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Crypto is Calling: How Congress Should Answer the Call to Provide a Knowledgeable Regulatory Framework

Paul C. Samuel*

I. Introduction

Innovation and growth of the cryptocurrency industry has outpaced regulation. While the public interest in the cryptocurrency and digital asset space is more of a recent trend due to the explosive growth of the global crypto market capitalization, the idea of a decentralized trustless transaction system was introduced over a decade ago in 2008 with Bitcoin.¹ At its inception and for much of its existence, Bitcoin was called a fraud and likened to historical market bubbles by financial industry leaders.² Others have criticized Bitcoin and cryptocurrencies for enabling criminals to launder money, traffic drugs, and finance hackers.³ Yet, the cryptocurrency industry has survived, innovated, and continued to grow over the last decade. There are now over 17,000 different cryptocurrencies and the total global market cap is around \$1.82 trillion, with Bitcoin and Ethereum, the two largest cryptocurrencies, comprising over sixty percent combined of the total global market cap, roughly forty-two and eighteen percent respectively.⁴ The same company that earlier shunned Bitcoin and the crypto industry as a fad is now offering crypto

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¹ Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, BITCOIN.ORG (Oct. 31, 2008), <https://bitcoin.org/bitcoin.pdf>.

² Fred Imbert, *JPMorgan CEO Jamie Dimon Says Bitcoin is a 'Fraud' That Will Eventually Blow Up*, CNBC (Sept. 12, 2017), <https://finance.yahoo.com/news/jpmorgan-ceo-jamie-dimon-says-172726303.html>.

³ See Paul Vigna, *Justice Department Seizes \$1 Billion of Bitcoin Tied to Silk Road Website*, WALL ST. J. (Feb. 5, 2015), <https://www.wsj.com/articles/justice-department-seizes-1-billion-of-bitcoin-tied-to-silk-road-website-11604612072>; Paul Vigna, *5 Things About Mt. Gox's Crisis*, WALL ST. J. (Feb. 25, 2014), <https://www.wsj.com/articles/BL-263B-352>.

⁴ See *Today's Cryptocurrency Prices by Market Cap*, COINMARKETCAP (Feb. 18, 2022), <https://coinmarketcap.com> [hereinafter *Today's Cryptocurrency Prices*].

products to their clients.⁵ The cryptocurrency industry demonstrated its ability to disrupt traditional finance, and as a result, is gaining the attention of innovators, regulators, and investors.⁶

Innovation frequently outpaces regulation. As former Treasury Secretary Henry Paulson stated, “Innovation is the hallmark of our capital markets and it brings with it significant benefits to individual investors and our overall economy.”⁷ The cryptocurrency industry’s growth occurred during a period where regulation of the industry was not accomplished with new rulemaking tailored to the developing industry, but rather with regulation by enforcement where regulators attempt to reign in violations after they occur. This type of regulatory path was likely chosen due to a combination of a skepticism that cryptocurrency would survive long enough to warrant the focus of government resources, a lack of technical understanding of the industry, the cumbersome process regulators apply when addressing new technologies and forms of economic activity, and gaps between the current regulatory framework and the developing industry. The industry is at a level of maturity where regulators realize cryptocurrency is here to stay, and although the technical understanding is improving among regulators and lawmakers, there remains a lack of clarity for industry leaders, regulators, and the markets.⁸ U.S. Securities and Exchange Commission (“SEC”) Chair Gary Gensler recently likened the current state of the

⁵ Danny Nelson, *JPMorgan Launches In-House Bitcoin Fund for Private Bank Clients*, COINDESK (Aug. 4, 2021), <https://www.coindesk.com/markets/2021/08/05/jpmorgan-launches-in-house-bitcoin-fund-for-private-bank-clients>.

⁶ Press Release, U.S. Dep’t Just., Attorney General William P. Barr Announces Publication of Cryptocurrency Enforcement Framework (Oct. 8, 2020), <https://www.justice.gov/opa/pr/attorney-general-william-p-barr-announces-publication-cryptocurrency-enforcement-framework> (“Cryptocurrency is a technology that could fundamentally transform how human beings interact, and how we organize society.”).

⁷ Henry Paulson, *Remarks on Current Housing and Mortgage Market Developments Georgetown University Law Center*, U.S. SEC’Y OF THE TREASURY (Oct. 16, 2007), <https://www.treasury.gov/press-center/press-releases/Pages/hp612.aspx>.

⁸ See *Oversight of the U.S. Securities and Exchange Commission Before the U.S. Comm. on Banking, Housing, and Urban Affairs*, 117th Cong. 5 (2021) (testimony of Gary Gensler, Chair, U.S. Sec. and Exch. Comm’n); Matt Levine, *You Get the Crypto Rules You Pay For*, BLOOMBERG (Feb. 15, 2022) <https://www.bloomberg.com/opinion/articles/2022-02-15/you-get-the-crypto-rules-you-pay-for>.

crypto industry to the Wild West and explained that a large segment of the crypto industry operates outside of the regulatory frameworks in place to protect investors, ensure financial stability, and guard against illicit activity.⁹ This regulatory uncertainty results in inefficient crypto markets as large, traditional financial market participants choose to sit out because of unknown regulatory risks.¹⁰

The challenge regulators face is balancing the protection of the public and markets with regulating in a way that fosters innovation rather than discourages it. Former SEC Chair Jay Clayton stated the SEC seeks to “foster innovative and beneficial ways to raise capital, while ensuring – first and foremost – that investors and our markets are protected.”¹¹ Although the burden is on industry participants to understand and follow regulations when engaging in regulated activity, crypto industry participants are often approaching the regulatory landscape by operating outside of the rules.¹² The resulting regulatory approach has been more reactionary to fraudulent and problematic activity rather than a proactive attempt to work with industry leaders towards compliant innovation.¹³ This regulatory approach unfortunately results in the public being unprotected until delayed enforcement occurs and is not accommodative to the development of innovative products.¹⁴

⁹ *Oversight of the U.S. Securities and Exchange Commission: Wall Street’s Cop Is Finally Back on the Beat*, 117th Cong. 5 (2021) (testimony of Gary Gensler, Chair, U.S. Sec. and Exch. Comm’n).

¹⁰ Interview with Alexey Demyanov, Managing Director of Digital Asset Initiatives, Bank of America (Jan. 14, 2022).

¹¹ *U.S. Securities Laws May Apply to Offers, Sales, and Trading of Interests in Virtual Organizations*, U.S. SEC. AND EXCH. COMM’N (July 25, 2017), <https://www.sec.gov/news/press-release/2017-131>.

¹² See Levine, *supra* note 8.

¹³ *See Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO*, U.S. SEC. AND EXCH. COMM’N (July 25, 2017), <https://www.sec.gov/litigation/investreport/34-81207.pdf>; Paul Grewal, Chief Legal Officer, *The SEC Has Told Us it Wants to Sue Us Over Lend. We Don’t Know Why.*, COINBASE BLOG (Sep. 7, 2021), <https://blog.coinbase.com/the-sec-has-told-us-it-wants-to-sue-us-over-lend-we-have-no-idea-why-a3a1b6507009>.

¹⁴ See Hester M. Peirce, *Statement on Settlement with BlockFi Lending LLC*, U.S. SEC. AND EXCH. COMM’N (Feb. 14, 2022), <https://www.sec.gov/news/statement/peirce-blockfi-20220214> (“[W]e need to do better than we have so far at accommodating innovation through thoughtful use of the exemptive authority Congress gave us.”).

The word “cryptocurrency” used throughout this Comment is meant to recognize the industry as a whole, essentially an umbrella term for all crypto assets. The important characteristic underlying cryptocurrencies, regardless of what type they fall under, is that they are built on blockchain technology that serves as a public ledger to record transactions.¹⁵ Cryptocurrencies and blockchain technology present an opportunity to transform traditional financial services into a more efficient, connected, and accessible global system.¹⁶ It is first helpful to explain the different uses and types of cryptocurrencies to understand the argument of how they should be regulated. Cryptocurrencies should be generally differentiated into three major types: (1) crypto-tokens, (2) crypto-coins, and (3) stablecoins.¹⁷ While the categories overlap in some regards, the distinctions align with characteristics of other assets subject to oversight by the SEC, the Commodity Futures Trading Commission (“CFTC”), and the U.S. Department of the Treasury (“Treasury”).

Crypto-tokens serve a purpose different from being a medium of exchange, generally either a utility function or a security function.¹⁸ A utility token enables the token holder access to services or products of the project at a point in the future, comparable to a traditional gift card to a store or service.¹⁹ A security token is a capital raising mechanism for a project in which investors provide capital in return for a token which may provide certain rights to the holder as

¹⁵ See *What is Cryptocurrency?*, COINBASE, <https://www.coinbase.com/learn/crypto-basics/what-is-cryptocurrency>, (last visited Jan. 13, 2021).

¹⁶ See Jeremy Allaire, *Circle Mission & Values*, CIRCLE INTERNET FIN. LTD. (Apr. 19, 2021), <https://www.circle.com/blog/circle-mission-and-values>.

¹⁷ See Pablo Febrero, *Cryptocurrencies, Crypto-tokens and Stablecoins. Why all Matter?*, TOSHI TIMES (Feb. 20, 2020), <https://toshitimes.com/cryptocurrencies-crypto-tokens-and-stablecoins/>.

¹⁸ See Jay Clayton, *Statement on Cryptocurrencies and Initial Coin Offerings*, U.S. SEC. AND EXCH. COMM’N (Dec. 11, 2017), <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11>.

¹⁹ *Security Token vs. Utility Token in Crypto: What are The Differences?*, PHEMEX (Aug. 5 2021), <https://phemex.com/academy/crypto-security-token-vs-utility-token>.

well as a value linked with the economic success of the project.²⁰ The best example of crypto-tokens are “ERC-20 Tokens” built on the Ethereum platform. These tokens can represent virtually anything: rewards points, lottery tickets, shares of financial assets, fiat currencies, etc.²¹ Crypto-coins are a subset of crypto-tokens but act primarily as a store of value and they also facilitate the exchange of value through a decentralized ledger system.²² This type of cryptocurrency is the most well-known and largest segment of the industry because of Bitcoin, which comprises nearly forty-two percent of the market capitalization of the industry with a total value of over \$760 billion.²³ Stablecoins, while arguably a subset of the crypto-coins, should be a distinct category because they serve as a better medium of exchange due to their price stability. Cryptocurrencies in this category attempt to peg their value to more stable assets such as the U.S. Dollar through a reserve mechanism that collateralizes the stablecoin, providing the benefits of efficient transfer, storage, and use without the large fluctuations in value associated with cryptocurrencies in the crypto-coin category.²⁴ “USDC” is one of the leading stablecoins with \$52.6 billion in circulation that is “fully backed by cash and equivalents and short-duration U.S. Treasuries, so that it is always redeemable 1:1 for U.S. Dollars.”²⁵

This Comment argues that knowledgeable, clear, and targeted rulemaking is needed now to encourage and foster innovation rather than stifle it through uncertainty and regulation by enforcement. Part II of this Comment will first discuss the current reactionary regulatory environment and how the SEC, the CFTC, and the Treasury are currently regulating and

²⁰ *Id.*

²¹ ERC-20 TOKEN STANDARD, ETHEREUM.ORG (Dec. 3, 2021), <https://ethereum.org/en/developers/docs/standards/tokens/erc-20/>.

²² *See id.*

²³ *See Today’s Cryptocurrency Prices*, *supra* note 4.

²⁴ *See* USDC: The World’s Leading Digital Dollar Stablecoin, CIRCLE INTERNET FIN. LTD., <https://www.circle.com/en/usdc> (last visited Feb. 18, 2021).

²⁵ *Id.*

enforcing through a disorganized, outdated, and fragmented approach which is restraining innovation. This Comment will then shift focus to proposed cryptocurrency legislation in Part III which will analyze the strengths and weaknesses of two recent cryptocurrency proposals: the Crypto-Currency Act of 2020 and the Digital Asset Market Structure and Investor Protection Act. Part IV calls for Congress to pass the Digital Asset Market Structure and Investor Protection Act and mandate a “do no harm” regulatory framework focused on providing guidance to foster continuing innovation in the cryptocurrency industry while also protecting investors and markets from unscrupulous activity.

II. The Fragmented Approach of Cryptocurrency Regulation and Enforcement

The regulatory framework of the financial system in the United States is highly complex and fragmented.²⁶ Regulation and enforcement comes from numerous federal agencies, state agencies, and industry self-regulatory organizations.²⁷ This Comment discusses three of the regulatory bodies that have taken regulatory oversight and enforcement actions on the cryptocurrency industry: the SEC, CFTC, and Treasury through the Financial Crimes Enforcement Network (“FinCEN”). The mission of the SEC is to “protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.”²⁸ To the extent a cryptocurrency has the characteristics of a “security”, transactions in that cryptocurrency and intermediaries involved are regulated by the SEC in accordance with longstanding law.²⁹ The mission of the CFTC is to “promote the integrity, resilience, and vibrancy of the U.S. derivatives

²⁶ Alejandro Komai & Gary Richardson, *A Brief History of Regulations Regarding Financial Markets in the United States: 1789 TO 2009*, NAT’L BUREAU OF ECON. RES. (2011).

²⁷ *Id.*

²⁸ *About the SEC*, U.S. SEC. AND EXCH. COMM’N (Nov. 22, 2016), <https://www.sec.gov/about.shtml>.

²⁹ Gary Gensler, *Remarks Before the Aspen Security Forum*, U.S. SEC. AND EXCH. COMM’N (Aug. 3, 2021), <https://www.sec.gov/news/public-statement/gensler-aspen-security-forum-2021-08-03>.

markets through sound regulation.”³⁰ Cryptocurrencies are commodities³¹ and the CFTC has regulatory power over futures contracts and derivative products of commodities.³² The Treasury’s mission is to “maintain a strong economy and create economic and job opportunities . . . strengthen national security by combating threats and protecting the integrity of the financial system, and manage the U.S. Government’s finances and resources effectively.”³³ FinCEN recently added cryptocurrencies to its National Priority list for anti-money laundering and countering the financing of terrorism.³⁴

While it may be clear in the traditional financial industry how each of these agencies oversees its respective market, the lines become blurred with cryptocurrencies. It is difficult for a cryptocurrency innovator to know which regulator has oversight, which agency to engage for guidance, and what regulations must be complied with when these rapidly evolving cryptocurrencies do not cleanly fall into a respective category. Legislative progress towards cryptocurrency regulation is slow and as a result both the SEC and CFTC have been competing for expanded authority to regulate the crypto market.³⁵ The following subsections analyze the current fragmented approaches taken by each of the agencies in their efforts to implement cryptocurrency regulation.

³⁰ *About the CFTC*, COMMODITY FUTURES TRADING COMM’N, <https://www.cftc.gov/About/AboutTheCommission> (last visited Jan. 13, 2022).

³¹ *CFTC v. McDonnell*, 287 F. Supp. 3d 213, 217 (E.D.N.Y. 2018) (holding that virtual currencies are commodities that may be regulated by the CFTC).

³² Dawn D. Stump, *Digital Assets: Clarifying CFTC Regulatory Authority & the Fallacy of the Question, “Is it a Commodity or a Security?”*, COMMODITY FUTURES TRADING COMM’N (Aug. 23, 2021), https://www.cftc.gov/media/6306/DigitalAssetsAuthorityInfographic_CommStump082321/download.

³³ *Role of the Treasury*, U.S. DEP’T OF THE TREASURY, <https://home.treasury.gov/about/general-information/role-of-the-treasury> (last visited Jan. 13, 2022).

³⁴ *Anti-Money Laundering and Countering the Financing of Terrorism National Priorities*, FIN. CRIMES ENFORCEMENT NETWORK (June 30, 2021), [https://www.fincen.gov/sites/default/files/shared/AML_CFT%20Priorities%20\(June%2030%2C%202021\).pdf](https://www.fincen.gov/sites/default/files/shared/AML_CFT%20Priorities%20(June%2030%2C%202021).pdf).

³⁵ Jeff Benson, *CFTC and SEC Are Vying for Crypto Regulation Control*, DECRYPT (Oct. 27, 2021), <https://decrypt.co/84599/cftc-sec-vying-crypto-regulation-control>.

A. SEC Cryptocurrency Regulation

The SEC was established by the Securities Exchange Act of 1934 in the aftermath of the Great Depression to restore public confidence in the stock market.³⁶ The SEC enforces the laws that govern the securities industry, notably the Securities Act of 1933,³⁷ Securities Exchange Act of 1934,³⁸ and the Investment Company Act of 1940.³⁹ This section will focus on the registration and the disclosure requirements for securities, the tests courts apply to determine if an offering is a security, and how these tests apply to cryptocurrencies.

1. The Securities Act of 1933

The Securities Act of 1933 requires that securities offered for sale must either be registered with the SEC or qualify for an exemption from registration requirements.⁴⁰ The Securities Act of 1933 serves two important purposes: to ensure that material information about securities offered to the public are fully and fairly disclosed and to prevent fraudulent activity in the sale of securities.⁴¹ The securities registration process allows for disclosure of important information such as a description of the business and securities offered for sale as well as financial and risk information pertaining to the security.⁴² The SEC registration statements and prospectuses are publicly available to search and the disclosures permit potential investors to evaluate the suitability of the investment, ultimately allowing them to make informed investment decisions.⁴³ Complying with the SEC's security registration requirements can be a complex,

³⁶ Securities Exchange Act of 1934, 15 U.S.C. § 78d (1934).

³⁷ Securities Act of 1933, 15 U.S.C. § 77a (1933).

³⁸ 15 U.S.C. § 78d.

³⁹ Investment Company Act of 1940, 15 U.S.C. § 80a-1 (1940).

⁴⁰ 15 U.S.C. § 77.

⁴¹ *Id.*

⁴² See Form S-1 Registration Statement Under the Securities Act of 1933, SEC.GOV, <https://www.sec.gov/files/forms-1.pdf> (last visited Jan. 20, 2022).

⁴³ See EDGAR, SEC.GOV, <https://www.sec.gov/edgar/search/> (last visited Jan. 20, 2022).

expensive, and time consuming process but such registration requirements proactively reduce fraud by reducing investor exposure to unregistered securities where material information is more likely to be misrepresented or concealed. Therefore, the key question for cryptocurrency innovators is whether or not their product is a security subject to SEC registration.

The Securities Act of 1933 broadly defines “security” to include “any note, stock, treasury stock, security future, security-based swap, bond . . . [and] investment contract”⁴⁴ Most of the security definitions are straightforward and need no analysis as to whether or not it is a security. However, the legislative definition of “security” includes several terms that are broadly interpreted to capture financial instruments and products that were not yet in use when the Securities Act was adopted. “Investment contract” is one of the terms in the statutory definition of “security” that allows regulation to adapt to new financial instruments and products as they are developed.

2. The *Howey* Test for Investment Contracts

The Supreme Court of the United States defined “investment contract” in *SEC v. W. J. Howey Co.*⁴⁵ In *Howey*, which was decided over seventy-five years ago, the Court found that an offering of parcels of a citrus grove development combined with a service contract for the cultivation, harvesting, and marketing of the citrus crops was an “investment contract,” and therefore, a security subject to the registration requirements of the Securities Act of 1933.⁴⁶ The Court held that, “an investment contract . . . means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the

⁴⁴ Securities Act of 1933, 15 U.S.C. § 77b(a)(1) (1933).

⁴⁵ 328 U.S. 293 (1946).

⁴⁶ *Id.* at 300.

efforts of the promoter or a third party. . .[.]”⁴⁷ In subsequent decisions, courts refined the definition of an investment contract into now what is simply known as the *Howey* test. There are four elements that must be met to satisfy the test:

- (i) there must be an investment of money or other value;⁴⁸
- (ii) in a common enterprise;⁴⁹
- (iii) with a reasonable expectation of profits;⁵⁰
- (iv) derived from the efforts of others.⁵¹

The SEC has not strayed far from the seventy-five-year-old *Howey* test when analyzing whether a cryptocurrency is or is not a security. Former SEC Chair Jay Clayton said it is unnecessary to change the “traditional definition of a security that has worked for a long time.”⁵² In 2019, the SEC released the “Framework for ‘Investment Contract’ Analysis of Digital Assets” to provide guidance to market participants when assessing whether a cryptocurrency is an

⁴⁷ *Id.* at 298–99.

⁴⁸ *Id.* at 299. Although the *Howey* decision used the term “money,” courts agree that cash or money is not the only investment able to satisfy this first element, but rather “goods and services” or “some other exchange of value” will suffice. *Uselton v. Commercial Lovelace Motor Freight, Inc.*, 940 F.2d 564, 574 (10th Cir. 1991).

⁴⁹ *Howey*, 328 U.S. at 299. There are two competing approaches to the “common enterprise” prong of the *Howey* test: the “horizontal commonality” approach and the “vertical commonality” approach. *Compare* *Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 622 F.2d 216, 224 (6th Cir. 1980) (rejecting the vertical commonality approach and holding that horizontal commonality occurs when there is a pooling relationship that “ties the fortunes of each investor to the success of the overall venture”), *with* *Hocking v. Dubois*, 839 F.2d 560, 566 (9th Cir. 1988) (holding that “vertical commonality requires that the investor and the promoter be involved in some common venture without mandating that other investors also be involved in that venture”). As a result of the split approaches, this prong is often the most contested.

⁵⁰ *Howey*, 328 U.S. at 299. Profits mean a return on investment, either by “capital appreciation resulting from the development of the initial investment” or by “participation in earnings resulting from the use of investors’ funds.” *United Housing Found., Inc. v. Forman*, 421 U.S. 837, 852 (1975).

⁵¹ *Howey*, 328 U.S. at 299. In *Howey*, the Court wrote that the expectation of profits must “solely” be from the efforts of a third party, however, subsequent decisions have omitted the “solely” distinction, finding that investor participation does not thwart satisfying this prong of the test. *See* *SEC v. Glenn W. Turner Enterprises, Inc.* 474 F.2d 476, 482 (9th Cir. 1973) (holding that a more realistic test is “whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise”).

⁵² Kate Rooney, *SEC Chief Says Agency Won’t Change Securities Laws to Cater to Cryptocurrencies*, CNBC (June 6, 2018), <https://www.cnbc.com/2018/06/06/sec-chairman-clayton-says-agency-wont-change-definition-of-a-security.html>.

investment contract and therefore, a security that must be registered.⁵³ The framework analysis follows the *Howey* test and its four elements.

The first prong, the investment of money, is the easiest to satisfy in the offer or sale of cryptocurrency because typically, the asset is purchased in exchange for valuable consideration.⁵⁴ For the second prong of the test, the SEC finds that a common enterprise typically exists because “the fortunes of digital asset purchasers have been linked to each other or to the success of the promoter’s efforts.”⁵⁵ This finding by the SEC refers to satisfaction of both the “horizontal commonality” approach, where pooling of investment is required,⁵⁶ and the “vertical commonality” approach, where the common enterprise need only be between the investor and the promoter.⁵⁷

The third prong of the test requires an analysis of whether the investor has a reasonable expectation of profits. Profits include the capital appreciation of the asset from the development of the business, an increase in the asset’s price due to speculation, or participation in earnings resulting from the invested funds.⁵⁸ Although the mere characterization of a cryptocurrency as a utility token, a crypto-token that enables the holder access to services or products of the project at a point in the future, is not definitive towards being classified as a non-security, it is an important distinction in the expectation of profits analysis. A cryptocurrency that is marketed

⁵³ *Framework for “Investment Contract” Analysis of Digital Assets*, n. 11, U.S. SEC. AND EXCH. COMM’N (Apr. 3, 2019), <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets> [hereinafter *Framework for Investment Contract Analysis*].

⁵⁴ See *Uselton v. Comm. Lovelace Motor Freight, Inc.*, 940 F.2d 564, 574 (10th Cir. 1991) (“[I]n spite of *Howey*’s reference to an ‘investment of money,’ it is well established that cash is not the only form of contribution or investment that will create an investment contract . . . the ‘investment’ may take the form of . . . some other ‘exchange of value.’”).

⁵⁵ *Framework for Investment Contract Analysis*, *supra* note 53.

⁵⁶ *Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 622 F.2d 216, 224 (6th Cir. 1980).

⁵⁷ *Hocking v. Dubois*, 839 F.2d 560, 566 (9th Cir. 1988).

⁵⁸ *United Housing Found., Inc. v. Forman*, 421 U.S. 837, 852 (1975); *Framework for Investment Contract Analysis*, *supra* note 53.

narrowly to users of a service or product, as compared to offered broadly to investors, is less likely to satisfy the “expectations of profits” prong.⁵⁹ Similarly, a cryptocurrency that is purchased to facilitate personal use or consumption is less likely to satisfy the “expectations of profits” element compared to one that is purchased to provide a return on investment.⁶⁰ The framework further clarifies that “[p]rice appreciation resulting solely from external market forces (such as general inflationary trends or the economy) impacting the supply and demand for an underlying asset generally is not considered ‘profit’ under the *Howey* test.”⁶¹

Finally, the fourth prong of the test considers whether the purchaser of the cryptocurrency is relying on the efforts of the promoter, sponsor, or other active participant to derive their profits. Two key questions ask if the purchaser reasonably expects “to rely on the efforts of an active participant”⁶² or if those efforts are “the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.”⁶³ When crucial tasks are performed or anticipated to be performed by third party participant(s), rather than the investor or a broader, decentralized network of users, the “efforts of others” prong is likely to be satisfied.⁶⁴ Bitcoin and Ethereum are examples of where the “efforts of others” prong is not satisfied and as a result are not securities, because the purchaser’s potential profits are tied to market price fluctuations due to the behavior of a dispersed community instead of the managerial efforts of other active participants.⁶⁵

⁵⁹ *Framework for Investment Contract Analysis*, *supra* note 53.

⁶⁰ *Forman*, 421 U.S. at 852; *Framework for Investment Contract Analysis*, *supra* note 53.

⁶¹ *Framework for Investment Contract Analysis*, *supra* note 53.

⁶² *Id.*

⁶³ *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 (9th Cir. 1973).

⁶⁴ *Framework for Investment Contract Analysis*, *supra* note 53.

⁶⁵ U.S. Sec. and Exch. Comm’n, Letter Re: Cipher Tech. Bitcoin Fund (Oct. 1, 2019) (“[W]e do not believe that current purchasers of bitcoin are relying on the essential managerial and entrepreneurial efforts of others to produce a profit.”).

The SEC brought its first cryptocurrency enforcement action in July 2013 and from that point through December 2020 brought seventy-five enforcement actions in total.⁶⁶ Over seventy percent of the actions alleged violations of securities laws because of unregistered securities.⁶⁷ The SEC has yet to lose a cryptocurrency enforcement case.⁶⁸ The framework works just fine when the analysis of the elements is straightforward, but there are now over 17,000 different cryptocurrencies⁶⁹ each with different characteristics that must be analyzed under the *Howey* test. Each cryptocurrency's status as a security depends on its own facts and circumstances. Regulators simply do not have the manpower or resources to evaluate each project on a case-by-case basis,⁷⁰ especially as the cryptocurrency industry continues to expand into areas of traditional finance. The crypto market is no longer limited to underlying cryptocurrencies; there are now crypto market innovations into broader areas of the financial markets such as exchanges, lending, and decentralized finance platforms that potentially implicate securities, commodities, and traditional banking laws.

While regulation of crypto exchange and decentralized finance platforms are beyond the scope of this Comment, crypto lending platforms are worth a brief exploration as SEC Chair Gensler recently emphasized, “Make no mistake: If a lending platform is offering securities, it also falls into SEC jurisdiction.”⁷¹ In addition to “investment contracts” and the other many forms of securities defined by the Securities Act of 1933, the broad definition of securities also

⁶⁶ *SEC Cryptocurrency Enforcement Activity*, CORNERSTONE RESEARCH (May 11, 2021), <https://www.cornerstone.com/wp-content/uploads/2021/12/SEC-Enforcement-Activity-FY2021-Update.pdf>.

⁶⁷ *Id.*

⁶⁸ Gensler, *supra* note 29.

⁶⁹ See *Today's Cryptocurrency Prices*, *supra* note 4.

⁷⁰ Thomas Franck, Senators Demand Cryptocurrency Regulation Guidance from SEC Chair Gary Gensler, CNBC (Sep. 14, 2021), <https://www.cnbc.com/2021/09/14/cryptocurrency-regulation-sec-chair-gary-gensler-grilled-by-senators.html>. (“[T] the regulator could use ‘a lot more people’ to evaluate the 6,000 novel digital ‘projects’ and determine whether they all qualify as securities under U.S. law.”)

⁷¹ Gensler, *supra* note 29.

includes “notes.”⁷² While generally irrelevant to underlying cryptocurrency regulation, the Supreme Court adopted a test in *Reves v. Ernst & Young* to exclude certain notes from the definition of security which is relevant to crypto innovations into new areas of traditional financial products, specifically lending.⁷³

3. The *Reves* Test for Excluding Certain Notes from Securities

The Supreme Court adopted a version of the Second Circuit’s “family resemblance” test allowing for an exception to the rule that every note is a security. The analysis begins by presuming that every note is classified as a security, subject to rebuttal only when the note “bears a strong resemblance” to certain types of borrowing based on four factors.⁷⁴ The first factor, examines the transaction to determine the motivations of a reasonable buyer and seller who would enter such a transaction.⁷⁵ An instrument is likely to be a security if the buyer is primarily interested in the profit the note generates and if the seller is raising money for a business enterprise or to finance investments.⁷⁶ But if the note is sold to advance a commercial or consumer purpose, the note is less likely to be a security (e.g., a note issued in the course of a consumer buying a washing machine on credit).⁷⁷ The second factor analyzes the “plan of distribution” of the instrument with a focus on whether the note is an instrument where there is “common trading for speculation or investment.”⁷⁸ The third factor considers the investing public’s reasonable expectations of the instrument.⁷⁹ If the investing public’s expectation is that an instrument is a security, then that expectation will be the basis for defining the instrument as a

⁷² Securities Act of 1933, 15 U.S.C. § 77b(a)(1) (1933).

⁷³ 494 U.S. 56, 65 (1990).

⁷⁴ *Id.* at 67.

⁷⁵ *Id.* at 66.

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Reves*, 494 U.S. at 66.

security even if there is an economic analysis that suggests the instrument may not be a security in the transaction.⁸⁰ The final factor explores if there is another regulatory scheme in place that significantly reduces the risk of the instrument, making the protections from the Securities Act of 1933 unnecessary.⁸¹

4. Applying the Securities Tests to Coinbase Lend

Coinbase CEO Brian Armstrong took to Twitter in September 2021 to air out frustration over the company's communication with the SEC regarding its planned launch of its USDC stablecoin lending program.⁸² Coinbase's Lend program offered customers the ability to lend USDC held on the Coinbase platform to earn interest at a 4% APY.⁸³ The company's Chief Legal Officer, Paul Grewal, wrote in a blog post, "Coinbase's Lend program doesn't qualify as a security—or to use more specific legal terms, it's not an investment contract or a note,"⁸⁴ clearly invoking the *Howey* and *Reves* security tests. His arguments against classification as a security were that customers would not be investing in the Lend program, but instead lending their USDC stablecoin held on the Coinbase platform as part of their existing relationship.⁸⁵ Additionally, Coinbase would have the obligation to pay the interest irrespective of its other business activities and Coinbase guaranteed that the customer's principal was not at risk.⁸⁶ Finally, the Lend program required Coinbase to repay the USDC to the customer on request.⁸⁷ Prior to ultimately scrapping the launch of the product, Paul Grewal and Brian Armstrong publicly complained of

⁸⁰ *Id.* at 66–67.

⁸¹ *Id.* at 67.

⁸² Brian Armstrong (@brian_armstrong), TWITTER, https://twitter.com/brian_armstrong (last visited Sept. 24, 2021).

⁸³ *Sign Up to Earn 4% APY on USD Coin with Coinbase*, <https://blog.coinbase.com/sign-up-to-earn-4-apy-on-usd-coin-with-coinbase-cdad79e5f5eb> [hereinafter *Sign Up*].

⁸⁴ Grewal, *supra* note 13.

⁸⁵ *Id.*

⁸⁶ *Sign Up*, *supra* note 83; Grewal, *supra* note 13.

⁸⁷ Grewal, *supra* note 13.

the lack of formal guidance from the SEC, outside of it informing Coinbase that it reasoned Coinbase's offering was a security under *Howey* and *Reves* precedent, even with Coinbase's attempts at engaging the regulator for clarity.⁸⁸ This begs the question, was this an example of regulation by threat of enforcement that suppressed a way for cryptocurrency holders to earn interest, or rather, was the Coinbase Lend product clearly a security under the *Howey* or *Reves* tests that Coinbase did not want to register?

Under *Howey*, the Coinbase's Lend product is very likely an investment contract. The first element of the test, the investment of money, presents a question even though it is often the easiest element to satisfy. On its face, the USDC holdings lent by customers to Coinbase would be another thing of value to satisfy the investment of money requirement. This element hinges on whether there is an exchange of value when customers already have their USDC holdings on the Coinbase platform and make it available to Coinbase for a use besides holding it for the customer. Coinbase's argument is that Coinbase already holds the customer's USDC so the customers are not actually investing anything when they opt in to receive interest,⁸⁹ but this is not very persuasive, as the customer's participation in the program is a valuable right that Coinbase receives because Coinbase can then loan the customer's USDC to others. Therefore, the investment prong is satisfied. For the second element, the common enterprise prong, there certainly appears to be vertical commonality here because the customers and Coinbase are involved in some common venture to generate returns on the USDC lent to borrowers. Horizontal commonality is also satisfied notwithstanding that customers can opt out at any time because it takes the participation of multiple customers to make the program commercially

⁸⁸ *Id.*; Armstrong, *supra* note 82.

⁸⁹ Grewal, *supra* note 13.

meaningful. Because the program is one of scale, it likely resembles a pooling or repayment scheme that “ties the fortunes of each investor” on a pro rata basis “to the success of the overall venture.”⁹⁰ Therefore, the common enterprise prong is satisfied. The third element, the expectation of profits, is easily satisfied as customers would reasonably expect the interest on their USDC holdings as profits. Established precedent treats interest on borrowings as a form of profit under the *Howey* framework.⁹¹ Similarly, the fourth element, the from the efforts of others prong, is also easily satisfied as Coinbase exerts substantial efforts in attracting institutional borrowers of USDC to earn enough revenue for Coinbase to pay 4% APY to customers with enough left over to presumably be profitable for the company.⁹² To conclude the *Howey* test, Coinbase’s Lend program is very likely an investment contract and therefore a security subject to SEC registration.

The result is similar under the *Reves* test as the Lend product resembles the characteristics of a note and thus is a security. The first factor, examining the transaction to determine the motivations of a reasonable buyer and seller who would enter such a transaction, weighs in favor of a security. The SEC would argue that the customer is primarily interested in receiving the 4% APY on their USDC, while Coinbase’s purpose is to finance their investment in an institutional lending platform. The second factor, the “plan of distribution,” weighs in favor of a security. Although there is no “common trading for speculation or investment” in the Lend program since it is an opt-in, opt-out agreement for existing customers to earn interest on USDC

⁹⁰ *Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 622 F.2d 216, 224 (6th Cir. 1980)..

⁹¹ *United Housing Found., Inc. v. Forman*, 421 U.S. 837, 852 (1975) (“By profits, the Court has meant . . . a participation in earnings resulting from the use of investors’ funds. . . .”).

⁹² See *Borrow Cash Using Bitcoin as Collateral*, COINBASE, <https://www.coinbase.com/borrow> (last visited Sept. 17, 2021).

they already hold on the Coinbase program through their existing relationship,⁹³ the Court has held that only a minimal offering and sale to a broad segment of the public is all that is necessary to establish the “common trading” in an instrument.⁹⁴ Coinbase disclosed that it had “hundreds of thousands of customers from across the country sign up”⁹⁵ for Lend which is likely enough to satisfy the minimal broad segment of the public requirement. The third factor, the investing public’s reasonable expectations, weighs in favor of a security. It is reasonable for the public to believe this product is characterized as an investment given the opportunity to earn better than market yields. The final factor, whether there are other regulatory regimes, weighs in favor of a security because there is no other risk-reducing regulatory scheme in place. Although Coinbase claims to guarantee the principal for the USDC balance in a customer’s Lend account, it admits that opted-in USDC is not protected by FDIC or SIPC insurance.⁹⁶ Weighing all of the factors together, it would be likely that Coinbase’s Lend product is a security.

Given that Coinbase’s Lend program is most likely a security, either by being an investment contract or a note, it is surprising that Coinbase aired their grievance with the SEC in such a public manner via blog posts and Twitter.⁹⁷ Coinbase CEO Brian Armstrong made the futile comment that “plenty of other crypto companies continue to offer a lend feature, but Coinbase is somehow not allowed to,”⁹⁸ mistakenly suggesting that Coinbase should be left alone to sell unregistered securities just because other companies are. Armstrong even questioned how the SEC was fulfilling its mission to protect investors and maintain fair markets

⁹³ *See id.*

⁹⁴ *Reves v. Ernst & Young*, 494 U.S. 56, 68 (1990).

⁹⁵ *Sign Up*, *supra* note 83.

⁹⁶ *Sign Up*, *supra* note 83; *Coinbase User Agreement*, COINBASE, https://www.coinbase.com/legal/user_agreement/united_states (last visited Sept. 17, 2021).

⁹⁷ Grewal, *supra* note 13; Armstrong, *supra* note 82.

⁹⁸ Armstrong, *supra* note 82.

by targeting Coinbase when similar products from other companies have proliferated in the crypto market for years.⁹⁹ In February 2022, the SEC continued its enforcement actions over these types of lending products announcing a settlement with BlockFi with regards to its crypto lending product that is very similar to the Coinbase Lend product.¹⁰⁰ The SEC determined that the BlockFi's crypto lending product was a security under *both* the *Howey* test *and* the *Reves* test.¹⁰¹ BlockFi was ordered to pay \$100 million in penalties and to pursue SEC registration of the product.¹⁰² After these enforcement actions, Coinbase's product remains shelved indefinitely while BlockFi is allowed to continue its product but cease accepting new investors and further investments.¹⁰³ Coinbase's frustration with the lack of regulatory clarity is understandable after the company directly engaged the SEC for guidance because although it may have dodged a large monetary fine, it certainly lost the first-mover competitive advantage which is important in the crypto industry.¹⁰⁴

Regulation by enforcement is not an efficient way of regulating the crypto industry and the innovation such industries hope to achieve. As innovation continues to outpace regulation, regulators need to put effort into developing new rules tailored to the industry rather than confining the industry to the old rules. SEC Commissioner Hester Peirce argued for the new rulemaking path with her dissent from the BlockFi settlement concluding, "[W]e need to commit

⁹⁹ *Id.*

¹⁰⁰ Press Release, U.S. Sec. and Exch. Comm'n, BlockFi Agrees to Pay \$100 Million in Penalties and Pursue Registration of its Crypto Lending Product (Feb. 14, 2022), <https://www.sec.gov/news/press-release/2022-26>.

¹⁰¹ In the Matter of BlockFi Lending LLC, SEC Admin. Proc. File No. 3-20758, 8 (Feb. 14, 2022), <https://www.sec.gov/litigation/admin/2022/33-11029.pdf>.

¹⁰² U.S. Sec. and Exch. Comm'n, *supra* note 100.

¹⁰³ In the Matter of BlockFi Lending LLC, *supra* note 101.

¹⁰⁴ See Armstrong, *supra* note 82 ("If we end up in court, we may finally get the regulatory clarity the SEC refuses to provide. But regulation by litigation should be the last resort for the SEC, not the first."); Grewal, *supra* note 13 ("Coinbase has been proactively engaging with the SEC about Lend for nearly six months").

to working with these companies to craft sensible, timely, and achievable regulatory paths.”¹⁰⁵

The regulation of the crypto lending products is an example of the call from both industry and regulatory stakeholders to Congress for the knowledgeable and targeted rulemaking that is needed encourage and foster innovation rather than stifle it through uncertainty and regulation by enforcement.

B. CFTC Cryptocurrency Regulation

The CFTC regulates derivatives markets in the United States, including futures contracts¹⁰⁶ on commodities, swaps, options, and other derivative products. The Commodity Exchange Act (“CEA”) grants the CFTC its jurisdiction, stating: “[t]he Commission shall have exclusive jurisdiction . . . with respect to accounts, agreements . . . and transactions involving swaps or contracts of sale of a commodity for future delivery . . . traded or executed on a contract market . . . or any other board of trade, exchange, or market”¹⁰⁷ The CEA gives the CFTC two types of authority: regulatory authority and enforcement authority.¹⁰⁸ It broadly defines “commodity” as including agricultural goods, all other goods and articles with limited exceptions, and all services, rights, and interests “in which contracts for future delivery are presently or in the future dealt in.”¹⁰⁹ Therefore, when there are derivatives traded on the good,

¹⁰⁵ Peirce, *supra* note 14.

¹⁰⁶ COMMODITY FUTURES TRADING COMM’N, *Basics of Futures Trading*, <https://www.cftc.gov/LearnAndProtect/AdvisoriesAndArticles/FuturesMarketBasics/index.htm> (last visited Feb. 17, 2022) (“A commodity futures contract is an agreement to buy or sell a particular commodity at a future date”).

¹⁰⁷ Commodity Exchange Act, 7 U.S.C. § 2(a)(1)(A) (1936).

¹⁰⁸ 7 U.S.C. § 2(a) (defining CFTC regulatory authority); 7 U.S.C. § 13 (defining violations and enforcement authority of those violations)

¹⁰⁹ 7 U.S.C. § 1(a)(9) (“The term “commodity” means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, *Solanum tuberosum* (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by section 13–1 of this title) and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in.”).

article, right, or interest, it is a commodity. The CFTC’s jurisdiction does not, however, “extend to transactions involving the sale or physical delivery of the actual commodity, which are referred to as ‘cash forwards’ or ‘spot’ transactions.”¹¹⁰ But while the CFTC may not have jurisdiction to regulate the cash commodity, it retains “broad authority to regulate price manipulation of *any* commodity in interstate commerce” as set forth in 7 U.S.C. § 13(a)(2).¹¹¹

In 2015, the CFTC decided that Bitcoin and other virtual currencies were appropriately classified as commodities.¹¹² The CFTC reached this conclusion because there were unregulated Bitcoin options contracts being dealt on the Derivabit.com website.¹¹³ Even though this decision came before there were widely traded Bitcoin and Ethereum regulated future contracts, the CFTC held that even a small website of approximately 400 users where Bitcoin options were listed was enough to make Bitcoin satisfy the broad definition of a commodity.¹¹⁴ The key question in the commodity analysis is if cryptocurrency is one “in which contracts for future delivery are presently or in the future dealt in”¹¹⁵ and whether derivative trading on some cryptocurrencies is enough to classify all cryptocurrencies as commodities.

There are now CFTC regulated futures contracts on Bitcoin and Ethereum making it clear that the two largest cryptocurrencies are commodities, however, the commodity definition likely applies to many more. A search of the largest cryptocurrency exchange, Binance, reveals futures contracts trading for thirty-three different cryptocurrencies including BTC, ETH, XRP, ADA,

¹¹⁰ U.S. Commodity Futures Trading Comm’n v. Reed, 481 F. Supp. 2d 1190, 1195 (D. Colo. 2007).

¹¹¹ 7 U.S.C. § 13(a)(2) (“It shall be a felony . . . for: Any person to manipulate or attempt to manipulate the price of any commodity in interstate commerce”); *Reed*, 481 F. Supp. 2d, at 1196 (holding that “§ 2(a)(1)(A), while granting the CFTC with exclusive jurisdiction to regulate transactions involving the futures market, does not limit the CFTC’s broad authority to regulate price manipulation of any commodity in interstate commerce, as set forth in § 13(a)”).

¹¹² In the Matter of Coinflip, Inc., CFTC Docket No. 15-29, 3 (Sept. 17, 2015).

¹¹³ *Id.* (noting there were “OTC Bitcoin Forward Contracts” available for trading).

¹¹⁴ *Id.*

¹¹⁵ 7 U.S.C. § 1(a)(9).

and DOGE to name a few.¹¹⁶ All of these cryptocurrencies in which futures contracts and derivative products are presently or in the future dealt in fall under the broad definition of commodity. Additionally, in 2018, a New York Eastern District Court in *CFTC v. McDonnell* cast an even broader definition of commodity, holding that “virtual currencies are ‘goods’ exchanged in a market for uniform quality and value” so they “fall well-within the common definition of ‘commodity’ as well as the CEA’s definition of ‘commodities.’”¹¹⁷

To call cryptocurrencies a commodity is generally unremarkable because the CFTC primarily regulates derivative markets rather than underlying cash commodities.¹¹⁸ Even without regulatory authority over cash cryptocurrency transactions, the CFTC has taken an active supervisory role over the crypto market with expanded enforcement actions taken over fraudulent and manipulative cash cryptocurrency transactions in interstate commerce.¹¹⁹ In *CFTC v. McDonnell*, the court recognized and accepted this expanded enforcement authority over cash commodities when there is evidence of manipulation or fraud.¹²⁰ Therefore, the CFTC has regulatory jurisdiction when a cryptocurrency is used in a derivatives or futures contract, or enforcement authority when there is fraud or price manipulation of a cryptocurrency in interstate commerce.¹²¹

The CFTC’s proactive regulatory approach attempts to provide greater regulatory certainty and understanding to encourage financial technology innovation to improve the quality,

¹¹⁶ *Trading Rules*, BINANCE FUTURES, <https://www.binance.com/en/futures/trading-rules/perpetual> (last visited Jan. 13, 2022).

¹¹⁷ 287 F. Supp. 3d 213, 228 (E.D.N.Y. 2018).

¹¹⁸ Stump, *supra* note 32.

¹¹⁹ See LABCFTC, COMMODITY FUTURES TRADING COMM’N, A CFTC Primer on Virtual Currencies 11 (Oct. 17, 2017) https://www.cftc.gov/sites/default/files/idc/groups/public/documents/file/labcftc_primercurrencies100417.pdf.

¹²⁰ *CFTC*, 287 F. Supp. 3d at 227.

¹²¹ LABCFTC, *supra* note 119.

resiliency, and competitiveness of the U.S. financial markets.¹²² Compared to the SEC, the CFTC seems more encouraging to innovation in the cryptocurrency industry. For example, the former CFTC Commissioner J. Christopher Giancarlo, introduced a “do no harm” approach to regulating fintech companies and launched the LabCFTC initiative to engage with fintech market participants.¹²³ Additionally, the first CFTC regulated Bitcoin futures contract began trading in December 2017, nearly four years earlier than the first SEC registered Bitcoin futures ETF, which was approved in October 2021.¹²⁴ While it may be that the regulatory provisions within the CFTC’s provisions are breached less often, it is notable that the CFTC has brought only one-third of the amount of enforcement actions that the SEC has brought over a similar five-year period.¹²⁵

C. Treasury Regulation through the FinCEN

FinCEN is a bureau of the Department of the Treasury with supervisory and enforcement authority over U.S. financial institutions to ensure the effectiveness of the Anti-Money Laundering (“AML”) / Combating the Financing of Terrorism (“CFT”) regime¹²⁶ and adherence to the Bank Secrecy Act.¹²⁷ FinCEN’s mission is to “safeguard the financial system from illicit

¹²² See Testimony of J. Christopher Giancarlo Chairman U.S. Commodity Futures Trading Commission Before the House Committee on Agriculture (Oct. 11, 2017),

<https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-29>.

¹²³ J. Christopher Giancarlo, *Blockchain: A Regulatory Use Case*, MARKIT GROUP, 2016 Annual Customer Conference (May 10, 2016), <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-15>.

¹²⁴ Evelyn Cheng, *Cboe Announces Bitcoin Futures to Start Trading Sunday*, CNBC (Dec. 4, 2017); Thomas Franck, *The SEC is Poised to Allow the First Bitcoin Futures ETFs to Begin Trading, Source Says*, CNBC (Oct. 15, 2021).

¹²⁵ The SEC brought approximately fifty-seven enforcement actions compared to the CFTC’s nineteen enforcement actions over the period from 2015 – Q2 2020. *SEC Cryptocurrency Enforcement Activity*, *supra* note 66; *Trends in CFTC Virtual Currency Enforcement Actions*, CORNERSTONE RESEARCH, <https://www.cornerstone.com/wp-content/uploads/2022/01/Trends-in-CFTC-Virtual-Currency-Enforcement-Actions-2015-Q2-2020.pdf>.

¹²⁶ *Leaders of CFTC, FinCEN, and SEC Issue Joint Statement on Activities Involving Digital Assets*, FINCEN (Oct. 11, 2019), https://www.fincen.gov/sites/default/files/2019-10/CVC%20Joint%20Policy%20Statement_508%20FINAL_0.pdf.

¹²⁷ *Application of FinCEN’s Regulations to Certain Business Models Involving Convertible Virtual Currencies*, FINCEN (May 9, 2019) <https://www.fincen.gov/sites/default/files/2019->

use, combat money laundering and its related crimes including terrorism, and promote national security through the strategic use of financial authorities and the collection, analysis, and dissemination of financial intelligence.”¹²⁸ In contrast to real currency, FinCEN defines virtual currency as a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency.¹²⁹ Notably, FinCEN states that virtual currency does not have legal tender status in any jurisdiction, however, El Salvador recently became the first country to recognize Bitcoin as legal tender.¹³⁰ FinCEN further defines a convertible virtual currency (“CVC”) as a type of virtual currency that either has an equivalent value in real currency, or acts as a substitute for real currency.¹³¹ In 2019, FinCEN issued interpretive guidance that, while providing no new regulatory requirements, focused on reminding persons who transact in CVCs that they must register with FinCEN and comply with AML programs, recordkeeping, monitoring, and reporting requirements including suspicious activity reporting and currency transaction reporting.¹³² FinCEN has recently taken a more aggressive approach towards its oversight of the cryptocurrency industry, by adding cryptocurrencies to its National Priority list for anti-money laundering and countering the financing of terrorism.¹³³

05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf [hereinafter *Application of FinCEN’s Regulations to Certain Business Models*].

¹²⁸ *Mission*, FINCEN, <https://www.fincen.gov/about/mission> (last visited Jan. 13, 2022).

¹²⁹ *Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, FINCEN (Mar. 18, 2013), <https://www.fincen.gov/resources/statutes-regulations/guidance/application-fincen-regulations-persons-administering> [hereinafter *Application of FinCEN’s Regulations to Persons*].

¹³⁰ Tim Padgett, *El Salvador Has Adopted Bitcoin As Legal Tender — The First Country To Do So*, NPR (Sept. 7, 2021), <https://www.npr.org/2021/09/07/1034926717/el-salvador-has-adopted-bitcoin-as-legal-tender-the-first-country-to-do-so>.

¹³¹ *Application of FinCEN’s Regulations to Persons*, *supra* note 129.

¹³² *Application of FinCEN’s Regulations to Certain Business Models*, *supra* note 127.

¹³³ *Anti-Money Laundering and Countering the Financing of Terrorism National Priorities*, FINCEN (June 30, 2021), [https://www.fincen.gov/sites/default/files/shared/AML_CFT%20Priorities%20\(June%2030%2C%202021\).pdf](https://www.fincen.gov/sites/default/files/shared/AML_CFT%20Priorities%20(June%2030%2C%202021).pdf)

In December 2020, FinCEN proposed a new rule that would adopt recordkeeping, verification, and reporting requirements for CVC transactions through a money services business that involve “unhosted” cryptocurrency wallets.¹³⁴ While the proposal was meant to mirror currency transaction reporting requirements, where financial institutions are required to report currency transactions over \$10,000, it imposes burdensome reporting and recordkeeping requirements that may be impossible to implement and ultimately frustrate financial services innovation using blockchain ledger technology.¹³⁵ A typical currency transaction report for a fiat transaction identifies who is involved in the transaction, including their name, address, and identifying information, the amount of the transaction and how it was performed, and the financial institutions through which it took place.¹³⁶ While this information is readily available for a typical fiat transaction, the information about the receiving end of a cryptocurrency transaction, particularly as part of a decentralized programmable or smart contract transaction, is most likely not.¹³⁷ Therefore, this proposal, when applied to cryptocurrency transactions, displays either a lack of understanding of developing smart contract technology or an acceptance that the development of financial technology has to take into account regulatory aims such as the prevention of money laundering and the enforcement of national security measures. To allow the crypto industry to thrive without compromising regulatory priorities, an update to FinCEN’s and other agencies’ rules may be needed. Cooperative industry engagement is the right step to

¹³⁴ Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets, 85 FR 83840 (Dec. 23, 2020), <https://www.federalregister.gov/documents/2020/12/23/2020-28437/requirements-for-certain-transactions-involving-convertible-virtual-currency-or-digital-assets> (describing “unhosted” wallets as one where the financial institution does not hold the private key required to transact in the wallet).

¹³⁵ *Why Is the Proposed FinCEN Rule for Unhosted Wallets Being Pushed So Quickly?*, UNCHAINED PODCAST (Dec. 22, 2020), https://www.youtube.com/watch?v=I1kcb39_zds (explaining how the proposed rule would prohibit the flow of cryptocurrencies from covered exchanges to smart contracts wallets which hinders ongoing development of programmable money).

¹³⁶ FINCEN Form 104, https://www.irs.gov/pub/irs-tege/fin104_ctr.pdf (last visited blank).

¹³⁷ UNCHAINED PODCAST, *supra* note 135.

make industry innovators aware of regulatory concerns and allow them to develop products with those concerns in mind while informing regulators of how to best tailor regulation for new technologies and commercial practices.

III. Recent Legislative Proposals Targeting the Cryptocurrency Industry

As the cryptocurrency industry continues its explosive growth, innovators, regulators, and investors are calling for legislators to address areas where regulations have uncertain or outdated applicability.¹³⁸ The United States needs reasonable regulation to foster continued innovation and investment in this industry rather than risk pushing cryptocurrency development to other jurisdictions which are more open to fostering its growth. Legislators are trying to answer these calls by recently proposing cryptocurrency focused bills in the last few years. This section will analyze some of these proposals that attempt to update regulation by granting the regulators power to comprehensively regulate cryptocurrencies. Part A will discuss the Crypto-Currency Act of 2020 and argue how it lacks substantive provisions to successfully change the status quo. Part B will analyze the Digital Asset Market Structure and Investor Protection Act and provide reasons why this is desirable legislation that will inform lawmakers how to implement a collaborative regulatory regime that fosters growth while protecting the public.

A. *The Crypto-Currency Act of 2020*

The Crypto-Currency Act of 2020 (“CCA”) attempts to provide tailored treatment of cryptocurrencies, providing related definitions, acknowledging the different types and uses of cryptocurrencies, and delineating regulatory jurisdiction.¹³⁹ The CCA’s purpose is to “[t]o clarify which Federal agencies regulate digital assets, to require those agencies to notify the

¹³⁸ See *id.*; Armstrong, *supra* note 82.

¹³⁹ See Crypto-Currency Act of 2020, H.R. 6154, 116th Cong. (2020) [hereinafter Crypto-Currency Act].

public of any Federal licenses, certifications, or registrations required to create or trade in such assets, and for other purposes.”¹⁴⁰

The CCA categorizes cryptocurrencies into three broad types by use. Primary regulators are assigned oversight depending on the category. The SEC is assigned to crypto-securities, the CFTC is assigned to crypto-commodities, and the Treasury is assigned to crypto-currencies.¹⁴¹ Under the CCA’s definitions, the term “crypto-security” means all debt and equity that rest on a blockchain or decentralized cryptographic ledger.¹⁴² Crypto-tokens should fall into this category, specifically, security-based tokens that serve as a capital raising mechanism for a project in which investors provide capital in exchange for a token asset with the expectation that the asset may become redeemable for an online service.

The CCA defines, “crypto-commodity” to mean economic goods or services, including derivatives, that have substantial fungibility and where the markets give no regard to who created the goods or services, that rest on a blockchain or decentralized cryptographic ledger.¹⁴³ This is the broadest of the three definitions and most crypto assets would fit in this category. Cryptocurrencies that function as a store of value such as Bitcoin, the largest cryptocurrency, meet this definition because they are fully fungible assets. Additionally, Ethereum and most utility-based tokens that provide token holders access to services or products of the project at a point in the future should likely fit in this category as well. The CCA defines “crypto-currency” to mean “representations of United States currency or synthetic derivatives resting on a

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ *Id.*

blockchain or decentralized cryptographic ledger”, such as stablecoins like USDC that are pegged to the value of the U.S. Dollar.¹⁴⁴

The CCA does well with acknowledging the different use types of cryptocurrencies, but the major problem with the CCA is its rigid technical nature and lack of substantive provisions. In focusing on the uses, the CCA replaces long-standing, understood, and well-defined tests that regulatory agencies currently use with definitions that, while invoking technical language, like blockchain and decentralized ledgers, will suffer from the same uncertainty issues when specific cryptocurrency product characteristics do not clearly fall within definitions. For example, the definition of crypto-security as “all debt and equity that rests on a blockchain”¹⁴⁵ is not much different than the Securities Act of 1933 definition of security which includes stocks, bonds, and investment contracts, among other things.¹⁴⁶

The problem industry stakeholders face now is not the lack of regulatory authority over cryptocurrencies but more so with how to implement regulations that allow for growth while still protecting the public. The CCA fails to provide substantive provisions and clear guidance to regulators to foster financial innovation, which will likely retain the status quo of a rigid regulatory framework. The CCA simply requires the regulatory agencies to “notify the public of any Federal licenses, certifications, or registrations required to create or trade in such assets.”¹⁴⁷ The financial industry is already on notice that securities and securities intermediaries are regulated by the SEC, derivatives on commodities and intermediaries in those derivatives—and to a lesser extent cash markets in commodities—are regulated by the CFTC. Similarly, industry

¹⁴⁴ *Id.*

¹⁴⁵ Crypto-Currency Act, *supra* note 139.

¹⁴⁶ Securities Act of 1933, 15 U.S.C. § 77b(a)(1) (1933).

¹⁴⁷ Crypto-Currency Act, *supra* note 139.

members understand that they must comply with anti-money laundering and other FinCEN regulations meant to police financial crimes. Additionally, the CCA lacks substantial provisions needed to manage such a developing industry. For example, the CCA lacks the foresight to manage how a crypto-security should transition into a crypto-commodity when a project matures from an idea in need of capital to an ongoing utility or service.

In introducing the Crypto-Currency Act of 2020, Rep. Paul Gosar took a meaningful step towards regulation of the industry by acknowledging the different types of cryptocurrencies and proposing certain regulators maintain oversight of each type.¹⁴⁸ While the CCA did not go far enough, Congress should build off this knowledgeable approach with proposals that task regulators to encourage innovation through a regulatory framework that provides supportive guidance to the industry to continue growing while keeping the regulatory missions of protecting investors, maintaining market integrity, and combating financial crime in mind.

B. The Digital Asset Market Structure and Investor Protection Act

The Digital Asset Market Structure and Investor Protection Act (“DMSP”) was introduced on July 28, 2021, with a purpose to provide for the regulation of digital assets.¹⁴⁹ The DMSP builds off the knowledgeable framework provided by the CCA that acknowledges the different uses and types of crypto-assets by defining three categories of digital assets.¹⁵⁰ The Act first defines a “digital asset security” as a digital asset that grants a debt or equity interest, rights to profits, interest or dividend payments, voting rights, or liquidation rights.¹⁵¹ Next, the DMSP defines “digital asset” as Bitcoin, Ether and other decentralized, digital ledger based assets

¹⁴⁸ *Id.*

¹⁴⁹ Digital Asset Market Structure and Investor Protection Act, H.R. 4741, 117th Cong. (2021) [hereinafter Digital Asset Market Structure].

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

including “virtual currencies”.¹⁵² The DMSP also defines a “digital asset fiat-based stablecoin” as a digital asset (as defined in this proposed Act) that is “tied, pegged to, or collateralized substantially by” the U.S. Dollar or fiat currencies.¹⁵³

At first glance, the cryptocurrency definitions in the DMSP are very similar, albeit slightly broader and more comprehensive, to those found in the CCA. The DMSP, however, is differentiated in how it applies those newly defined assets. Importantly, the Act amends the multiple federal securities laws to include “digital asset security” in the definition of security while also excluding “digital assets” from those same definitions.¹⁵⁴ Similarly, the Act amends the CEA to include “digital assets” in the definition of commodity while excluding “digital asset security” from the definitions of some of the entities the CFTC regulates.¹⁵⁵ In an important effort to provide legal certainty to regulatory oversight, the Act requires the SEC and CFTC to publish a final rule classifying each of the “major digital assets” as either a “digital asset” or a “digital asset security.”¹⁵⁶ Additionally, the DMSP expands CFTC regulatory authority to cash cryptocurrency transactions intermediated by registered entities by adding an “Optional Federal Charter for Digital Asset Trading and Clearing” in the CEA.¹⁵⁷ The DMSP also grants the Treasury regulatory authority over “digital asset fiat-based stablecoins” and limits the issuance and use of such stablecoins that are not approved by the Treasury.¹⁵⁸

¹⁵² *Id.*

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ Digital Asset Market Structure, *supra* note 149.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* (“The Commission shall have exclusive jurisdiction under this paragraph over any agreement, contract, or transaction involving a contract of sale of a commodity in interstate commerce (including any digital asset) which is listed, traded, or cleared on or through a registered entity and, provided further, such contracts shall be treated for regulatory and enforcement purposes as if they were contracts of sale of a commodity for future delivery.”).

¹⁵⁸ *Id.*

These changes in the statutory language for securities, commodities, and stablecoins clearly function to delineate the regulatory oversight between the SEC, CFTC, and Treasury, providing much needed clarity to both the industry participants and regulators on where to focus regulatory attention. These proposals, if implemented, would eliminate the waste of resources used in litigating which particular regulator has jurisdiction over ninety percent of the cryptocurrency market.¹⁵⁹ The saved resources will be much better spent on encouraging innovation and growth of the industry.

The most important aspect of the DMSP is the final section that calls for various regulators, agencies, and departments to submit digital asset reports to Congress. The required reports include analyses on digital asset ownership and taxes, how ransomware attacks involve digital assets, decentralized finance, custody of digital assets and digital asset securities, digital asset trading platforms, and fraudulent or deceptive transactions on digital asset trading platforms.¹⁶⁰ This section of the Act acknowledges that more information is needed by legislators to truly understand how the cryptocurrency industry is disrupting traditional financial markets and where regulatory efforts should be focused. It is a display of restraint by the legislature to first hear recommendations on how to promote the missions of investor protection, market integrity, and anti-money laundering rather than make sweeping legislative changes that could negatively affect the industry or drive it to more amenable foreign jurisdictions. The DMSP is a promising bill that will remove ambiguity from the current regulatory framework,

¹⁵⁹ “Major digital assets,” as defined by the DMSP, are the top twenty-five digital assets, including digital asset securities, by market capitalization and daily trading volume, which at the time the DMSP was proposed was approximately ninety percent of the crypto market. Press Release, Beyer Introduces New Legislation to Regulate Digital Assets (July 28, 2021), <https://beyer.house.gov/news/documentsingle.aspx?DocumentID=5307>.

¹⁶⁰ Digital Asset Market Structure, *supra* note 149.

look to implement a sensible regulatory environment that promotes the innovation and growth of the industry, and provide investor and market protections.

IV. Congress Should Pass the Digital Asset Market Structure and Investor Protection Act

With a “Do No Harm” Regulatory Approach to Foster Continuing Innovation

A disorganized, outdated, and fragmented approach to regulation leaves gaps where inefficiencies linger because of uncertainty and lack of recognition of new technologies and commercial models. Congress, as a *first* meaningful step towards comprehensive regulation of the cryptocurrency industry, should acknowledge the different types of cryptocurrencies by passing the Digital Asset Market Structure and Investor Protection Act. The DMSP will enhance regulatory certainty so that industry leaders can focus their efforts on their innovative products and be comfortable that they are conforming to regulation. It is also very important that this *first* step is not overly comprehensive because it should not be a disruptive change for the industry before legislators and regulators acquire a better sense of the industry’s innovations and potential. Congress needs to understand the cryptocurrency industry better before making sweeping changes to regulation. Therefore, *first* step is emphasized because the overall regulatory solution needs to be forward looking and collaborative with the industry.

The current state of regulatory oversight over the cryptocurrency industry is overly rigid and unreceptive to innovative ideas that do not easily relate with traditional financial market concepts. Regulators need to adopt outside the box thinking with regards to the cryptocurrency industry rather than reactively attempting to fit the industry to what is already in place.¹⁶¹ This begins with knowledgeable and informed lawmakers. The DMSP attempts to promote this by

¹⁶¹ See Report on Stablecoins, U.S. DEP’T OF THE TREASURY (Nov. 1 2021), https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

calling for various regulators, agencies, and departments to submit digital asset reports to Congress, but this approach can be improved. If the reports are limited to input from governmental sources, they will unfortunately be reactionary. A reactionary approach to such a developing industry is destined to be outpaced by innovation. To understand where the industry is heading, Congress should encourage collaboration and industry engagement with cryptocurrency innovators.

This Comment suggests a *second* step by adopting a collaborative approach from one piece of cryptocurrency legislation that recently passed a House vote.¹⁶² The Eliminate Barriers to Innovation Act of 2021 directs the establishment of a joint working group on cryptocurrencies.¹⁶³ The joint working group shall be comprised of governmental representatives from the SEC and CFTC.¹⁶⁴ But more importantly, it shall include non-governmental stakeholders from cryptocurrency industry companies, traditional financial firms, digital asset advocacy groups, fintech small businesses, investor protection organizations, and institutions that support investment in historically-underserved businesses.¹⁶⁵ A joint working group allows for a deep analysis of the crypto industry from all stakeholders' perspectives. Government will be able to encourage its mission to protect investors, promote market integrity, and combat financial crimes while the industry will be able to articulate an understanding of the technology and how outdated regulation is negatively affecting innovation.

After being informed from a collaborative joint working group, this Comment suggests to Congress, a *third* step, regulatory oversight of the crypto industry should be mandated as a “do

¹⁶² Eliminate Barriers to Innovation Act of 2021, H.R. 1602, 117th Cong. (2021).

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

no harm” approach. Promotion of regulatory guidance should be encouraged over reactionary enforcement actions that could stifle development before it has a chance to succeed. Former CFTC Commissioner J. Christopher Giancarlo employed the “do no harm” attitude during his tenure leading the CFTC.¹⁶⁶ The “do no harm” approach is a multi-step culture focused on collaboration instead of confrontation. Regulators should put their best foot forward with tech savvy employees who can work collaboratively with industry leaders to provide clarity on the regulatory framework.¹⁶⁷ Regulators should give some breathing room to allow for thoughtful innovation without smothering growth with threats of enforcement actions and fines.¹⁶⁸ Regulators should get involved by advancing understanding of new technologies so that regulators may adopt them to more efficiently and effectively do their jobs.¹⁶⁹ Regulators should listen and learn by closely working with innovators to determine how regulations should be adapted to enable disruptive technologies to thrive.¹⁷⁰ Finally, regulators should collaborate with each other to avoid a fragmented regulatory regime that could stifle innovation.¹⁷¹

V. Conclusion

The passage of the Digital Asset Market Structure and Investor Protection Act, as a *first* step, provides the regulatory clarity the cryptocurrency industry is calling for to foster continuing innovation in the financial markets. By acknowledging the different types of cryptocurrencies and clearing up the statutory ambiguity over which particular regulator has oversight over which particular crypto-asset, resources will be better focused on innovation rather than litigation. The

¹⁶⁶ Giancarlo, *supra* note 123.

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

collaborative joint working group comprised of government and industry stakeholders, is the important *second* step to enlighten government how cryptocurrencies can be a disruptive yet beneficial force to encourage the missions to protect investors, maintain fair financial markets, and fight financial crimes. The *third* step, the “do no harm” regulatory approach, is a roadmap to incubate and encourage crypto innovation with prospective regulatory guidance rather than restrictive enforcement. The accelerating growth of crypto adoption is increasing investment and focus on this disruptive industry which in turn further pushes crypto innovation to outpace regulation. Knowledgeable, clear, and targeted regulation now from Congress will encourage and foster innovation rather than stifle innovation or push the cryptocurrency industry away to other countries.