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S. 3087

To impose requirements on digital exchanges, and for other purposes.

IN THE SENATE OF THE UNITED STATES

OCTOBER 19, 2023

Mr. TILLIS (for himself and Mr. HICKENLOOPER) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL

To impose requirements on digital exchanges, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Proving Reserves Of
5 Others’ Funds Act” or the “PROOF Act”.

6 **SEC. 2. DEFINITIONS.**

7 In this Act:

8 (1) COVERED ASSET.—

9 (A) IN GENERAL.—The term “covered
10 asset” means, with respect to a customer of a

1 digital exchange, money, an asset, or property
2 of the customer.

3 (B) EXCEPTIONS.—

4 (i) PROPRIETARY FUNDS.—The term
5 “covered asset” does not include propri-
6 etary funds of a digital exchange.

7 (ii) MARGIN ACCOUNTS.—If a cus-
8 tomer of a digital exchange has opened a
9 margin account for the purposes of bor-
10 rowing cash or digital assets, or other re-
11 lated activity, the assets in that margin ac-
12 count are not covered assets.

13 (2) DIGITAL ASSET.—The term “digital asset”
14 means any digital representation of value that is re-
15 corded on a cryptographically secured digital ledger.

16 (3) DIGITAL COMMODITY.—The term “digital
17 commodity” means any form of fungible and intan-
18 gible personal property that—

19 (A) can be—

20 (i) exclusively possessed; and

21 (ii) transferred from a person to an-
22 other person without necessary reliance on
23 an intermediary; and

24 (B) is not an investment contract.

25 (4) DIGITAL CUSTODIAN.—

1 (A) IN GENERAL.—The term “digital cus-
2 todian” means an entity that holds, maintains,
3 or safeguards digital commodities, digital as-
4 sets, and other assets on behalf of a customer.

5 (B) EXCEPTION.—Any entity facilitating
6 clearing or settling services of a covered asset
7 on behalf of a customer shall not be considered
8 to be a digital custodian of that covered asset
9 for the duration of the clearing or settling proc-
10 ess.

11 (5) DIGITAL EXCHANGE.—The term “digital ex-
12 change” means a trading facility that lists for trad-
13 ing not less than 1 digital commodity or digital
14 asset.

15 (6) DIGITAL WALLET.—The term “digital wal-
16 let” means any device, physical medium, program, or
17 service that stores a digital asset or digital com-
18 modity.

19 (7) INVESTMENT CONTRACT.—

20 (A) IN GENERAL.—The term “investment
21 contract” means a contract—

22 (i) that provides for an investment of
23 money in an enterprise with a sponsor; and

24 (ii) the objective of the performance of
25 which is primarily profit (rather than con-

1 sumption), which is derived primarily from
2 the managerial or entrepreneurial efforts
3 of the sponsor described in clause (i).

4 (B) USE OF CERTAIN TERMS.—For the
5 purposes of subparagraph (A)—

6 (i) the term “money” means—

7 (I) any medium of exchange rec-
8 ognized as legal tender anywhere in
9 the world; or

10 (II) any convertible virtual cur-
11 rency, as defined by the Financial
12 Crimes Enforcement Network of the
13 Department of the Treasury; and

14 (ii) the term “sponsor” means a man-
15 ager or entrepreneur that has solicited in-
16 vestment in a contract described in that
17 subparagraph.

18 (C) EFFECT OF MEMBERSHIP IN CERTAIN
19 ORGANIZATIONS.—A member of a formal or in-
20 formal decentralized autonomous organization
21 is not, solely by reason of that membership, or
22 through participation in such an organization,
23 the holder of an investment contract.

24 (D) EXCLUSIONS.—A contract that would
25 otherwise be an investment contract under this

1 paragraph is not an investment contract if the
2 obligee of that contract—

3 (i) as of the date on which the con-
4 tract became effective, primarily expected
5 profit from performance of the contract;
6 and

7 (ii)(I) at a date after the date de-
8 scribed in clause (i)—

9 (aa) primarily expects to con-
10 sume goods or services associated with
11 the contract; or

12 (bb) no longer expects profit pri-
13 marily from the managerial or entre-
14 preneurial efforts of the sponsor de-
15 scribed in subparagraph (A)(i) with
16 respect to the contract.

17 (8) OFFICE.—The term “Office” means the Of-
18 fice of Domestic Finance of the Department of the
19 Treasury.

20 (9) UNDER SECRETARY.—The term “Under
21 Secretary” means the Under Secretary of the Treas-
22 ury for Domestic Finance.

1 **SEC. 3. REQUIREMENTS FOR DIGITAL EXCHANGES RE-**
2 **GARDING TREATMENT OF CUSTOMER AS-**
3 **SETS.**

4 (a) **REQUIRED STANDARDS AND PROCEDURES.—**

5 Each digital exchange shall establish baseline accounting
6 standards and procedures that are designed to protect and
7 ensure the safety of covered assets of customers of the
8 exchange.

9 (b) **HOLDING OF CUSTOMER ASSETS.—**

10 (1) **IN GENERAL.—**Each digital exchange shall
11 hold the covered assets of each customer of the ex-
12 change in a manner that minimizes—

13 (A) the risk of loss by the customer of any
14 such covered asset; and

15 (B) any delay in the customer accessing
16 any such covered asset.

17 (2) **SEGREGATION OF FUNDS.—**

18 (A) **IN GENERAL.—**Each digital exchange
19 shall treat and deal with all covered assets of a
20 customer of the exchange that are received by
21 the exchange as belonging to the customer.

22 (B) **CO-MINGLING PROHIBITED.—**Except
23 as provided in subparagraph (C), with respect
24 to any covered asset of a customer of a digital
25 exchange, the exchange may not—

1 (i) co-mingle that covered asset with
2 assets that are not covered assets; or

3 (ii) use that covered asset to margin,
4 secure, or guarantee any trade or account
5 of any person other than the customer for
6 which that item is held.

7 (C) EXCEPTIONS.—

8 (i) IN GENERAL.—A digital exchange
9 may, for convenience, co-mingle and de-
10 posit a covered asset of a customer of the
11 exchange in the same account as funds of
12 the exchange with any bank, trust com-
13 pany, or qualified digital custodian.

14 (ii) WITHDRAWAL.—A digital ex-
15 change may withdraw from a bank, trust,
16 or digital wallet account such share of a
17 covered asset of a customer of the ex-
18 change as may be necessary in the ordi-
19 nary course of business to margin, guar-
20 antee, secure, transfer, adjust, or settle a
21 transaction regarding a digital asset or
22 digital commodity with another digital ex-
23 change, including for the payment of a
24 commission, a brokerage fee, interest,
25 taxes, storage costs, or any other charge

1 that lawfully accrues in connection with a
2 digital commodity transaction.

3 (iii) SUBSTITUTION.—A customer may
4 explicitly consent to a digital exchange sub-
5 stituting covered assets of the customer
6 with certain other assets.

7 (c) ENFORCEMENT.—

8 (1) IN GENERAL.—If, in the process of review-
9 ing a report submitted to the Under Secretary under
10 section 4(b) with respect to a digital exchange, the
11 Under Secretary discovers that the digital exchange
12 has violated a provision of this section, the Under
13 Secretary, through the Office, shall impose a civil
14 penalty on the digital exchange in the manner de-
15 scribed in clauses (i), (ii), and (iii) of section
16 4(c)(1)(A) (subject to paragraph (2) of this sub-
17 section).

18 (2) RULE OF CONSTRUCTION.—For the pur-
19 poses of a civil penalty imposed under paragraph
20 (1)—

21 (A) an entity that is subject to the require-
22 ments of section 4(a), as described in section
23 4(c)(1)(A), shall be deemed to be an entity that
24 is subject to the requirements of this section;
25 and

1 (B) the failure of an entity to satisfy the
2 requirements of section 4(a), as described in
3 section 4(c)(1)(A), shall be deemed to be a fail-
4 ure to satisfy the requirements of this section.

5 **SEC. 4. ATTESTATION REQUIREMENTS.**

6 (a) ATTESTATION.—

7 (1) IN GENERAL.—Not later than 30 days after
8 the effective date of this section, and monthly there-
9 after, each digital exchange and each digital custo-
10 dian shall obtain from an independent auditing firm
11 an attestation that the applicable entity has proof of
12 reserves, which shall be accompanied by appropriate
13 evidence demonstrating proof of those reserves, as
14 described further in subsection (b).

15 (2) INABILITY TO OBTAIN SERVICES OF AUDIT-
16 ING FIRM.—

17 (A) IN GENERAL.—A digital exchange or
18 digital custodian may contract with, or other-
19 wise obtain the services of, a disinterested third
20 party to carry out the responsibilities of an
21 independent auditing firm under paragraph (1)
22 only if the digital exchange or digital custodian
23 is unable to contract with, or otherwise obtain
24 the services of, an independent auditing firm to
25 carry out those responsibilities.

1 (B) APPLICABILITY.—If a digital exchange
2 or digital custodian contracts with, or otherwise
3 obtains the services of, a disinterested third
4 party as described in subparagraph (A), that
5 third party shall be subject to the requirements
6 of this section to the same extent as an inde-
7 pendent auditing firm carrying out the respon-
8 sibilities described in paragraph (1).

9 (3) INDUSTRY STANDARD.—

10 (A) SOLICITATION OF STANDARD.—Not
11 later than 90 days after the date of enactment
12 of this Act, the Public Company Accounting
13 Oversight Board and the American Institute of
14 Certified Public Accountants shall jointly issue
15 a request for public comment soliciting pro-
16 posals from the digital asset industry regarding
17 a standard for the attestations required under
18 this section.

19 (B) ESTABLISHMENT OF ADVISORY COM-
20 MITTEE.—After the expiration of the 90-day pe-
21 riod described in subparagraph (A), the Public
22 Company Accounting Oversight Board and the
23 American Institute of Certified Public Account-
24 ants shall establish an advisory committee that

1 shall be comprised of the entities that submit
2 proposals under that subparagraph.

3 (C) CREATION OF STANDARD.—The advi-
4 sory committee established under subparagraph
5 (B) shall—

6 (i) create a proposed standard for the
7 purposes described in subparagraph (A);
8 and

9 (ii) submit to the Public Company Ac-
10 counting Oversight Board and the Amer-
11 ican Institute of Certified Public Account-
12 ants the proposed standard described in
13 clause (i) for approval of the proposed
14 standard by those entities.

15 (D) APPROVAL OF STANDARD.—

16 (i) IN GENERAL.—Not later than 18
17 months after the date of enactment of this
18 Act, the Public Company Accounting Over-
19 sight Board and the American Institute of
20 Certified Public Accountants shall jointly
21 approve a proposed standard submitted to
22 those entities under subparagraph (C).

23 (ii) EXTENSION OF DEADLINE.—If, as
24 of the date that is 18 months after the
25 date of enactment of this Act, the Public

1 Company Accounting Oversight Board and
2 the American Institute of Certified Public
3 Accountants have not issued a joint ap-
4 proval described in clause (i), the 18-
5 month deadline described in that clause
6 with respect to that approval shall be ex-
7 tended by consecutive 180-day periods
8 until the date on which those entities issue
9 such an approval.

10 (b) REPORTS.—

11 (1) IN GENERAL.—An auditing firm that pre-
12 pares an attestation under subsection (a) with re-
13 spect to an entity shall, after making the attestation,
14 submit to the Under Secretary a report that ad-
15 dresses the following with respect to the entity:

16 (A) Cryptographic proof of possession or
17 control over keys that are capable of effec-
18 tuating the transfer, change of control, or
19 movement of a chain of assets that are owned
20 by a person other than that entity, such as a
21 customer of the entity.

22 (B) Verification of cryptographic proof of
23 reserves of the entity.

24 (C)(i) Verification of cryptographic proof
25 of the liabilities of the entity.

1 (ii) For the purposes of clause (i), cryp-
2 tographic proof means a cryptographically
3 verifiable attestation using a Merkle tree struc-
4 ture, a zero-knowledge proof, or another similar
5 mechanism that can prove—

6 (I) the existence of the applicable li-
7 abilities; and

8 (II) that the applicable liabilities are
9 the legal responsibility of the entity that is
10 the subject of the report.

11 (2) PUBLIC AVAILABILITY.—The Under Sec-
12 retary, through the Office, shall make each report
13 received under paragraph (1) available to the public,
14 which shall include, in addition to the material de-
15 scribed in subparagraphs (A), (B), and (C) of that
16 paragraph—

17 (A) the name of the entity for which the
18 attestation that is the subject of the report was
19 performed; and

20 (B) the name of the auditing firm that
21 made the attestation described in subparagraph
22 (A) of this paragraph.

23 (c) ENFORCEMENT.—

24 (1) CIVIL PENALTIES.—

1 (A) IN GENERAL.—With respect to an en-
2 tity that is subject to the requirements under
3 subsection (a) and fails to satisfy those require-
4 ments, the Under Secretary, through the Office,
5 shall, subject to subparagraph (B), impose a
6 civil penalty on the entity as follows:

7 (i) If that failure is the only such fail-
8 ure by the entity during the most recent
9 24-month period, the amount of the pen-
10 alty shall be the greater of the following:

11 (I) 25 cents per user or customer
12 of the entity (as applicable), as of the
13 date on which the penalty is imposed.

14 (II) 2.5 basis points of the total
15 assets under management by the enti-
16 ty, as of the date on which the penalty
17 is imposed.

18 (ii) If the entity has 1 additional such
19 failure during the most recent 24-month
20 period, the amount of the penalty shall be
21 the greater of the following:

22 (I) 55 cents per user or customer
23 of the entity (as applicable), as of the
24 date on which the penalty is imposed.

1 (II) 5.5 basis points of the total
2 assets under management by the enti-
3 ty, as of the date on which the penalty
4 is imposed.

5 (iii) If the entity has more than 1 ad-
6 ditional such failure during the most re-
7 cent 24-month period, the amount of the
8 penalty shall be the greater of the fol-
9 lowing:

10 (I) 90 cents per user or customer
11 of the entity (as applicable), as of the
12 date on which the penalty is imposed.

13 (II) 9 basis points of the total as-
14 sets under management by the entity,
15 as of the date on which the penalty is
16 imposed.

17 (B) LIMITATION.—The Under Secretary,
18 through the Office, may not impose a penalty
19 on an entity under subparagraph (A) if the im-
20 position of that penalty would cause the total
21 amount of penalties imposed on that entity
22 under that subparagraph for the year in which
23 the penalty would be imposed to exceed the
24 lesser of the following:

1 (i) \$1 per user or customer of the en-
2 tity (as applicable), as of the date on which
3 the penalty would be imposed.

4 (ii) 10 basis points of the total assets
5 under management by the entity, as of the
6 date on which the penalty would be im-
7 posed.

8 (2) PUBLICATION.—The Under Secretary,
9 through the Office, shall make publicly available,
10 with respect to the most recent 24-month period, the
11 name of each entity that is subject to the require-
12 ments under subsection (a) and has failed to satisfy
13 those requirements.

14 (3) APPEALS.—

15 (A) IN GENERAL.—The Under Secretary
16 shall establish a process through which an enti-
17 ty on which a penalty is imposed under para-
18 graph (1) may appeal that penalty.

19 (B) WAIVER OF PENALTY.—The Under
20 Secretary shall waive a penalty imposed under
21 paragraph (1) if the Under Secretary deter-
22 mines in an appeal brought under subpara-
23 graph (A) of this paragraph that the reason
24 that the Under Secretary did not receive a re-
25 port under subsection (b)(1) is because of an

1 action or omission by an auditing firm and not
2 the entity on which the Under Secretary im-
3 posed the penalty.

4 (C) PAUSE IN PAYMENT.—An entity on
5 which the Under Secretary imposes a penalty
6 under paragraph (1) shall not be required to
7 pay that penalty during the period in which an
8 appeal brought by the entity under this para-
9 graph is pending.

10 (d) EFFECTIVE DATE.—This section shall take effect
11 on the date on which the Public Company Accounting
12 Oversight Board and the American Institute of Certified
13 Public Accountants jointly approve, under subsection
14 (a)(3), an industry standard for the attestations required
15 under this section.

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