer to view at least quarterly an accounting of any outstanding liabilities owed to the customer and the customer's digital assets held in reserve by the provider. The plan must also allow an auditor to access and view at any time the information made viewable to each customer. The bill requires each provider, not later than the 90th day after the end of each fiscal year, to file a report with the Texas Department of Banking that includes the following information:

- an attestation by the provider of outstanding liability to customers;
- evidence of customer assets held by the provider;
- a copy of the provider's plan for the viewing of certain liability information; and
- an attestation by an auditor that the information in the report is true and accurate.

The bill requires the auditor fulfilling the requirements under these provisions to be an independent certified public accountant licensed in the United States and to apply attestation standards adopted by the American Institute of Certified Public Accountants.

C.S.H.B. 1666 requires a provider to comply with the bill's requirements to obtain and maintain any money transmission license and authorizes the department to suspend and revoke such a license if the provider violates the bill's provisions.

For purposes of the bill's provisions, C.S.H.B. 1666 defines the following terms:

- "commission" means the Finance Commission of Texas;
- "customer funds" means the digital assets, fiat currency, or other property deposited by a digital asset customer;
- "digital asset" means a natively electronic asset that confers economic, proprietary, or access rights and is recorded or stored in a blockchain, cryptographically secured distributed ledger, or similar technology, and includes a virtual currency or a digital asset that the laws of any country consider to be legal tender;
- "digital asset customer" means a person who deposits fiat currency or a digital asset with a digital asset service provider; and
- "digital asset service provider" means an electronic platform that facilitates the trading of digital assets on behalf of a digital asset customer and maintains custody of the customer's digital assets.

C.S.H.B. 1666 requires the department to administer the bill's provisions and authorizes the Finance Commission of Texas to adopt rules to administer and enforce the bill's provisions, including rules necessary and appropriate to implement and clarify the bill's provisions. The bill exempts from its provisions a bank or an entity excluded by commission rule or by order of the banking commissioner of Texas based on a finding that the entity is not required to hold a money transmission or is not subject to the bill's requirements.

EFFECTIVE DATE

September 1, 2023.

COMPARISON OF INTRODUCED AND SUBSTITUTE

While C.S.H.B. 1666 may differ from the introduced in minor or nonsubstantive ways, the following summarizes the substantial differences between the introduced and committee substitute versions of the bill.

The substitute includes a provision that was not in the introduced requiring the department to administer the bill's provisions. The substitute also changes the entity granted rulemaking authority under the bill from the department, as in the introduced, to the commission. The substitute expands the scope of the rulemaking authority granted. Whereas the introduced granted the authority to adopt rules necessary to the implement the bill's provisions, the substitute authorizes the adoption of rules to administer and enforce the bill's provisions, including those necessary and appropriate to implement and clarify the provisions.

The substitute includes an condition absent from the introduced that must be satisfied for the bill's provisions to apply to a digital asset service provider doing business in Texas, which is that the provider hold a money transmission license. With respect to the provision exempting certain entities from the applicability of the bill's provisions, the substitute does the following:

- omits the exemption included in the introduced for an institutional trading division or accredited investor division of a digital asset service provider; and
- replaces the exemption for an institution excluded by rule by the commissioner with an exemption for an entity excluded by commission rule or by order of the banking commissioner based on a finding that the entity is not required to hold a money transmission license or is not subject to the bill's requirements.

The substitute omits the provision from the introduced that prohibits a digital asset service provider from investing in certain other obligations.

The substitute revises the list of options for where a digital asset service provider may hold their reserves. Whereas the introduced included an option holding the reserves in a commingled account in which digital assets of customers are not strictly segregated from other assets, the substitute includes instead as an option holding the reserves in an omnibus account that only contains digital assets of customers and in which those assets are not strictly segregated from each other. The substitute also includes as an option not included in the introduced holding the reserves in separate accounts for obligations to each customer.

The substitute does not include the requirement present in the introduced that the attestation by the digital asset service provider of outstanding liability to digital asset customers and the evidence of customer assets held that is included in the quarterly report filed with the department be documented using zero-knowledge encryption or a similar industry standard. The substitute includes a provision absent from the introduced requiring an auditor fulfilling the requirements of the bill relating to the quarterly reports and the providers' plans to be an independent certified public accountant licensed in the United States and to apply attestation standards adopted by the American Institute of Certified Public Accountants.

The substitute includes a definition of "commission," which was absent in the introduced. Whereas the introduced defined "customer funds" as the digital assets, fiat currency, or other property of a digital asset customer, the substitute defines that term as the digital assets, fiat currency, or other property deposited by a digital asset customer.