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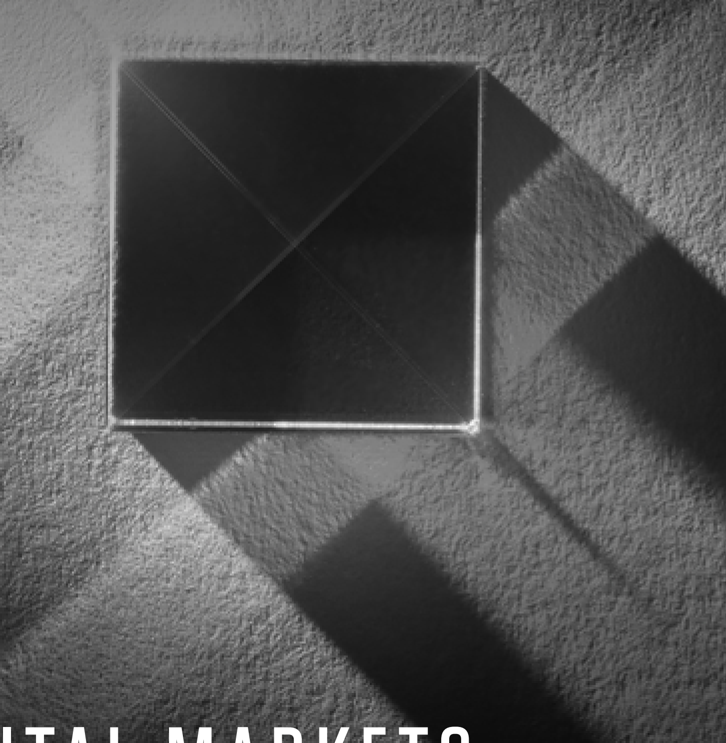
ALTERNATIVE MARKETS

U.S. law: Crypto is money, property, a commodity, and a security, all at the same time

CAROL R. GOFORTH



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U.S. LAW: CRYPTO IS MONEY, PROPERTY, A COMMODITY, AND A SECURITY, ALL AT THE SAME TIME

CAROL R. GOFORTH | Clayton N. Little Professor of Law, University of Arkansas

ABSTRACT

The first crypto assets were all designed as replacements for fiat currency, and as such the label "cryptocurrency" made sense. That singular word accurately described bitcoin and all of the early altcoins. However, as innovators have developed additional functionality for crypto, it no longer makes sense to assume that all crypto are the same. Nonetheless, regulatory authorities in the U.S. continue to lump them together. That does not, however, mean that the various agencies are in agreement about how to classify crypto. In an effort to fit crypto assets into existing regulations, crypto in the U.S. is being simultaneously treated as money, as property, as a commodity, and as a security. This has led to conflicting and overlapping regulations, which are not likely to be harmonized unless and until regulators accept that not all crypto are the same, and that they should not all be regulated monolithically.

1. INTRODUCTION

Persons familiar with bitcoin and blockchain are generally well aware that there has been a remarkable proliferation of cryptocoins and tokens (sometimes just called "crypto") in the past few years. Sources such as CoinMarketCap list more than 2000 different active coins and tokens. While some of the coins in particular have clearly been designed to serve solely or predominantly as replacements for traditional, fiat currencies (led, of course, by bitcoin), many coins and tokens have been designed with additional functionality in mind. Ether, for example, fuels the Ethereum network, a platform on which most tokens are hosted. XRP is utilized by Ripple to facilitate cross-border financial transactions by banks and payment providers.

Despite the fact that many of these assets have utility other than simply serving as a replacement for fiat currency, U.S. regulators tend to lump crypto assets into a single category. That reaction has undoubtedly been encouraged by the fact that "cryptocurrency" is a term widely used to cover the universe of crypto, regardless of the nature of any particular coin or token. It may, therefore, be unsurprising that regulatory authorities also tend to treat all crypto alike, regarding it all as "virtual currency."

2. WHAT IS CRYPTO ANYWAY?

Originally, a regulatory approach that treated all crypto as a currency substitute may have made sense. The mysterious Satoshi Nakamoto's innovative whitepaper on bitcoin specifically talked about the need to replace traditional payment systems, and, of course, "bitcoin" includes the word "coin." In addition, bitcoin's closest and earliest progeny were all altcoins specifically designed to supplant fiat currencies, albeit with different attributes that each developer suggested made that coin a superior option. Given this history, and the perceived need for regulators to step in quickly to resolve problems and abuses that were proliferating in the system, it might have been predictable that the word "cryptocurrency" would be used to talk about all such assets and that all crypto would be regulated in a similarly monolithic way.

This approach is now subject to criticism, particularly in the regulatory sphere, because not all currently-available coins and tokens are intended to or indeed actually do act like traditional currency. Currency generally serves exclusively as a medium of exchange, a store of value, and/or unit of account. One might, therefore, expect that coins and tokens would be regarded as "virtual" currencies when they are intended to act like traditional currency, serving only as a medium of exchange, a store of value, or a unit of account, while lacking intrinsic value or external utility, but this is not the case.

The problem of how crypto assets are understood goes beyond having a somewhat misleading label, because this unitary approach has lead most enforcement agencies in the U.S. to treat crypto as if it were all the same. Thus, if a regulatory agency treats some crypto as currency, it tends to treat all crypto that way. The same phenomenon exists for when it is classified as property, a commodity, and even as a security. Because different agencies in the U.S. have different regulatory powers and responsibilities, each tend to classify the very same assets differently in order to assert jurisdiction. Combined with the tendency to treat all crypto alike, and faced with the reality that there are bad actors in the space, the U.S. is now faced with a mix of overlapping, confusing, and extremely complicated regulations with which developers, issuers, and persons who facilitate the buying and selling of crypto must all comply. Sometimes even purchasers of crypto are affected.

2.1 FinCEN (and state banking authorities): Crypto is currency

One of the earliest U.S. regulators of crypto was the Department of Treasury, acting through FinCEN (the Financial Crimes Enforcement Network). FinCEN's mission pursuant to the Bank Secrecy Act (BSA) is focused on regulating the flow of money so that it is not used to fund illegal operations, such as terrorism, and cannot be funneled out of illegal operations through laundering schemes. It does this in part by subjecting "financial institutions" to a wide range of monitoring, record-keeping, and reporting obligations. Broker-dealers who might facilitate similarly illegal activities through transactions involving securities are also regulated.

Given the obvious importance of this mission, it is not surprising that when early cryptocurrencies were used to fund illegal operations on the so-called dark web, Treasury and FinCEN wanted crypto to be treated as virtual "money," making persons and businesses involved in selling and exchanging it subject to FinCEN jurisdiction. In early 2013, FinCEN issued guidance that defined virtual currency as any "medium of exchange" lacking legal tender status, which "either has an equivalent value in real currency, or acts as a substitute for real currency."[1] Any intermediary facilitating the use of any such virtual currency, therefore, became a "money transmitter," required to report to FinCEN, subject to inspection by it, and required to comply with the Anti-Money Laundering (AML) and Know-Your-Customer (KYC) requirements of the BSA.

Even given that there are legitimate public policy reasons for FinCEN to oversee such businesses, it should at least be recognized that FinCEN utilized a very broad definition of virtual currency in order to accomplish its objectives. Like any other property, crypto is always likely to have a value in "real" currency (regardless of whether it was designed to act as a substitute for fiat), and most coins or tokens can serve as a medium of exchange regardless of the developer's intentions, any utility that the assets might possess, or how they are marketed and to whom. While traditional currencies have no purpose other than acting as a medium of exchange, store of value, or unit of account, this limitation is not included in the FinCEN definition of virtual currency, which, therefore, serves to expand FinCEN's jurisdiction and the reach of any other agency using this definition. In other words, the FinCEN definition potentially makes issuers of crypto assets that were never designed or intended to act as a currency subject to rules that were specifically designed for persons engaged in the business of transmitting and exchanging money rather than other kinds of assets.

In addition to this federal regulation, there are state banking authorities to consider. To date, these state agencies have tended to use the same definitions as those employed by FinCEN, treating all crypto as virtual currency. For example, the Conference of State Bank Supervisors (CSBS) defines virtual currency as "a digital representation of value used as a medium of exchange,

[1] FinCEN, 2013, "Application of FinCEN's regulations to persons administering, exchanging, or using virtual currencies," FINA-2013-G001, March 18, https://bit.ly/2le57iz archived at https://bit.ly/2teTomF

a unit of account, or a store of value" that lacks legal tender status.[2] A proposed uniform act designed to help states decide when state money transmitter laws should apply to businesses involved with virtual currencies, first published by the Uniform Law Commission in 2017, also defines "virtual currency" as "a digital representation of value that: (i) is used as a medium of exchange, unit of account, or store of value; and (ii) is not legal tender…"[3] It offers a relatively burdensome set of regulations for such money transmitter businesses, but as of February, 2019, the Uniform Act had not been adopted by any American jurisdiction.

In fact, state money transmitter laws apply very differently depending on the jurisdiction in question. More than a dozen states require such businesses to either obtain a money transmitter license or some other form of authorization. New York, for example, requires a BitLicense in order for a business to operate as a cryptocurrency exchange. At the other end of the spectrum, at least ten states have decided either that no license is required or that none is required unless a "sovereign" currency is involved. Somewhere in the middle, almost half of all American states are either silent or are still undecided about how to treat crypto.

One problem with this state regulatory approach is that few money transmitter businesses involved with crypto are likely to be doing business in only a single state. Crypto is inherently an online business, where customers may come from all over. A business that interacts with customers from multiple states may well have to comply with federal banking requirements and then a mix of inconsistent (but often extensive and burdensome) state money transmitter requirements as well. And because all crypto are regarded as currency, these rules apply to every issuer of coins or tokens that have value, and potentially every person facilitating the exchange of such assets.

2.2 I.R.S.: Crypto is property, mostly

Another early actor in the U.S. was the I.R.S., which adopted a similarly broad definition of "virtual currency" in 2014. This early "guidance" from the I.R.S. focused on explaining "how existing general tax principles apply to transactions using virtual currency," and to that end, the I.R.S. defined virtual currency as "a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value."[4] This definition sweeps virtually all crypto within its scope, because once a crypto asset has any value in "real" currency (or if it is intended to act as a substitute for fiat), there is realistically no way that it can avoid being a medium of exchange, a unit of account, or a store of value in addition to whatever else it might be. This broad definition, applied across the board to all coins and tokens, allows for no difference in treatment based on the intended function of the asset, or how it is marketed or exchanged.

While agreeing that essentially all crypto should be treated alike, the I.R.S. elected not to classify it as "currency" under the Tax Code, deciding it was property instead of currency (as FinCEN had previously declared). This is a difference with important consequences. By classifying crypto as property, taxpayers are precluded from using cryptocurrencies to generate foreign currency gain or loss for U.S. federal income tax purposes. In addition, the I.R.S. has made persons involved in crypto transactions subject to the same record-keeping and reporting requirements as those involved in stock trading. Moreover, after December 31, 2017, it is clear that this kind of property is not eligible for the so-called "like-kind" exception that some investors had previously relied upon, meaning that profits and losses on any swap of one form of crypto for another, or even any sale and repurchase of the same kind of coin or token, must be reported and will be subject to tax.

Despite its general statement and approach, the I.R.S. has not been entirely consistent in treating crypto as property. In 2016, the I.R.S. had the Department of Justice issue a summons seeking to force Coinbase, Inc. to identify U.S. customers who had traded in convertible cryptocurrencies in the prior three years in order to combat systemic under-reporting of crypto transactions. In essence, in this context, the I.R.S. elected to treat Coinbase as a financial institution, with the currency at issue being the crypto assets which its customers were trading.

In addition to this kind of inconsistency, there are also some open issues with regards to how crypto should be treated for tax purposes. One prevalent question is whether crypto is ordinary property or a capital asset in the hands of an owner. The answer to this question determines whether a sale of the asset produces ordinary or capital gains and losses, and the I.R.S. has essentially

2 CSBS, 2015, "State regulatory requirements for virtual currency activities," CSBS Model Regulatory Framework, September 15, https://bit.ly/2BkDGdT archived at https://bit.ly/2SavhV2

3 ULC, 2017, Uniform Regulation of Virtual Currency Businesses Act § 102(23), first published October 9, https://bit.ly/2QiRCi0 archived at https://bit.ly/2TsfkWJ

4 IRS Virtual Currency Guidance, 2014, I.R.S. Notice 2014-21, 2014-16 I.R.B. 938, released March 26; published April 14, https://bit.ly/2MODJmH archived at https://bit.ly/2GoPwHp

said that it depends. The I.R.S.' guidance on this point simply notes that stocks, bonds, and other investment property are generally treated as capital assets, while inventory and property held mainly for sale are not. This means each individual taxpayer will need to make an independent determination of how to characterize any virtual currencies that it owns when it sells or exchanges the asset.

There are also open tax issues arising out of particular events relating to virtual currencies. For example, all American taxpayers who owned bitcoin prior to July, 2017 received what is known as an "airdrop" when a group of miners introduced a fork and created Bitcoin Cash. This resulted in bitcoin owners receiving one unit of Bitcoin Cash for every bitcoin owned. It is, however, unclear if the I.R.S. expects to treat this transaction like a dividend, on which tax would be owed immediately, or if recipients are required to report gain and pay tax only when the Bitcoin Cash is sold.

> "...even when every agency agrees independently that it is important not to stifle innovation in the space, if multiple authorities regulate and have enforcement powers over the same asset and same transactions, the total regulatory burden can easily become excessive."

None of this, however, takes away from the general I.R.S. conclusion that crypto is property for purposes of the federal income tax code. This is, of course, only the story at the federal level, since most states also impose their own level of taxes.

Many states are silent on the taxation of crypto assets, leaving open the question of how the interests or transactions involving them will be taxed at the state level. With regards to state income tax, there are some states that have specifically adopted the federal approach and a few that have expressly rejected it. Most states are silent or are studying the issue. State tax issues can also include sales tax as well as income tax, and states are not at all consistent in their approach to that kind of taxation either. Specifically, with regard to sales tax, most states have yet to act, although a few have said that transactions in any virtual currency are subject to such taxes while some have concluded that they are not. Among the states that do apply sales tax, the question of how to calculate the tax (based either on the value of the crypto or the value of the other property) is also handled inconsistently. A few advisors have gone so far as to recommend that persons owning large amounts of crypto relocate to a tax-friendly jurisdiction before selling or exchanging the interest.

2.3 CFTC: All crypto is a commodity

The Commodity Futures Trading Commission (CFTC) also traces its involvement in the regulation of virtual currencies back to 2014, and its definitions are consistent with those used by FinCEN and the I.R.S. On the other hand, its conclusion as to the result of that definition is not.

The CFTC released a "Primer" on virtual currencies in 2017, which explicitly relies on the I.R.S. approach to define virtual currency as "a medium of exchange, a unit of account, and/or a store of value" that acts like a "real" currency while lacking "legal tender status."[5] If a coin or token fits within this broad definition of virtual currency, the CFTC takes the position that it is a commodity. This does not appear consistent with the previously discussed FinCEN position (which would subject businesses involved in the exchange of crypto assets to regulation as money transmitters), given that in 2008 FinCEN concluded that brokers and dealers in commodities regulated by the CFTC would generally not be money transmitters.

It is, however, fairly obvious why the CFTC believes that it needs to be active in the space. The CFTC is particularly concerned with fraud and manipulation in the markets that it oversees, including not only futures and derivative markets but also spot markets for commodities. The prevalence of fraudulent trading activities helps explain the breadth of the CFTC's definition and its approach to what it claims within its jurisdiction. This approach does not take into account any differences in the varied coins and tokens available today, but it does mean that the CFTC has both regulatory oversight and enforcement authority over any futures contract or derivative involving virtual currencies. On the other hand, consistent with its Congressional mandate, the CFTC has only enforcement power when it comes to direct trades in a virtual currency and lacks the ability to regulate by setting standards for spot trading in crypto.

[5] LabCFTC, 2017, "A CFTC primer on virtual currencies," U.S. CFTC, October 17, https://bit.ly/2DaEHW2 archived at https://bit.ly/2RC2PpX

2.4 The SEC: Crypto is a security, usually

The Securities Exchange Commission (SEC) is the final major player at the federal level in the U.S. when it comes to regulating crypto. The SEC has been very active because of a pervasive concern that unsophisticated investors have been preyed upon by unscrupulous issuers and third parties. In a 2017 Investor Bulletin warning the public about the risks of participating in Initial Coin Offerings (ICOs), the SEC specifically adopted the prevailing definition of virtual currency, agreeing that it is "a digital representation of value that can be digitally traded and functions as a medium of exchange, unit of account, or store of value."[6] On the other hand, the same bulletin noted that "[v]irtual tokens or coins may represent other rights as well." The SEC, therefore, does not claim to regulate based on whether or not a particular interest is properly regarded as a virtual currency, and instead looks at whether the asset is being sold as an investment contract.

That approach is known as the Howey test in reference to the U.S. Supreme Court case [SEC v. Howey Co., 328 U.S. 293 (1946)] that set out the elements of an investment contract. This test considers the following: (1) is there an investment, (2) of money or something of value, (3) in a common enterprise, (4) where the investor expects profits, (5) based primarily on the entrepreneurial efforts of others? If the answer to all these questions is yes, then the interest is a security. Not surprisingly, the SEC has concluded that new issues of coins or tokens will almost certainly involve the sale of securities.

On the other hand, under this approach, some virtual currencies will not be regulated as securities. The SEC has now decided that the two most heavily capitalized crypto assets, bitcoin and ether, are not securities, based not on how the assets or their developers behaved when both were first introduced, but on where the markets are today. Ownership of bitcoin and ether is so widely dispersed that the market determines profitability, rather than there being any particular third party upon whom an investor would be relying to create value. Thus, these interests are not currently regulated by the SEC as securities.

In addition to the SEC, which regulates securities at the federal level, sales of crypto may also be regulated by state securities authorities. For example, as of mid-2018, a number of jurisdictions had initiated enforcement proceedings against allegedly fraudulent ICOs under state law, including Texas, Massachusetts, New Jersey, and North Carolina. While many states rely

[6] SEC, 2017, "Investor bulletin: Initial Coin Offerings," July 25, https://bit.ly/2v5xHDZ archived at https://bit.ly/2RC3Pud

on the Howey investment contract test to determine when various interests are securities, other states have declined to follow this federal approach, often relying on a "risk capital" test instead. This test asks whether (1) the offeree furnished value to the offeror, (2) at least some of the value is subject to the risks of the enterprise, (3) this was induced by representations that gave rise to a reasonable understanding by the offeree that a valuable benefit over the initial value would be returned to the offeree as a result of the operation of the enterprise, and (4) the offeree has any right to exercise practical and actual control over the management of the enterprise. Because compliance with federal law does not automatically insure compliance with state requirements, this can produce conflicting requirements on developers and sellers of crypto. (Similarly, compliance with the state requirements is irrelevant to the question of whether the SEC requirements have been met.)

At the other end of the spectrum, Wyoming was the first state to expressly exempt so-called "utility tokens"[7] from the state securities laws so long as the developer or seller files a notice of intent with the secretary of state; the purpose of the token is for consumption and shall be exchangeable for goods, services, or content; and the developer or seller did not sell the token to the initial buyer as a financial investment. Compliance with the Wyoming statute does not affect federal requirements.

2.5 Other agencies

The previous sections of this article deal with those federal agencies having the largest roles in regulating crypto in the U.S., but other federal agencies can also become involved in particular instances. For example, the Federal Trade Commission has halted specific activities that have amounted to deceptive advertising involving crypto assets. In fact, in recognition of the reality that crypto can be used by persons intending to defraud the public, the FTC has an active Blockchain Working Group.

Similarly, the Department of Justice (DoJ) (acting through various U.S. Attorneys General) becomes involved when it comes to pursuing potential criminal liability. The DoJ investigates and litigates on behalf of the U.S. and has done so in the context of enforcement actions in coordination with various federal agencies. The DoJ does not promulgate regulations, but when intentional violations amount to crimes under other regulatory regimes, the DoJ prosecutes actions on behalf of the U.S. It does not, however, adopt its own definitions of crypto or virtual currencies, and it does not impose requirements in addition to those overseen by other federal agencies.

Criminal violations of state laws can and have resulted in similar enforcement actions at the state level, and as mentioned earlier, various state agencies are also active in regulating crypto asset transactions.

3. WHY CLASSIFICATION MATTERS

Under current law, crypto assets (and especially any newer coins or tokens) are likely to be simultaneously treated as currency by FinCEN, property by the I.R.S., commodities by the CFTC, and securities by the SEC. Not only is crypto itself classified differently by each of these agencies, but transactions involving these assets are likely to be subject to multiple regulatory requirements that do not always align. One of the biggest problems is that even when every agency agrees independently that it is important not to stifle innovation in the space, if multiple authorities regulate and have enforcement powers over the same asset and same transactions, the total regulatory burden can easily become excessive.

Most regulators in the U.S. agree that blockchain and many of its developments are important and potentially revolutionary, and that technological improvements in the space are highly desirable. J. Christopher Giancarlo, the Chairman of the CFTC, for example, has cautioned legislators about the need for a "proper balance of sound policy, regulatory oversight and private sector innovation," in order to insure the growth of "new technologies [that] will allow American markets to evolve in responsible ways and continue to grow our economy and increase prosperity."[8] The SEC Chairman has also commented on the need to balance legitimate industry needs with appropriate and efficient regulation while avoiding over-regulation.

It is, however, far from clear that this nuanced balancing of regulations and the need of industry to be free to innovate is actually happening. Consider, for example, the regulations imposed by the SEC upon the sale of any crypto asset that it characterizes as a security. The SEC requires any such coin or token to be either registered or exempt from registration before it can be sold. In either

7 There is no indication that Wyoming intends this to apply only to technical tokens, so a crypto asset operating on its own blockchain could also fit this definition, providing it has a viable function.

8 U.S. CFTC, 2018, Speeches & Testimony, Written Testimony of Chairman J. Christopher Giancarlo before the Senate Banking Committee, February 6, https://bit.ly/2D8TAID archived at https://bit.ly/2BjRVQq

case, there are substantial anti-fraud requirements in place to protect potential investors, and the SEC is used to policing fraud in the securities markets, either alone in civil actions or together with the DoJ in the case of criminal violations. Registration with the SEC requires incredibly detailed disclosures formatted in very specific ways, and most exemptions under the securities laws are also designed to ensure that investors have access to material information before making a purchase. It would seem that very little is gained by having additional agencies require similar information in different formats, and it does not seem necessary to have the same kinds of fraud policed by other agencies such as the CFTC (which claims jurisdiction over fraud and manipulation in spot markets involving any commodity, including all crypto).

In point of fact, even when the regulations of a single agency are examined, the risk of bad actors has obviously weighed very heavily in various administrative decisions. Consider the SEC's reaction to various requests to approve exchange traded funds (ETFs) that would deal in bitcoin. An ETF is essentially an investment vehicle that would allow investors to buy a "basket of securities" through a brokerage firm on a stock exchange. Multiple observers have concluded that a crypto ETF is "crucial to bringing legitimacy to crypto trading."[9] Unfortunately for investors, the SEC has so far declined to approve any such ETF, rejecting several applications for bitcoin ETFs to date. Its stated rationale has been that the proposals created too much of a risk of "market manipulation and fraud."[10]

This may be a reasonable conclusion when viewed from the perspective of the particular proposals that the SEC was evaluating, but the result is a potentially significant limitation on the viability and success of crypto-based operations in the U.S. To the extent that innovation in the space is desirable, this consideration appears to have been less important than avoiding the risk of bad behavior. Perhaps this too is understandable in light of the heavy burdens generally placed on ETFs. ETFs are regulated under both the Securities Act of 1933 and the Securities Exchange Act of 1934 as well as the Investment Company Act of 1940, making them one of "the most stringently regulated investment products available in the United States."[11] If, however, the existence of a viable ETF trading platform is indeed important for the long term viability of crypto, the unwillingness of the SEC to approve any of the options presented to it is troublesome. Certainly, the bitcoin market has been depressed since the SEC's decisions to reject so many ETF applications (although other factors may account for the relatively low trading value).

On the flip-side of over-regulation, the existing overlap of authority and jurisdiction of various regulatory authorities also means that certain kinds of issues or transactions can fall in the cracks where no agency has clear jurisdiction. Consider what happens when the SEC determines that some kinds of crypto are not securities, which is exactly what has happened with regard to bitcoin and ether. Clearly, the markets for these interests require some oversight and ideally prospective regulation as well, because of the continuing risk of fraudulent and manipulative behavior.

In cases such as this, the CFTC might appear to be the logical choice, since both bitcoin and ether are regarded as commodities by the agency. However, it is clear that under the current statutory mandates, the CFTC lacks authority to regulate spot markets and transactions not involving a futures sale of any virtual currency (or other commodity). According to testimony from the Chairman of the CFTC before the Senate Banking Committee in early 2018, "the CFTC does not have authority to conduct regulatory oversight … including imposing registration requirements, surveillance and monitoring, transaction reporting, compliance with personnel conduct standards, customer education, capital adequacy, trading system safeguards, cybersecurity examinations, or other requirements."[12] The availability of after-the-fact enforcement power in the event of fraud and manipulation seems inadequate in light of the established fact that such events have occurred in the past, and appear likely to happen in the future.

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[9] For example, see Roberts, D., 2018, "Amid 2018 crypto crash, 3 kinds of believers come into focus," Yahoo Finance, September 8, https://yhoo.it/2O48zaX archived at https://bit.ly/2Bf6NPV

[10] Young, J., 2018, "Why did the SEC reject all derivative-backed bitcoin ETFs?" CCN, August 23, https://bit.ly/2WIxZQ9 archived at https://bit.ly/2UHGKYK

[11] Vanguard, "Who regulates ETFs," https://vgi.vg/2SsBvyH archived at https://bit.ly/2GcqmfT

[12] Written testimony of Chairman Giancarlo, cited at note 8 above.

4. WHERE MIGHT THE U.S. GO FROM HERE?

Most countries do not have the range of overlapping regulatory authorities that exist in the U.S., but realistically it seems unlikely that the U.S. will choose to do away with any of the agencies in question or to remove crypto from the jurisdiction of any existing agency in order to consolidate oversight power. Certainly, prior attempts to consolidate functions of the CFTC and SEC have not progressed very far. Legislators and regulators alike have specifically recognized that existing authorities have differing areas of expertise. Courts have approved of the concurrent jurisdiction that currently exists, as (for example) between the CFTC and SEC in the case of crypto assets. It would, therefore, make sense, when these agencies meet and when Congress determines that it is appropriate or necessary to exercise additional oversight, that a more concerted effort is made to coordinate enforcement and regulatory oversight. This is likely to require a more nuanced approach, where cryptos are not all treated as being alike, and where the specific expertise of each agency is highlighted and respected.

"To avoid the problems of over-regulation, agencies will need to accept a change in perspective. This requires a paradigm shift that moves away from treating crypto as a single kind of asset, when in reality they are not."

For example, the reality is that not all crypto is intended to function as a currency, and it probably should not be regarded as such. Some crypto is clearly being designed to function as a substitute for traditional investment vehicles, and those kinds of interests seem well aligned with the SEC's expertise in regulating investments. Crypto that does work as a currency substitute would seem to fit within the CFTC's framework, and derivatives and futures contracts involving crypto would similarly seem to belong with the CFTC. FinCEN and other banking authorities might be able to apply regulations based on whether an intermediary acting to facilitate transactions in a given crypto asset are acting more like a financial institution in converting currency or a broker-dealer in exchanging securities. It is, however, not at all clear that every crypto asset should be regarded as a currency substitute such that intermediaries are treated as money transmitters. Ideally, the I.R.S. should buy into this kind of differentiation as well.

5. CONCLUSION

When crypto was new, it made sense to think of it a "cryptocurrency," and it made sense to lump all of the early altcoins together. That is no longer the environment in which cryptos operate.

Nonetheless, in the U.S., most regulators continue to treat crypto monolithically, applying regulations to all crypto regardless of how it functions and who (if anyone) has control over its further development. The SEC has at least suggested that it might be willing to treat some crypto as something other than a security, although its chairman has also opined that "every ICO" he has seen has involved the sale of securities. In order to avoid the existing situation, where the same interest is classified differently by different regulators, and multiple agencies claim authority to regulate the same interest, it is important to recognize that cryptos are not all the same. Unless and until this happens, cryptos are likely to be poorly regulated.

To avoid the problems of over-regulation, agencies will need to accept a change in perspective. This requires a paradigm shift that moves away from treating crypto as a single kind of asset, when in reality they are not. Hopefully, American regulators will realize this, and act on this reality, sooner rather than later.

ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

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