

Current Events in Federal Crypto Regulation

Presentation to the California State Assembly Committee on Banking and Finance and Senate Committee on Banking and Financial Institutions

February 22, 2023

- Existing Legal Framework
- Multiple Agency Madness
- Recent Headlines
- Helping the Industry Help Consumers

What do Harry Truman and Florida Orange Groves Have in Common?

- The **Securities Exchange Commission (SEC)** is the primary regulator
- All securities offered and sold in the United States must be registered with the SEC, unless an exemption applies. Registration can be onerous.
- What is a security? The SEC applies the 1946 *Howey* Supreme Court ruling:
 - (1) An investment of money,
 - (2) in a common enterprise,
 - (3) with a profit expectation,
 - (4) where profits are derived from the efforts of others.
- Or the “*Reves*” test: does the instrument “resemble” a security?
- Broker-Dealer regulation applied to token exchanges
- Registered Investment Adviser (RIA) rules proposed to encompass token custodians



Back to the Futures (and also the Options)

- The SEC is not the only agency with oversight of cryptocurrencies and the blockchain ecosystem
- The **Commodity Futures Trading Commission (CFTC)** has taken steps to regulate Bitcoin
 - Declared Bitcoin a “commodity” in 2014
 - Launched enforcement actions against unregistered Bitcoin futures exchanges
 - Issued warnings on virtual currency valuation and volatility
 - Proposed “heightened review” for virtual currency contracts
 - Problem of modernizing the Commodity Exchange Act to apply to spot trading



Federal Blockchain Regulation Blocked (for now)

- Reform efforts in Congress have not advanced (e.g., the Lummis-Gillibrand Responsible Financial Innovation Act)
- Biden Executive Order (No. 14067, “Ensuring Responsible Development of Digital Assets”) resulted in research and reporting, but little tangible action so far
- But crypto-smart Rep. Patrick McHenry (R-NC) now chairs the House Financial Services Committee and recently created a new subcommittee on Digital Assets, Financial Technology and Inclusion (Rep. French Hill (R-AR), chair)



Multiple Agencies Step into the Breach

- Department of the Treasury and Office of the Comptroller of the Currency (OCC)
 - Stablecoins
- Securities Exchange Commission (SEC)
 - Tokens, Stablecoins (*Paxos, Binance*), Staking (*Kraken*)
- Department of Justice (DOJ) and the Financial Crimes Enforcement Network (FinCEN)
 - Bank Secrecy Act (anti-money laundering), USA PATRIOT Act (“know your customer”)
- State Regulators
 - BitLicense (New York State Department of Financial Services)
 - Money Transmitter Licenses (states)
 - Lender Licensing (federal and state banking agencies)



FTX and BlockFi and Celsius. Oh My!

- FTX – Simple fraud (allegedly); not really a crypto story
- BlockFi – Failure to Register a securities offering
- Celsius, Voyager and Gemini – Investigations Continue
- As do the Investor Impacts:
 - Billions lost in 2022 due to market declines and malfeasance
 - Investors disenchanted with lack of safeguards
 - Individual cases settle, resulting in bad industry precedent (e.g., Kim Kardashian, Paul Pierce, BlockFi)



Reward the Good (and the Good Faith), Weed Out the Bad Actors

- Regulatory Certainty
 - The current regulatory environment is uncertain and haphazard (regulation by enforcement)
 - ◆ Tezos, BlockFi – Accounts earning interest are investment contracts
 - ◆ Kraken – Staking accounts are securities
- Regulators Risk Being Too Broad (or Too Narrow)
 - Greater Collaboration – Opportunities to be heard without being fined
 - Greater Coordination – Interoperability with other state and international regulations and to prevent jurisdictional flight



Thank You!



Brian S. Korn

Partner

New York, New York

bkorn@manatt.com

(212) 790-4510



Benjamin T. Brickner

Partner

New York, New York

bbrickner@manatt.com

(212) 790-4612