



August 13, 2018

## Financial Services Update

### Federal Regulation of Cryptocurrencies

#### Introduction

This memorandum will provide a survey of federal action on cryptocurrencies (aka virtual currencies), including enforcement and guidance. At present, some federal regulators have begun asserting oversight and enforcement authority under their existing powers while other potential regulators have not yet indicated publicly what, if any, oversight they will exercise. Other federal stakeholders on cryptocurrencies have also begun to engage. However, the U.S. government's approach to virtual currencies remains fluid.

#### SEC and CFTC

To date, both the Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) have used their existing authorities to assert jurisdiction over some aspects of virtual or crypto currencies.

In June 2018, CFTC Commissioner Rostin Behnam reiterated in a [speech](#) that the CFTC “determined that virtual currencies, such as Bitcoin, met the definition of “commodity” under the Commodity Exchange Act.” However, as he noted, “the CFTC does NOT have regulatory jurisdiction under the CEA over markets or platforms conducting cash or “spot” transactions in virtual currencies or other commodities or over participants on such platforms.” Behnam asserted that “the CFTC does have both regulatory and enforcement jurisdiction under the CEA over derivatives on virtual currencies traded in the United States.”

In June 2018, in an [interview on CNBC](#), SEC Chairman Jay Clayton explained:

We are not going to do any violence to the traditional definition of a security that has worked for a long time. There's no need to change the definition. A token, a digital asset, where I give you my money and you go off and make a venture, and in return for giving you my money I say 'you can get a return?'] that is a security and we can regulate that. We regulate the offering of that security and regulate the trading of that security.

However, Clayton distinguished crypto or virtual currencies used as “sovereign currencies.” He remarked that “[c]ryptocurrencies: these are replacements for sovereign currencies, replace the dollar, the euro, the yen with bitcoin.” Clayton added “[t]hat type of currency is not a security.”

Also, in June, the SEC named Valerie A. Szczepanik the Senior Advisor for Digital Assets and Innovation. In its [press release](#), the agency specified that “Szczepanik will coordinate efforts across all SEC Divisions and Offices regarding the application of U.S. securities laws to emerging digital asset technologies and innovations, including Initial Coin Offerings and cryptocurrencies.” Additionally, Szczepanik “has [also] been named Associate Director of the Division of Corporation Finance.” Previously, Szczepanik served as an Assistant Director in the Division of Enforcement’s Cyber Unit” and “is the Head of the SEC’s Distributed Ledger Technology Working Group, Co-Head of its Dark Web Working Group, and a member of its FinTech Working Group.”

The *New York Times* [reported in April](#) that the “Venture Capital Working Group” headed by Andreessen Horowitz had approached the SEC with a proposal to have the agency establish a “safe harbor” for coins that have achieved “full decentralization” or “full functionality.” The *New York Times* explained:

[The proposal] adds that full decentralization could occur under several conditions, including “when the token creator no longer has control of the network based on its ability to make unilateral changes to the functionality of the tokens.” The proposal says a token is fully functional when it can be used for its intended purpose on a computer network and is not just useful as a speculative investment, which is the case with many tokens today.

To the extent the SEC has weighed in on this proposal, the results have not been made public. Yet, in June 2018 in [public remarks](#), SEC Division of Corporation Finance Director William Hinman “address[ed] a topic that is the subject of considerable debate in the press and in the crypto-community – whether a digital asset offered as a security can, over time, become something other than a security.” Hinman emphasized that per Supreme Court precedent, the SEC will look beyond a label to determine whether a financial instrument qualifies as a security. Thus, in Hinman’s view, it is immaterial as to whether a digital currency or token is called a “utility.” Rather, the test of when the SEC would regulate turns on the degree to which “the network on which the token or coin is to function is sufficiently decentralized – where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts – the assets may not represent an investment contract.” He added that “when the efforts of the third party are no longer a key factor for determining the enterprise’s success, material information asymmetries recede.” Hinman claimed that “[a]s a network becomes truly decentralized, the ability to identify an issuer or promoter to make the requisite disclosures becomes difficult, and less meaningful.” However, it bears note that the SEC posted the following footnote to Hinman’s remarks on its website: “[t]his speech expresses the author’s views and does not necessarily reflect those of the Commission, the Commissioners or other members of the staff.”

In May 2018, the CFTC’s Division of Market Oversight (DMO) and Division of Clearing and Risk (DCR) “issued a [joint staff advisory](#) that gives exchanges and clearinghouses registered with the CFTC guidance for listing virtual currency derivative products.” DMO and DCR stated that

“[h]ighlighted in the advisory are certain key areas that require particular attention in the context of listing a new virtual currency derivatives contract. They are:

- Enhanced market surveillance
- Close coordination with CFTC staff
- Large trader reporting
- Outreach to member and market participants
- Derivatives Clearing Organization risk management and governance

In May 2018, the SEC Chairman Jay Clayton [announced](#):

The SEC’s Office of Investor Education and Advocacy recently launched a sample ICO website. The offering is not real. It is a fake. But it does illustrate the common “red flags” of fraud in the ICO markets and how little work it takes to engage in such a fraud. I encourage investors to visit and view the materials [here](#) to help you tell a real investment opportunity from a scam. Also, I previously suggested a list of sample questions for investors considering a cryptocurrency or ICO investment opportunity [here](#). Investors should demand answers to these and other questions about potential investments. Investors should also remember that although the SEC and other federal, state, and provincial regulators are committed to protecting investors in these markets, there is a real risk that enforcement efforts may not make investors whole who have lost their investments to fraud.

On May 1, the *Wall Street Journal* [reported](#) that the SEC is considering whether cryptocurrencies should be subject to the same regulation as stocks with respect to investor protections. Consequently, cryptocurrencies already available to investors may be deemed unregistered securities.

On March 7, the SEC released a statement articulating its position that cryptocurrencies are securities and platforms allowing for the trading in these securities are exchanges. Hence, the SEC can regulate both initial coin offerings (ICOs) and cryptocurrency exchanges. In its [press release](#), the SEC stated:

A number of these platforms provide a mechanism for trading assets that meet the definition of a “security” under the federal securities laws. If a platform offers trading of digital assets that are securities and operates as an “exchange,” as defined by the federal securities laws, then the platform must register with the SEC as a national securities exchange or be exempt from registration.

In early March, the CFTC prevailed in a [lawsuit](#) against Patrick McDonnell and his company Coin Drop Markets regarding allegations that the “defendants ‘operated a deceptive and fraudulent virtual currency scheme . . . for purported virtual currency trading advice’ and ‘for virtual currency purchases and trading . . . and simply misappropriated [investor] funds.’” The U.S. District Court for the Eastern District of New York (Court) held that “[v]irtual currencies can be regulated by CFTC as a commodity...[and the] CFTC has standing to exercise its enforcement power over fraud related to virtual currencies sold in interstate commerce.”

Parenthetically, the Court noted, “[u]ntil Congress clarifies the matter, the CFTC has concurrent authority, along with other state and federal administrative agencies, and civil and criminal courts,

over dealings in virtual currency.” The Court also noted that “[t]he jurisdictional authority of CFTC to regulate virtual currencies as commodities does not preclude other agencies from exercising their regulatory power when virtual currencies function differently than derivative commodities.” The Court further observed that “[a]n important nationally and internationally traded commodity, virtual currency is tendered for payment for debts, although, unlike United States currency, it is not legal tender that must be accepted.”

In early April, the *Wall Street Journal* [reported](#) that “Coinbase, a leading cryptocurrency firm, has approached [the SEC] about registering as a licensed brokerage firm and electronic-trading venue, a move that comes as regulators have waged an aggressive campaign to supervise the fledgling industry.” At present, the outcome of these discussions is unknown.

On January 24, 2018 SEC Chairman Jay Clayton and CFTC Chairman J. Christopher Giancarlo published an [op-ed](#) in the *Wall Street Journal* titled “Regulators Are Looking at Cryptocurrency,” in which they explained, “[o]ur task, as market regulators, is to set and enforce rules that foster innovation while promoting market integrity and confidence.” They noted “[e]arlier this month, the collective market capitalization of cryptocurrencies [topped](#) \$700 billion.” Clayton and Giancarlo stated that “[d]irect participation by U.S. investors in cryptocurrencies is significant...[and] [t]he prices for these currencies are set by trading on ‘spot’ platforms.” They stated that “[m]any of these platforms are based offshore—and none are registered with the CFTC or the SEC.”

Clayton and Giancarlo asserted that “[a] key issue before market regulators is whether our historical approach to the regulation of currency transactions is appropriate for the cryptocurrency markets.” They explained that “[c]heck-cashing and money-transmission services that operate in the U.S. are primarily regulated by states...[and] [m]any of the internet-based cryptocurrency-trading platforms have registered as payment services and are not subject to direct oversight by the SEC or the CFTC.” Clayton and Giancarlo said, “[w]e would support policy efforts to revisit these frameworks and ensure they are effective and efficient for the digital era.”

Clayton and Giancarlo explained, “[i]n some areas, federal authority to police cryptocurrencies is clear.” They stated that “[t]he Bank Secrecy Act and its implementing regulations establish federal anti-money-laundering obligations that apply to most people engaged in the business of accepting and transmitting, selling or storing cryptocurrencies.” Clayton and Giancarlo said that “[i]n other areas, some say, federal authority is murkier.” They stated, “[s]ome proponents of cryptocurrencies note that the jurisdiction of the CFTC and SEC over cryptocurrency transactions is limited and cite the absence of U.S. and other government market regulation as an investment attribute. Such claims should give prospective investors pause.”

Clayton and Giancarlo explained that “[r]ecently, two of the largest CFTC-regulated exchanges listed bitcoin futures products...[and] [a]s a result, the CFTC gained oversight over the U.S. bitcoin futures market and access to data that can facilitate the detection and pursuit of bad actors in underlying spot markets.” They stated that “[t]he SEC does not have direct oversight of transactions in currencies or commodities...[y]et some products that are labeled cryptocurrencies have characteristics that make them securities.” Clayton and Giancarlo said that “[t]he offer, sale and

trading of such products must be carried out in compliance with securities law...[and] [t]he SEC will vigorously pursue those who seek to evade the registration, disclosure and antifraud requirements of our securities laws. In addition, the SEC is monitoring the cryptocurrency-related activities of the market participants it regulates, including broker-dealers, investment advisers and trading platforms.

At a January 31 CFTC Market Risk Advisory Committee (MRAC) Committee [meeting](#), Giancarlo said:

In fact, it is Designated Contract Markets (DCMs) and Designated Clearing Organizations (DCOs) - and not CFTC staff - that must solicit and address stakeholder concerns in new product self-certifications. Interested parties, especially clearing members, should indeed have an opportunity to raise appropriate concerns for consideration by regulated platforms proposing virtual currency derivatives and DCOs considering clearing new virtual currency products.

That is why I have asked CFTC staff to add an additional element to its Review and Compliance Checklist for virtual currency product self-certifications. That is requiring DCMs and Swaps Execution Facilities (SEFs) to disclose to CFTC staff what steps they have taken in their capacity as self-regulatory organizations to gather and accommodate appropriate input from concerned parties, including trading firms and Futures Commission Merchants (FCMs). Further, I have asked staff to take a close look at DCO governance around the clearing of new virtual currency products and formulate recommendations for possible further action. There may well be other improvements to consider.

On April 26, Commissioner Brian Quintenz made [remarks](#) at the Eurofi High Level Seminar 2018 stated, "I would note that the regulatory landscape for cryptocurrencies, including so-called tokens, within the United States is an evolving one." He said, "[r]egulators in the United States, including the CFTC, are monitoring cryptocurrencies and working collaboratively to develop effective regulatory approaches for this new asset class." Quintenz stated that "[t]he Treasury Department has established a crypto-asset working group which includes the CFTC, Securities and Exchange Commission, and banking regulators...[and] [o]ngoing communication among regulators is critical because oversight jurisdiction over cryptocurrencies is shared across multiple agencies in the United States."

Quintenz stated:

The CFTC and SEC also have jurisdiction over cryptocurrencies depending on their status as a commodity or as a security. From our own perspective, the CFTC has both oversight and enforcement authority over derivatives on commodity cryptocurrencies, but only enforcement authority over the spot transactions of commodity cryptocurrencies. This means that the CFTC's role is broad and far reaching with respect to derivatives trading on cryptocurrencies – such as futures contracts on Bitcoin – including setting requirements for registration of trading platforms or firms, trade execution, orderly trading, data reporting, and recordkeeping. However, in the spot markets, or the platforms where cryptocurrencies themselves are actually bought and sold, the CFTC has *only* enforcement authority - the CFTC can only police fraud and manipulation in the actual trading of cryptocurrencies, but has no ability to make platforms register with the Commission or set any customer protection policies.

On the other hand, if the cryptocurrency or digital asset is a security, it must be traded on a platform that is registered with the SEC or is specifically exempt from registration. In addition, the SEC has stated that many initial coin offerings (ICOs) used to raise capital for business projects may be securities, thereby triggering the fully panoply of registration and investment protection requirements under American securities laws.

Quintenz added, “[i]n light of the patchwork of state and federal regulation that currently exists in the United States, and until such time as Congress might choose to add spot commodity markets to a regulator’s jurisdiction, I have also encouraged cryptocurrency spot platforms to come together and form an SRO-like entity that could develop and enforce customer protection rules to strengthen the integrity of these growing markets.”

On January 18, the SEC’s Division of Investment Management released a staff [letter](#) regarding the creation of registered funds holding cryptocurrencies and cryptocurrency-related products. In the letter to the Investment Company Institute (ICI) and the Securities Industry and Financial Markets Association (SIFMA), Division of Investment Management Director Dalia Blass stated that while the Division is open to engagement on these funds, “there are a number of significant investor protection issues that need to be examined before sponsors begin offering these funds to retail investors.” Blass went on to describe several areas in which the SEC has significant concerns: (1) valuation; (2) liquidity; (3) custody; (4) arbitrage; (5) potential manipulation and other risks.

Blass concluded by stating:

Until the questions identified above can be addressed satisfactorily, we do not believe that it is appropriate for fund sponsors to initiate registration of funds that intend to invest substantially in cryptocurrency and related products, and we have asked sponsors that have registration statements filed for such products to withdraw them.

In December 2017, Clayton released a “[Statement on Cryptocurrencies and Initial Coin Offerings](#).” Clayton said “[t]his statement is my own and does not reflect the views of any other Commissioner or the Commission...[and] is not, and should not be taken as, a definitive discussion of applicable law, all the relevant risks with respect to these products, or a statement of my position on any particular product.” Clayton detailed a list of questions and concerns those advising clients and those investing should consider when dealing with virtual or crypto currencies.

In November 2017, the SEC warned in a [public statement](#) that “virtual tokens or coins sold in ICOs may be securities, and those who offer and sell securities in the United States must comply with the federal securities laws”. Moreover, in July 2017, the SEC “issued a [Report of Investigation under Section 21\(a\)](#) of the Securities Exchange Act of 1934 describing an SEC investigation of The DAO, a virtual organization, and its use of distributed ledger or blockchain technology to facilitate the offer and sale of DAO Tokens to raise capital.” The SEC “applied existing U.S. federal securities laws to this new paradigm, determining that DAO Tokens were securities.” The SEC “stressed that those who offer and sell securities in the U.S. are required to comply with federal securities laws,

regardless of whether those securities are purchased with virtual currencies or distributed with blockchain technology.”

In January 2018, the CFTC released a “[Backgrounder on Oversight of and Approach to Virtual Currency Futures Markets](#),” that “provides clarity regarding federal oversight of and jurisdiction over virtual currencies; the CFTC’s approach to regulation of virtual currencies; the self-certification process generally, as well as specifically regarding the recent self-certification of new contracts for bitcoin futures products by designated contract markets (DCMs); background on the CFTC’s “heightened review” for virtual currency contracts; and a discussion of the constituencies the CFTC believes could be impacted by virtual currency futures.” The CFTC noted it “declared virtual currencies to be a “commodity” subject to oversight under its authority under the Commodity Exchange Act (CEA)” in 2014. The CFTC acknowledged that “US law does not provide for direct, comprehensive Federal oversight of underlying Bitcoin or virtual currency spot markets...[and] [a]s a result, US regulation of virtual currencies has evolved into a multifaceted, multi-regulatory approach:

- State Banking regulators oversee certain US and foreign virtual currency spot exchanges largely through state money transfer laws.
- The Internal Revenue Service (IRS) treats virtual currencies as property subject to capital gains tax.
- The Treasury’s Financial Crimes Enforcement Network (FinCEN) monitors Bitcoin and other virtual currency transfers for anti-money laundering purposes.
- The SEC takes increasingly strong action against unregistered initial coin offerings.

In October 2017, the CFTC released a [Primer on Virtual Currencies](#), which was “intended to be an educational tool regarding emerging FinTech innovations...[and] is not intended to describe the official policy or position of the CFTC, or to limit the CFTC’s current or future positions or actions.”

## **SEC and CFTC Statements and Guidance**

- J. Christopher Giancarlo – January 4, 2018- statement on virtual currencies. Notes the risks of the technology and the CFTC’s response thus far.  
<http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement010418>
- CFTC Backgrounder on Oversight of and Approach to Virtual Currency Futures Markets- January 4, 2018.  
[http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/backgrounder\\_virtualcurrency01.pdf](http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/backgrounder_virtualcurrency01.pdf)
- Giancarlo Commends SEC Chairman Clayton on ICO Statement- December 11, 2017.  
<http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement121117>
- CFTC Launches Virtual Currency Resource Web Page- December 15, 2017.  
<http://www.cftc.gov/PressRoom/PressReleases/pr7665-17>
- CFTC Issues Proposed Interpretation on Virtual Currency “Actual Delivery” in Retail Transactions- December 15, 2017.

<http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2017-27421a.pdf>

- CFTC Statement on Self-Certification of Bitcoin Products by CME, CFE and Cantor Exchange- December 1, 2017.  
[http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/bitcoin\\_factsheet120117.pdf](http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/bitcoin_factsheet120117.pdf)
- Joint statement from CFTC and SEC Enforcement Directors Regarding Virtual Currency Enforcement Actions- January 19, 2018.  
<http://www.cftc.gov/PressRoom/PressReleases/mcdonaldstatement011918>
- SEC Issues Investigative Report Concluding DAO Tokens, a Digital Asset, Were Securities- July 25, 2017. <http://www.sec.gov/litigation/investreport/34-81207.pdf>
- Statement by the Divisions of Corporation Finance and Enforcement on the Report of Investigation on The DAO- July 25, 2017. <https://www.sec.gov/news/public-statement/corpfen-enforcement-statement-report-investigation-dao>
- SEC INVESTOR BULLETIN: INITIAL COIN OFFERINGS- July 25, 2017.  
<https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-initial-coin-offerings>

## Department of Justice

In mid-July 2018, President Donald Trump signed an [executive order](#) “to strengthen the efforts of the Department of Justice and Federal, State, local, and tribal agencies to investigate and prosecute crimes of fraud committed against the U.S. Government or the American people, recover the proceeds of such crimes, and ensure just and effective punishment of those who perpetrate crimes of fraud.” The Attorney General is required to establish a Task Force on Market Integrity and Consumer Fraud, and one of its responsibilities will be to “provide guidance for the investigation and prosecution of cases involving fraud on the government, the financial markets, and consumers, including...securities and commodities fraud, as well as other corporate fraud, with particular attention to fraud affecting the general public; digital currency fraud.”

In 2015, then Assistant Attorney General Leslie R. Caldwell made [remarks](#) on the Department of Justice’s (DOJ) approach to cryptocurrencies. She stated that “virtual currency facilitates a wide range of traditional criminal activities as well as sophisticated cybercrime schemes.” Caldwell explained that “we rely principally on money services business, money transmission and anti-money laundering statutes.” She said, “Whether the currency involved is virtual or traditional, the [DOJ] enforces these critical laws to prosecute money services businesses that engage in money laundering or facilitate crime by flouting registration and licensing requirements.” She added that the DOJ’s enforcement actions have evolved along with the virtual currency ecosystem.” Caldwell stated, “As the virtual currency markets attempt to move past their association with the Silk Roads and Liberty Reserves of the online world, are used to finance legitimate activity, and are becoming increasingly subject to regulation, robust compliance with existing anti-money laundering laws and regulations is necessary – indeed, critical – to bolster the reliability and value of virtual currency.”

## Department of the Treasury

A number of the Department of the Treasury's component agencies have addressed various aspects of cryptocurrencies, including the assertion of jurisdiction. Moreover, at a recent Congressional hearing, CFTC Chairman Giancarlo explained that Secretary of the Treasury Steven Mnuchin "has been out in front on this [issue and has]...formed a virtual currency working group of ourselves, the SEC, the Fed" and the Financial Crimes Enforcement Network (FinCEN).

In its July 2018 [report](#) on "Nonbank Financials, Fintech, and Innovation," Treasury notes that blockchain and distributed ledger technologies as well as digital assets, "are being explored separately in an interagency effort led by a working group of the Financial Stability Oversight Council [FSOC]." The report explained, "The working group is a convening mechanism to promote coordination among regulators as these technologies evolve."

The report further stated:

Interest in crypto-assets from a range of financial authorities has increased substantially over the past year, as evidenced in the March 2018 G20 Finance Ministers and Central Bank Governors Communiqué. For the first time, the G20 explicitly addressed crypto-assets, and assigned the Financial Stability Board (FSB) "in consultation with other standard-setting bodies, including the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions, and Financial Action Task Force (FATF) to report in July 2018 on their work on crypto-assets." The resulting report sets out the metrics that the FSB will use to monitor crypto-asset markets as part of its ongoing assessment of vulnerabilities in the financial system. The G20 authorities are cognizant of the inherent risks these new assets currently pose for investor protection and anti-money laundering and illicit finance regimes.

Treasury added:

Related to these issues, but separate from the focus on crypto-assets, is continuing international interest in the underlying technology. The financial services industry is already developing applications for distributed ledger technology (DLT), including in commodities trading and securities settlement, property registries, and secure, trusted identity products and services, among other use-cases. Some central banks have contemplated the potential for central bank-backed digital currencies, or a tokenized form of a fiat currency that utilizes DLT, asserting that they could potentially help reduce fees, processing times, and operational risk for market participants.

In January 2018, the Department of the Treasury's Office of Foreign Assets Control (OFAC) updated its [FAQs](#) on sanctions levied on Venezuela in response to media reports that the country may issue commodity backed cryptocurrency. OFAC explained that "[a] currency with these characteristics would appear to be an extension of credit to the Venezuelan government...[and] Executive Order 13808 prohibits U.S. persons from extending or otherwise dealing in new debt with a maturity of greater than 30 days of the Government of Venezuela." OFAC cautioned that "U.S. persons that deal in the prospective Venezuelan digital currency may be exposed to U.S. sanctions risk."

In response to a December 2017 [letter](#) from Senate Finance Committee Ranking Member Ron Wyden (D-OR) request that Financial Crimes Enforcement Network (FinCEN) provide “[i]nformation about FinCEN’s oversight and enforcement capabilities over the growing use of blockchain technology for financial transactions.” Wyden stressed, “I seek clarification of FinCEN’s authority and capabilities to apply anti-money laundering and counter-terrorism financing (CTF) laws to non-cash tokens.” Wyden further argued that “businesses such as token developers need clarification on when to register as a money services business (MSB) or money transmission business (MSB).”

In its February 2018 [letter](#) to Wyden, Assistant Secretary of the Treasury for Legislative Affairs Drew Maloney explained that FinCEN is working closely with the SEC and CFTC “to clarify and enforce the AML/CTF obligations of businesses engaged in ICO activities that implicate the regulatory authority of these agencies.” However, Maloney added “the application of AML/CTF obligations to participants in ICOs will depend on the nature of the financial activity involved in any particular ICO.” Maloney stated that under existing statutes and regulations:

a developer that sells convertible virtual currency, including in the form of ICO coins or tokens, in exchange for another type of value that substitutes for currency is a money transmitter and must comply with AML/CFT requirements that apply to this type of MSB. An exchange that sells ICO coins or tokens, or exchanges them for other virtual currency, fiat currency, or other value that substitutes for currency, would typically also be a money transmitter.

Maloney further stated that how an ICO is structured (security vs. commodity) will govern whether the SEC has jurisdiction or the CFTC does, but once one of those agencies can assert jurisdiction, their AML/CTF requirements would be applicable.

In March 2014, the Internal Revenue Service (IRS) released [Notice 2014-21](#) that “describes how existing general tax principles apply to transactions using virtual currency...[and] provides this guidance in the form of answers to frequently asked questions.”

In March 2013, FinCEN issued an [interpretive guidance](#) to clarify the applicability of the regulations implementing the Bank Secrecy Act (BSA) to persons creating, obtaining, distributing, exchanging, accepting, or transmitting virtual currencies.” FinCEN determined that “[a] user of virtual currency is not an MSB under FinCEN’s regulations and therefore is not subject to MSB registration, reporting, and recordkeeping regulations...[h]owever, an administrator or exchanger is an MSB under FinCEN’s regulations, specifically, a money transmitter, unless a limitation to or exemption from the definition applies to the person.”

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## Federal Reserve

So far, the Federal Reserve Board has not asserted oversight authority over virtual or crypto currencies. Instead, the agency released a staff working paper titled “[Distributed ledger technology in payments, clearing, and settlement](#),” which “examined how distributed ledger technology (DLT) can be used in the area of payments, clearing and settlement and identifies both the opportunities and challenges facing its long-term implementation and adoption.”

However, in May 2018 Governor Lael Brainard noted in a [speech](#) on cryptocurrencies that “some have advocated that central banks should create their own digital forms of currency as more stable and reliable alternatives to cryptocurrencies.” She noted that “a central bank digital currency could overcome the volatility risks associated with an unbacked asset with no intrinsic value by substituting a digital instrument that is the direct liability of the central bank.” Brainard added that “[e]ven though central bank digital currencies may at first glance appear to address a number of challenges associated with the current crop of cryptocurrencies, this appeal may not withstand closer scrutiny:

- First, there are serious technical and operational challenges that would need to be overcome, such as the risk of creating a global target for cyberattacks or a ready means of money laundering.
- Second, the issuance of central bank digital currency could have implications for retail banking beyond payments.
- Finally, there is no compelling demonstrated need for a Fed-issued digital currency.

Brainard allowed that “[i]t is important for the Fed and other central banks to continue to research these issues as technology evolves, exploring the technical and economic possibilities and limitations of central-bank-issued digital currencies...[and] [e]ven though the case for a digital currency for general use may not be compelling, opportunities for more targeted and restricted use may nonetheless prove to have value.” She asserted, “Even if cryptocurrencies prove to have a very limited role in the future, the technology behind them is likely to live on and offer improvements in the way we transfer and record more traditional financial assets...[and] [d]istributed ledger technology could also facilitate other applications that could improve the way we share information, validate possessions, and handle logistics.”

## Federal Trade Commission

The Federal Trade Commission (FTC) announced a June 25 Cryptocurrency Workshop “to examine scams involving cryptocurrencies” the agency explained in its [press release](#). The FTC explained that “[t]he [“Decrypting Cryptocurrency Scams” workshop](#) will bring together consumer groups, law enforcement, research organizations, and the private sector to explore how scammers are exploiting public interest in cryptocurrencies such as bitcoin and Litecoin and to discuss ways to empower and protect consumers.” This workshop follows the FTC’s March 9 [FinTech Forum](#) on Artificial Intelligence and Blockchain Technology.

In March 2018, the FTC announced “a [lawsuit against four individuals alleging that they have promoted one or more fraudulent “chain referral schemes”](#)...[that] used bitcoin, a cryptocurrency.” The FTC added that it “brought its [first cryptocurrency-related case in June 2015](#), [another in February 2016](#), and held a [public forum on blockchain technology in March 2017](#).” In the same [press release](#), the FTC’s acting Chief Technologist announced the formation of “an internal FTC Blockchain Working Group...[that] builds on the significant work the FTC has already done on these topics.” Moreover, “[t]he working group has at least three goals:

- First, build on FTC staff expertise in cryptocurrency and blockchain technology through resource sharing and by hosting outside experts.
- Second, facilitate internal communication and external coordination on enforcement actions and other related projects.
- And third, serve as an internal forum for brainstorming potential impacts on the FTC’s dual missions and how to address those impacts.

## **Bureau of Consumer Financial Protection**

In July 2018, the Bureau of Consumer Financial Protection (CFPB) [announced](#) that Paul Watkins will lead the new Office of Innovation that will examine blockchain and cryptocurrencies according to media reports. Watkins previously led the fintech efforts in Arizona, including a regulatory sandbox.

In August 2014, the CFPB released a [consumer advisory](#) titled, “Risks to consumers posed by virtual currencies.” The CFPB did not articulate a regulatory stance beyond warning consumers of potential risks posed by the nature of cryptocurrency and potentially criminal activity. The agency urged consumers to submit complaints should they “encounter a problem with virtual currency or a virtual currency company.”

## **State Action**

In May, U.S. and Canadian state securities regulators announced a major enforcement action against allegedly fraudulent ICOs and “cryptocurrency-related investment products.” In their [press release](#), the “North American Securities Administrators Association (NASAA) today announced one of the largest coordinated series of enforcement actions by state and provincial securities regulators in the United States and Canada to crack down on fraudulent Initial Coin Offerings (ICOs), cryptocurrency-related investment products, and those behind them.” NASAA stated that regulators “from more than 40 jurisdictions throughout North America participated in “Operation Cryptosweep,” which to date has resulted in nearly 70 inquiries and investigations and 35 pending or completed enforcement actions related to ICOs or cryptocurrencies since the beginning of May.”

On April 17, 2018, then New York Attorney General Eric Schneiderman sent [letters](#) and a [questionnaire](#) “to thirteen major virtual currency trading platforms requesting key information on their operations, internal controls, and safeguards to protect customer assets.” Responses were due on May 1, 2018. He explained that the letters are part of the new “Virtual Markets Integrity Initiative, a fact-finding inquiry into the policies and practices of platforms used by consumers to

trade virtual or “crypto” currencies like bitcoin and ether.” Schneiderman added that “the Initiative seeks to increase transparency and accountability as it relates to the platforms retail investors rely on to trade virtual currency, and better inform enforcement agencies, investors, and consumers.” Schneiderman’s office “sent letters to the following virtual currency trading platforms: (1) Coinbase, Inc. (GDAX); (2) Gemini Trust Company; (3) bitFlyer USA, Inc.; (4) iFinex Inc. (Bitfinex); (5) Bitstamp USA Inc.; (6) Payward, Inc. (Kraken); (7) Bittrex, Inc.; (8) Circle Internet Financial Limited (Poloniex LLC); (9) Binance Limited; (10) Elite Way Developments LLP (Tidex.com); (11) Gate Technology Incorporated (Gate.io); (12) itBit Trust Company; and (13) Huobi Global Limited (Huobi.Pro).”

## **National Institute of Standards and Technology**

A key authority weighed in on these issues with a general survey of blockchain. In January 2018, the National Institute of Standards and Technology (NIST) has released for comment the “[Draft NIST Interagency Report \(NISTIR\) 8202: Blockchain Technology Overview](#),” which “provides a high-level technical overview of blockchain technology.” Comments are due by February 23, 2018. NIST noted that the draft report “discusses its application to electronic currency in depth, but also shows its broader applications...[and its] purpose is to help readers understand how blockchains work, so that they can be appropriately and usefully applied to technology problems.” NIST added that its report “explores some specific blockchain applications and some examples of when a blockchain system should be considered for use.”

NIST stated that “[b]ecause there are countless news articles and videos describing the “magic” of the blockchain, this paper aims to describe the method behind the magic (i.e., how a blockchain system works).” NIST stated that “[t]here is a high level of hype around the use of blockchains, yet the technology is not well understood.” NIST explained that “[i]t is not magical; it will not solve all problems...[and] [a]s with all new technology, there is a tendency to want to apply it to every sector in every way imaginable.”

NIST acknowledged that “blockchain technology is the foundation of modern cryptocurrencies, so named because of blockchain’s heavy usage of cryptographic functions.” NIST noted that “blockchain technology is more broadly applicable than its application to cryptocurrencies.” NIST explained that “[c]ompanies that need to maintain a public record, such as holding land title, marriage, or birth records, should consider how their problem sets might be addressed by blockchain technologies.” NIST stated that “[b]lockchains also have strong potential for storing and recording supply chain records...[because a] blockchain can record each step in a product's life, from when it was created in a factory, to when it was shipped and subsequently delivered to a store, and finally to when a consumer purchased it.” NIST stated that “[t]here may even be new industries, such as digital notaries who can prove a person had access to a specific piece of information by recording the hash of it into the blockchain.” NIST claimed “[t]here are many potential uses and opportunities for blockchain technologies.”

## Government Accountability Office

In April 2017, the Government Accountability Office (GAO) released a report titled “[FINANCIAL TECHNOLOGY: Information on Subsectors and Regulatory Oversight](#),” which covers the area of financial technology more broadly than crypto currencies. Interestingly, it listed a number of agencies that may be able to assert jurisdiction over these activities including:

- Federal Reserve System
- Federal Deposit Insurance Corporation
- National Credit Union Administration
- Office of the Comptroller of the Currency
- Bureau of Consumer Financial Protection
- Department of the Treasury FinCEN
- Federal Communications Commission
- Federal Trade Commission
- SEC
- CFTC
- State banking regulators
- State securities regulators

However, in June 2014, the GAO looked more closely at these issues and released its report “[VIRTUAL CURRENCIES: Emerging Regulatory, Law Enforcement, and Consumer Protection Challenges](#),” which “discusses (1) federal financial regulatory and law enforcement agency responsibilities related to the use of virtual currencies and associated challenges and (2) actions and collaborative efforts the agencies have undertaken regarding virtual currencies.”

The GAO stated, “Bitcoin and other virtual currencies are technological innovations that provide users with certain benefits but also pose a number of risks.” The GAO stated that “[b]ecause virtual currencies touch on the responsibilities of multiple federal agencies, addressing these risks will require effective interagency collaboration.” The GAO stated that “[t]hus far, interagency efforts have had a law enforcement focus, reflecting the attractiveness of virtual currencies to those who may want to launder money or purchase black market items...[and] [i]f virtual currencies become more widely used, other types of regulatory and enforcement issues may come to the forefront.”

The GAO stated that “[t]o help ensure that federal interagency collaboration on virtual currencies addresses emerging consumer protection issues, we recommend that the Director of the Consumer Financial Protection Bureau (CFPB) (1) identify which interagency working groups could help CFPB maintain awareness of these issues or would benefit from CFPB’s participation; and (2) decide, in coordination with the agencies already participating in these efforts, which ones CFPB should participate in.”

## Enforcement Actions

Below are lists of SEC, CFTC, and DOJ enforcement actions on crypto or virtual currencies.

## SEC:

- *SEC v. Trendon T. Shavers and Bitcoin Savings and Trust*, Civil Action No. 4:13- CV-416 (E.D. Tex., complaint filed July 23, 2013), <https://www.sec.gov/litigation/complaints/2013/comp-pr2013-132.pdf> - This case involves fraudulent offers and sales of securities by Shavers and BTCST, a Bitcoin-denominated Ponzi scheme.
- *In re Erik T. Voorhees*, Rel. No. 33-9592 (June 3, 2014), <https://www.sec.gov/litigation/admin/2014/33-9592.pdf> - unregistered offerings of shares of FeedZeBirds and SatoshiDICE in exchange for Bitcoins- SEC filed a cease and desist order, \$15,000 disgorgement and \$35,000 in civil monetary penalties.
- *In re BTC Trading, Corp. and Ethan Burnside*, Rel. No. 33-9685 (Dec. 8, 2014), <https://www.sec.gov/litigation/admin/2014/33-9685.pdf> - cease and desist order for unregistered, online, virtual currency-denominated securities exchanges and broker-dealers – disgorgement of \$58,387.07 and \$10,000 in civil monetary penalties.
- *SEC v. Homero Joshua Garza, Gaw Miners, LLC, and ZenMiner, LLC (d/b/a Zen Cloud)*, Civil Action No. 3:15-CV-01760 (D. Conn., complaint filed Dec. 1, 2015) , <https://www.sec.gov/litigation/complaints/2015/comp23415.pdf> - defendants sold – to over 10,000 investors – investment contracts representing shares in the profits they claimed would be generated from using their purported computing power to “mine” for virtual currency- SEC requests permanent injunction.
- *In re Bitcoin Investment Trust and SecondMarket, Inc.*, Rel. No. 34-78282 (July 11, 2016), <https://www.sec.gov/litigation/admin/2016/34-78282.pdf> - SecondMarket purchased 85,721 BIT shares from shareholders during the restricted period in violation of Rule 101 of Regulation M of the Exchange Act – cease and desist order, disgorgement of \$53,755.79.
- *In re Sunshine Capital, Inc.*, File No. 500-1 (Apr. 11, 2017), <https://www.sec.gov/litigation/suspensions/2017/34-80435.pdf> - The Commission temporarily suspended trading in the securities of SCNP because of questions regarding the accuracy of assertions by SCNP in press releases to investors concerning, among other things, the liquidity and value of the company’s assets.
- AriseBank, charged by the SEC with alleged fraud and issuing unregistered securities during its recent initial coin offering (ICO), <https://www.sec.gov/news/press-release/2018-8> , <https://www.sec.gov/litigation/complaints/2018/comp-pr2018-8.pdf>
- The Crypto Company - <http://money.cnn.com/2017/12/19/investing/bitcoin-cryptocurrencies-sec-bubble/index.html> - The Securities and Exchange Commission suspended trading December 19 until January 3, citing “concerns regarding the accuracy and adequacy of information” about compensation paid to promote the firm and plans for insider sales.
- PLEXCORPS - <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-219.pdf> - emergency asset freeze to halt a fast-moving Initial Coin Offering (ICO) fraud that raised up to \$15 million from thousands of investors since August by falsely promising a 13-fold profit in less than a month.
- My Big Coin Pay, Inc., along with its agents Randall Crater and Mark Gillespie, <http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading>

[/enfmybigcoinpaycomplt011618.pdf](#) -for allegedly making materially misleading statements in connection with the offer and sale of a “fully functioning” virtual currency called My Big Coin (“MBC”), and misappropriating customer funds for Ponzi-style payments and personal enrichment.

- *In the Matter of MUNCHEE INC.*, <https://www.sec.gov/litigation/admin/2017/33-10445.pdf> - California-based company selling digital tokens to investors to raise capital for its blockchain-based food review service halted its initial coin offering (ICO) after being contacted by the Securities and Exchange Commission, and agreed to an order in which the Commission found that its conduct constituted unregistered securities offers and sales.
- RECOIN GROUP FOUNDATION, LLC, DRC: WORLD INC. a/k/a DIAMOND RESERVE CLUB: and MAKSIM ZASLAVSKIY, <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-185.pdf> - Maksim Zaslavskiy and his companies have been selling unregistered securities, and the digital tokens or coins being peddled don't really exist. *Securities and Exchange Commission v. REcoin Group Foundation, et al.*, Civil Action No. 17-cv-05725 (E.D.N.Y., filed Sep. 29, 2017)- Litigation Release No. 24081 / March 26, 2018- <https://www.sec.gov/litigation/litreleases/2018/lr24081.htm>- The SEC obtained an emergency court order to freeze the assets of Zaslavskiy and his companies.
- DAO Tokens- <https://www.sec.gov/litigation/investreport/34-81207.pdf> - found that tokens offered and sold by a “virtual” organization known as “The DAO” were securities and therefore subject to the federal securities laws.
- *In re BTC Trading, Corp. and Ethan Burnside* - <https://www.sec.gov/news/press-release/2017-185-0> - The SEC “charged a businessman and two companies with defrauding investors in a pair of so-called initial coin offerings (ICOs) purportedly backed by investments in real estate and diamonds.” (September 29, 2017)
- *SEC v. Jon E. Montroll and Bitfunder* - <https://www.sec.gov/news/press-release/2018-23> - The SEC “charged a former bitcoin-denominated platform and its operator with operating an unregistered securities exchange and defrauding users of that exchange...[and] also charged the operator with making false and misleading statements in connection with an unregistered offering of securities.” (February 21, 2018)
- *SEC v. Sobrab Sharma, Robert Farkas, and Raymond Trapani*, 18 Civ. 02909 (DLC) (S.D.N.Y., filed April 20, 2018)- SEC charged the defendants with engaging in illegal unregistered securities offerings and making material misstatements related to the offer and sale of the Centra ICO. <https://www.sec.gov/litigation/complaints/2018/comp-pr2018-70.pdf>
- *SEC v. T.J. Jesky, Esq. and Mark F. DeStefano*, Civil Action No. 18-CV-05980 (S.D.N.Y, Filed July 2, 2018) – SEC charged two men alleged to have profited from illegal sales of stock of a company claiming to have a blockchain related business. The two men made over \$1.4 million by selling shares of UBI Blockchain Internet, Ltd. Over a ten day period. The court approved a settlement in which the two agreed to return approximately \$1.4 million, pay \$1888,682 in civil penalties, and be subject to permanent injunctions. <https://www.sec.gov/litigation/litreleases/2018/lr24190.htm>
- *Securities and Exchange Commission v. Titanium Blockchain Infrastructure Services, Inc., EHI Internetwork and Systems Management, Inc. aka EHI-INSM, Inc., and Michael Alan Stollery aka Michael Stollaire* Civil Action No. 2:18-CV-04315-DSF (JPRx) (C.D. Cal. filed May 22, 2018)-

SEC charged the defendants with lying about business connections and violating securities laws. The Court entered a preliminary injunction and orders freezing assets and other relief involving an initial coin offering (ICO) that raised as much as \$21 million from investors in and outside the U.S. <https://www.sec.gov/litigation/litreleases/2018/lr24160.htm>

#### **CFTC:**

- *CFTC v. Dillon Michael Dean and The Entrepreneurs Headquarters Limited*-<http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfentrepreneurscomplt011818.pdf>, alleged Ponzi scheme for options fraud, failure to register as a Commodity Pool Operator (“CPO”) and as an Associated Person of a CPO, and CPO fraud. On July 9, 2018 a New York federal court judge ordered the defendant to pay over \$1.9 million in civil monetary penalties and restitution. <https://www.cftc.gov/PressRoom/PressReleases/7760-18>
- *CFTC v. Patrick K. McDonnell and CabbageTech, Corp. d/b/a Coin Drop Markets*-<http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcdmcomplaint011818.pdf> - asserts that the Defendants fraudulently induced customers to send them funds in exchange for purported virtual currency trading advice and investment and trading services.
- *CFTC v. Nicholas Gelfman, and Gelfman Blueprint, Inc. (GBI)*, <http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfgelfmancomplaint09212017.pdf> - charging them with fraud, misappropriation, and issuing false account statements in connection with solicited investments in Bitcoin, a virtual currency.
- *CFTC v. Blake Harrison Kantor aka Bill Gordon, Nathan Mullins, Blue Bit Bane, Blue Bit Analytics, Ltd., G. Thomas Client Services, and Mercury Cove, Inc.*, Civil Action No. 18-CV-2247-SJF-ARL (E.D.N.Y., filed April 16, 2018) – charged with operating a fraudulent scheme involving binary options and virtual currency known as ATM Coin. The District Court issued an emergency order freezing the Defendant’s assets and granting CFTC immediate access to the Defendant’s books. <https://www.cftc.gov/PressRoom/PressReleases/7714-18>
- *CFTC v. My Big Coin Pay, Inc., Randall Crater, and Mark Gillespie*, Case No. 18-10077-RWZ (District of Massachusetts, Filed January 16, 2018) – Charging commodity fraud and misappropriation related to the ongoing solicitation of customer for a virtual currency known as My Big Coin. The U.S. District Court for the District of Massachusetts issued a restraining order freezing the Defendant’s assets. <https://www.cftc.gov/PressRoom/PressReleases/pr7678-18>

#### **DOJ:**

- *United States v. Faiella*, 39 F. Supp. 3d 544 (S.D.N.Y. 2014)-holding that Bitcoin qualifies as ‘money’ or ‘funds’ for purposes of unlicensed money transmitting business and conspiracy to commit money laundering.

- *United States v. Murgio*, No. 15-cr-769, 2016 WL 5107128, at \*4 (S.D.N.Y. Sep. 19, 2016)-holding that the [I.R.S. Notice 2014-21](#) does not forestall criminal liability under 18 USC §1960.
- *United States v. Budovsky*, No. 15-cr-368, 2015 WL 5602853 (S.D.N.Y. Sep. 23, 2015))-holding that the [I.R.S. Notice 2014-21](#) does not forestall criminal liability under 18 USC §1960.
- *United States v. Mansy*, No. 2:15-cr-198-GZS, 2017 U.S. Dist. LEXIS 71786 (D. Me. May 11, 2017)-holding that virtual currencies are money or funds and are therefore subject to 18 USC §1960.
- *United States v. Klein*, No. 17-03056-01-CR-S-MDH, 2017 U.S. Dist. LEXIS 74799 (W.D. Mo. May 17, 2017)-holding that virtual currencies are money or funds and are therefore subject to 18 USC §1960.
- In May public reports suggested that DOJ and CFTC had begun a broad investigation into price manipulation in cryptocurrency markets.

## Conclusion

There continues to be some uncertainty with federal regulation of crypto and virtual currencies by the federal agencies that are or may be able to assert oversight and jurisdiction. However, it appears no one agency will be able to assert complete jurisdiction over these various new instruments, meaning there may continue to be overlapping, possibly even conflicting regulation. Unless Congress chooses to clear away ambiguities, a number of agencies will continue to be stakeholders on crypto and virtual currencies.

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