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
4 SECTION 1. SHORT TITLE.
5 This Act may be cited as the “Proving Reserves of
6 Others’ Funds Act” or the “PROOF Act”.
7
8 SEC. 2. DEFINITIONS.
9 In this Act:
10 (1) COVERED ASSET.—
11 (A) IN GENERAL.—The term “covered
12 asset” means, with respect to a customer of a
digital exchange, money, an asset, or property of the customer.

(B) Exceptions.—

(i) Proprietary Funds.—The term “covered asset” does not include proprietary funds of a digital exchange.

(ii) Margin Accounts.—If a customer of a digital exchange has opened a margin account for the purposes of borrowing cash or digital assets, or other related activity, the assets in that margin account are not covered assets.

(2) Digital Asset.—The term “digital asset” means any digital representation of value that is recorded on a cryptographically-secured digital ledger.

(3) Digital Commodity.—The term “digital commodity” means any form of fungible and intangible personal property that—

(A) can be—

(i) exclusively possessed; and

(ii) transferred from a person to another person without necessary reliance on an intermediary; and

(B) is not an investment contract.

(4) Digital Custodian.—
(A) IN GENERAL.—The term “digital custodian” means an entity that holds, maintains, or safeguards digital commodities, digital assets, and other assets on behalf of a customer.

(B) EXCEPTION.—Any entity facilitating clearing or settling services of a covered asset on behalf of a customer shall not be considered to be a digital custodian of that covered asset for the duration of the clearing or settling process.

(5) DIGITAL EXCHANGE.—The term “digital exchange” means a trading facility that lists for trading not less than 1 digital commodity or digital asset.

(6) DIGITAL WALLET.—The term “digital wallet” means any device, physical medium, program, or service that stores a digital asset or digital commodity.

(7) INVESTMENT CONTRACT.—

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

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

(ii) the objective of the performance of which is primarily profit (rather than con-
sumption), which is derived primarily from
the managerial or entrepreneurial efforts
of the sponsor described in clause (i).

(B) Use of Certain Terms.—For the
purposes of subparagraph (A)—

(i) the term “money” means—

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

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

(ii) the term “sponsor” means a man-
ger or entrepreneur that has solicited in-
vestment in a contract described in that
subparagraph.

(C) Effect of Membership in Certain
Organizations.—A member of a formal or in-
formal decentralized autonomous organization
is not, solely by reason of that membership, or
through participation in such an organization,
the holder of an investment contract.

(D) Exclusions.—A contract that would
otherwise be an investment contract under this
paragraph is not an investment contract if the obligee of that contract—

(i) as of the date on which the contract became effective, primarily expected profit from performance of the contract; and

(ii)(I) at a date after the date described in clause (i)—

(aa) primarily expects to consume goods or services associated with the contract; or

(bb) no longer expects profit primarily from the managerial or entrepreneurial efforts of the sponsor described in subparagraph (A)(i) with respect to the contract.

(8) OFFICE.—The term “Office” means the Office of Domestic Finance of the Department of the Treasury.

(9) UNDER SECRETARY.—The term “Under Secretary” means the Under Secretary of the Treasury for Domestic Finance.
SEC. 3. REQUIREMENTS FOR DIGITAL EXCHANGES REGARDING TREATMENT OF CUSTOMER ASSETS.

(a) Required Standards and Procedures.—

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

(b) Holding of Customer Assets.—

(1) In general.—Each digital exchange shall hold the covered assets of each customer of the exchange in a manner that minimizes—

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

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

(2) Segregation of Funds.—

(A) In general.—Each digital exchange shall treat and deal with all covered assets of a customer of the exchange that are received by the exchange as belonging to the customer.

(B) Co-mingling Prohibited.—Except as provided in subparagraph (C), with respect to any covered asset of a customer of a digital exchange, the exchange may not—
(i) co-mingle that covered asset with assets that are not covered assets; or

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

(C) EXCEPTIONS.—

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

(ii) WITHDRAWAL.—A digital ex-change may withdraw from a bank, trust, or digital wallet account such share of a covered asset of a customer of the ex-change as may be necessary in the ordi-nary course of business to margin, guar-antee, secure, transfer, adjust, or settle a transaction regarding a digital asset or digital commodity with another digital ex-change, including for the payment of a commission, a brokerage fee, interest, taxes, storage costs, or any other charge.
that lawfully accrues in connection with a digital commodity transaction.

(iii) Substitution.—A customer may explicitly consent to a digital exchange substituting covered assets of the customer with certain other assets.

(e) Enforcement.—

(1) in general.—If, in the process of reviewing a report submitted to the Under Secretary under section 4(b) with respect to a digital exchange, the Under Secretary discovers that the digital exchange has violated a provision of this section, the Under Secretary, through the Office, shall impose a civil penalty on the digital exchange in the manner described in clauses (i), (ii), and (iii) of section 4(c)(1)(A) (subject to paragraph (2) of this subsection).

(2) Rule of construction.—For the purposes of a civil penalty imposed under paragraph (1)—

(A) an entity that is subject to the requirements of section 4(a), as described in section 4(c)(1)(A), shall be deemed to be an entity that is subject to the requirements of this section; and
(B) the failure of an entity to satisfy the requirements of section 4(a), as described in section 4(c)(1)(A), shall be deemed to be a failure to satisfy the requirements of this section.

SEC. 4. ATTESTATION REQUIREMENTS.

(a) Attestation.—

(1) In general.—Not later than 30 days after the effective date of this section, and monthly thereafter, each digital exchange and each digital custodian shall obtain from an independent auditing firm an attestation that the applicable entity has proof of reserves, which shall be accompanied by appropriate evidence demonstrating proof of those reserves, as described further in subsection (b).

(2) Inability to obtain services of auditing firm.—

(A) In general.—A digital exchange or digital custodian may contract with, or otherwise obtain the services of, a disinterested third party to carry out the responsibilities of an independent auditing firm under paragraph (1) only if the digital exchange or digital custodian is unable to contract with, or otherwise obtain the services of, an independent auditing firm to carry out those responsibilities.
(B) APPLICABILITY.—If a digital exchange or digital custodian contracts with, or otherwise obtains the services of, a disinterested third party as described in subparagraph (A), that third party shall be subject to the requirements of this section to the same extent as an independent auditing firm carrying out the responsibilities described in paragraph (1).

(3) INDUSTRY STANDARD.—

(A) SOLICITATION OF STANDARD.—Not later than 90 days after the date of enactment of this Act, the Public Company Accounting Oversight Board and the American Institute of Certified Public Accountants shall jointly issue a request for public comment soliciting proposals from the digital asset industry regarding a standard for the attestations required under this section.

(B) ESTABLISHMENT OF ADVISORY COMMITTEE.—After the expiration of the 90-day period described in subparagraph (A), the Public Company Accounting Oversight Board and the American Institute of Certified Public Accountants shall establish an advisory committee that
shall be comprised of the entities that submit proposals under that subparagraph.

(C) **Creation of Standard.**—The advisory committee established under subparagraph (B) shall—

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

(ii) submit to the Public Company Accounting Oversight Board and the American Institute of Certified Public Accountants the proposed standard described in clause (i) for approval of the proposed standard by those entities.

(D) **Approval of Standard.**—

(i) **In General.**—Not later than 18 months after the date of enactment of this Act, the Public Company Accounting Oversight Board and the American Institute of Certified Public Accountants shall jointly approve a proposed standard submitted to those entities under subparagraph (C).

(ii) **Extension of Deadline.**—If, as of the date that is 18 months after the date of enactment of this Act, the Public
Company Accounting Oversight Board and the American Institute of Certified Public Accountants have not issued a joint approval described in clause (i), the 18-month deadline described in that clause with respect to that approval shall be extended by consecutive 180-day periods until the date on which those entities issue such an approval.

(b) Reports.—

(1) In general.—An auditing firm that prepares an attestation under subsection (a) with respect to an entity shall, after making the attestation, submit to the Under Secretary a report that addresses the following with respect to the entity:

(A) Cryptographic proof of possession or control over keys that are capable of effectuating the transfer, change of control, or movement of a chain of assets that are owned by a person other than that entity, such as a customer of the entity.

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

(C)(i) Verification of cryptographic proof of the liabilities of the entity.
(ii) For the purposes of clause (i), cryptographic proof means a cryptographically verifiable attestation using a Merkle tree structure, a zero-knowledge proof, or another similar mechanism that can prove—

(I) the existence of the applicable liabilities; and

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

(2) Public availability.—The Under Secretary, through the Office, shall make each report received under paragraph (1) available to the public, which shall include, in addition to the material described in subparagraphs (A), (B), and (C) of that paragraph—

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

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

e) Enforcement.—

(1) Civil penalties.—
(A) IN GENERAL.—With respect to an entity that is subject to the requirements under subsection (a) and fails to satisfy those requirements, the Under Secretary, through the Office, shall, subject to subparagraph (B), impose a civil penalty on the entity as follows:

(i) If that failure is the only such failure by the entity during the most recent 24-month period, the amount of the penalty shall be the greater of the following:

(1) 25 cents per user or customer of the entity (as applicable), as of the date on which the penalty is imposed.

(II) 2.5 basis points of the total assets under management by the entity, as of the date on which the penalty is imposed.

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

(I) 55 cents per user or customer of the entity (as applicable), as of the date on which the penalty is imposed.
(II) 5.5 basis points of the total assets under management by the entity, as of the date on which the penalty is imposed.

(iii) If the entity has more than 1 additional such failure during the most recent 24-month period, the amount of the penalty shall be the greater of the following:

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

(II) 9 basis points of the total assets under management by the entity, as of the date on which the penalty is imposed.

(B) LIMITATION.—The Under Secretary, through the Office, may not impose a penalty on an entity under subparagraph (A) if the imposition of that penalty would cause the total amount of penalties imposed on that entity under that subparagraph for the year in which the penalty would be imposed to exceed the lesser of the following:
(i) $1 per user or customer of the entity (as applicable), as of the date on which the penalty would be imposed.

(ii) 10 basis points of the total assets under management by the entity, as of the date on which the penalty would be imposed.

(2) **Publication.**—The Under Secretary, through the Office, shall make publicly available, with respect to the most recent 24-month period, the name of each entity that is subject to the requirements under subsection (a) and has failed to satisfy those requirements.

(3) **Appeals.**—

   (A) **In General.**—The Under Secretary shall establish a process through which an entity on which a penalty is imposed under paragraph (1) may appeal that penalty.

   (B) **Waiver of Penalty.**—The Under Secretary shall waive a penalty imposed under paragraph (1) if the Under Secretary determines in an appeal brought under subparagraph (A) of this paragraph that the reason that the Under Secretary did not receive a report under subsection (b)(1) is because of an
action or omission by an auditing firm and not
the entity on which the Under Secretary im-
posed the penalty.

(C) Pause in Payment.—An entity on
which the Under Secretary imposes a penalty
under paragraph (1) shall not be required to
pay that penalty during the period in which an
appeal brought by the entity under this para-
graph is pending.

(d) Effective Date.—This section shall take effect
on the date on which the Public Company Accounting
Oversight Board and the American Institute of Certified
Public Accountants jointly approve, under subsection
(a)(3), an industry standard for the attestations required
under this section.