



July 2020

WHAT YOU NEED TO KNOW ABOUT

Cryptocurrency Regulations

PRO POINTS

- **Cryptocurrency is among the trendiest financial products** on the market, with some \$270 billion in circulation. But there's confusion about how the technology is regulated.
- **Oversight falls into two buckets:** Digital assets are either considered commodities subject to the Commodity Futures Trading Commission or securities subject to the Securities and Exchange Commission.
- **Crypto providers generally want to be** overseen by the CFTC because they believe the Commodity Exchange Act is more relevant to their activities. They also view the agency's approach as more business-friendly than the SEC, which has largely focused on clamping down on abuses such as securities fraud.
- **Digital asset providers say SEC regulations don't make sense** for their activities, such as a requirement that coin offerings use broker dealers or underwriters.

HOW WE GOT HERE

The industry and its regulators initially saw cryptocurrency trading as a financial experiment. But as its popularity and market share grew, regulators zeroed in.

The value of a single Bitcoin was almost nothing in 2009 when the effort launched — but valuations surpassed \$1,000 each by November 2013, and it's the largest digital currency.

The CFTC has declared that Bitcoin and Ethereum, the second-largest crypto platform, are commodities, clarifying the rules in play for approximately 72 percent of the market.

Commodity investors usually expect to profit solely based on the value of a "coin" or "token" itself. The SEC is concerned that some crypto is being marketed to buyers as a currency but is actually being used by the sellers to raise capital outside the requirements of the securities laws.

The SEC has recently halted a number of "initial coin offerings" — a public sale of cryptocurrency — by asserting the activity involves securities and is subject to its regulations.

A major problem dogging regulators has to do with the system for managing crypto transactions called a blockchain. Transactions are recorded on a ledger that's distributed across a completely electronic, peer-to-peer network.

A key feature is the lack of centralized control — unlike in the case with a bank — providing greater anonymity for individual transactions.

While that quality has attracted investors, it has confounded regulators, which rely on bank records to enforce laws to prevent money laundering or financing illicit activities. Investor fraud is also harder to track.

Crypto is still a relatively small market
COMPARING CRYPTO AND STOCK MARKETS



Sources: CoinMarketCap, World Bank



The recent Twitter hack linked to Bitcoin theft verified accounts ranging from Joe Biden to Oprah Winfrey demonstrated how rapidly hackers could accomplish financial fraud using digital assets using social media.

Scrutiny from regulators intensified after hackers infiltrated storehouses of crypto and stole billions, despite widespread assumptions that digital asset systems were a safer way to stash money than a bank.

The perceived anonymity of cryptocurrency has made the technology popular with criminals looking to hide transactions. That has drawn attention from the IRS, the Treasury Department's Financial Crimes Enforcement Network and the DOJ.

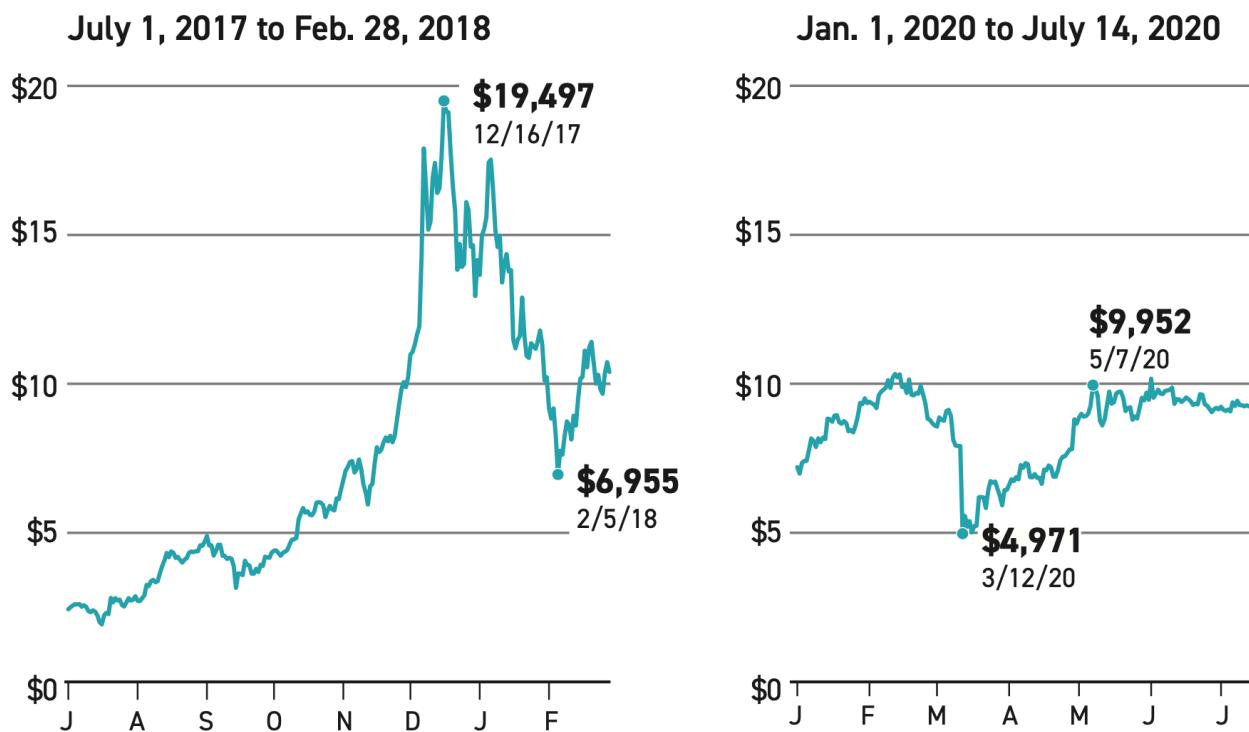
WHAT'S NEXT

Congress renewed its focus on cryptocurrency regulation when Facebook announced its foray into the industry in June 2019, with CEO Mark Zuckerberg unveiling plans to establish a digital currency called Libra.

But following a congressional inquiry — and a warning from top regulators about the project — numerous backers including Mastercard, Visa and eBay dropped out of the Libra Association, the nonprofit that was established in Geneva — outside the direct scrutiny of U.S. regulators — to support Libra's creation.

Bitcoin price was volatile at start of pandemic but did not match 2017 decline

BITCOIN DAILY CLOSING PRICE, THOUSANDS OF DOLLARS



Source: CoinMarketCap

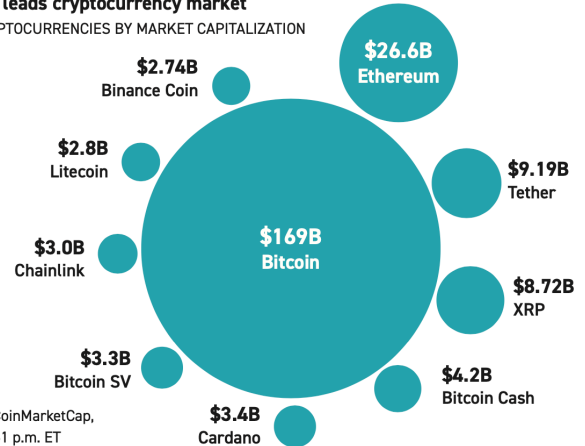


Meanwhile, the SEC continues to swipe back at efforts to trade digital assets on stock exchanges.

One of the latest setbacks was in February, when the agency rejected an application to establish an exchange- traded-fund — a type of pooled investment traded on a stock exchange — made up of Bitcoin. The move suggested that the SEC isn't ready to fully jump into the cryptocurrency arena without greater assurance that the asset can't be manipulated.

Bitcoin leads cryptocurrency market

TOP CRYPTOCURRENCIES BY MARKET CAPITALIZATION



Source: CoinMarketCap,
7/15 12:51 p.m. ET

POWER PLAYERS



SEC Chairman Jay Clayton

Clayton's rejection of the Bitcoin ETF showed the SEC is still holding back on crypto. How and when it starts to allow securities based off cryptocurrencies onto U.S. exchanges will determine the power and reach of this new product.



CFTC Chairman Heath Tarbert

Tarbert wants the U.S. to lead the way in cryptocurrency, and the CFTC has been more bullish about creating a regulatory framework for these products to thrive. Still, both regulators must strike agreement on major policy.



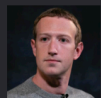
Christopher Giancarlo

The former CFTC chairman is known as "crypto dad." Giancarlo now leads an effort to establish a digital dollar and advises the Chamber of Digital Commerce.



Winklevoss twins

Cameron (top) and Tyler Winklevoss are among cryptocurrency's most powerful players, having launched one of the largest exchange platforms known as Gemini. The SEC under Clayton rejected their application for a Bitcoin ETF.



Mark Zuckerberg

Despite failures surrounding Libra, Zuckerberg has one of the world's largest networks to launch a digital currency. Facebook's reach could transform how digital currency is used, and drive how Congress ramps up scrutiny of digital assets.

Office of the Comptroller of the Currency

The regulator could overhaul digital assets through its bank charter program. The OCC was stalled by legal challenges when it unveiled a plan for a national charter for digital assets, but the agency has recently renewed its efforts.