Smart Start on Cryptocurrency--
A Current Road Map to Regulation

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Cryptocurrency Innovation--
Characteristics That Make It Useful

• Quasi-Anonymous
• Electronic
• Fast
• Cross-Border
• No Intermediaries
The Imperative To Regulate Cryptocurrencies

• Criminal Uses
  • Money Laundering
  • Ransomware
  • Terror Financing
• Tax Evasion
• Money Laundering
• Investment Fraud
  • Ponzi Schemes
  • ICOs
• Market Manipulation
• Hacks/Theft
Factors That Affect the Extent of Regulation

Categories of Attributes Of Cryptocurrency
• Digital Currency ("Spot")
• Derivatives
• ICO
• Utility
• Record of Real Assets

How It Is Used And By Who
• Miners
• Issuers/Administrators
• Consumers/Merchants
• Exchangers
• Custodians
• Transmitters
• Intermediaries (Brokers, Investment Advisors, Fund Managers)
How Regulators View Cryptocurrency

• A Commodity (CFTC)
• A Medium Of Exchange That Operates Sort of Like a Currency (FINCEN and State Banking Regulators)
• A Security or Investment Contract (SEC)
• Property (IRS)
CFTC Jurisdiction—Commodity Derivatives

• Exclusive Jurisdiction Over Commodity Derivatives
  • Futures
  • Options
  • Swaps

• Public Interest
  • Promotion of Risk Management
  • Price Discovery
  • Prevention of Manipulation
  • Prevention of Fraud
  • Promotion of Financial Integrity
  • Promotion of Responsible Innovation
Commodity Definition

• Commodity Defined
  • Enumerated Agricultural Commodities
  • Metals
  • Energy
  • Foreign Currency
  • Interest Rates
  • Stock Indices
  • “all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in”
    • Credit indices
    • Macroeconomic indices
    • Weather
    • Environmental

• Not a Commodity
  • Onions!
  • Movie Box Office Receipts
  • Political Events/Sporting Events
Cryptocurrencies Are Commodities

• CFTC Coinflip Order
• CFTC Bitfinex Order—Leveraged Retail Contracts
• TeraExchange -- CFTC Approved swap exchange
• LedgerX—CFTC Approved option exchange
• CME/CFE—CFTC Approved futures exchanges
• CFTC Intermediary Registration -- FCMs/IBs, CPOs, CTA
• CFTC Regulatory Regime—Regulatory Capital, Disclosure, Reporting, Recordkeeping, Customer Protection
• CFTC Anti-manipulation and Antifraud Jurisdiction
FINCEN

- Views Cryptocurrency as Money
- Protect Financial System From Criminals, Money Launderers, Sanctions Evaders, Hostile Foreigners
- Promote Financial Innovation
- Three Groups of Virtual Currency Actors: Users, Administrators and Exchangers
- Money Services Businesses (MSB) Requirements: Registration, KYC/ CIP, AML, SAR, Currency Transaction Reporting, Cybersecurity
State Regulation

- Money Transmitter Licences—Parallel to FINCEN Requirements
- New York BitLicence
  - Virtual Currency Business Activity
    - Receiving or Transmitting
    - Storing, Holding, or Maintaining Custody or Control For Others
    - Buying and Selling As A Customer Business
    - Exchanger for Customers
    - Administering or Issuing
- Not Included
  - Software Developers and Miners
NY DFS BitLicense Requirements

• Registration—background checks
• AML Program
• Cybersecurity Program/BCP/DR
• Regulatory Capital
• Risk Disclosure Requirements
• No Exemption For Otherwise Regulated Entities Except For NY State Chartered Banks, and Merchants That Utilize VC Solely For Purchase and Sale of Goods Or For Investment Purposes
• No Reciprocity With Other States
Uniform Law Commission (State Laws)—Uniform Regulation of Virtual-Currencies Business Act

- Uniform Regulation of Virtual-Currencies Business Act Adopted in July 2017
- Not self-executing—needs to be adopted state by state
- Similar to NY DFS BitLicense definition of virtual currency business
- Similar requirements to NYS DFS BitLicense requirements
- Numerous exceptions for otherwise regulated entities
- Provides for State reciprocity
SEC Jurisdiction

• Regulatory Mission is to Protect Investors, Maintain Fair, Orderly and Efficient Markets, and Facilitate Capital Raising

• Security Definition is Very Broad

• SEC has Never Claimed That Virtual Currency Such as Bitcoin is a Security

• But...instruments issued by entities that own virtual currencies or that provide returns based on virtual currency assets are likely securities
  • ETFs
  • Indexed Notes
  • Many ICOs
“Howey Test” for Investment Contracts

• *Howey* Investment Contract Test=Security
  1. An investment of money
  2. In a common enterprise
  3. With a reasonable expectation of profits
  4. From the entrepreneurial or management efforts of others

• *The DAO*

• *Munchee* (Failed as a “Utility Token”)

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SEC Regulation and Enforcement

• If an ICO is the offer of Security, then it must either be registered, or exempt under a Reg A+ limited public offering, a Reg D Private offering under 3(c)(1) or 3(c)(7), or Reg S for only non-US investors

• Secondary Trading of Securities ICOs on Exchanges Requires Exchange Registration

• Intermediaries—Brokers and Advisors Must Be Registered

• Ponzi Schemes—Shaver

• ICO Fraud --Zaslavsky, Lacroix, Centra Token

• Mining Schemes—GAW Miners/ZenMiner
IRS-Tax Regulation

• IRS views virtual currency as property
• Each sale or exchange is a taxable event and related gain or loss must be reported on annual tax return
• IRS John Doe subpoena on Coinbase
• IRS may treat non-reporting of virtual currency gains/losses the same way as unreported offshore income
Conclusion

• Try to reconcile promotion of innovation with regulatory imperatives
• Existing regulatory regime is fractured—no single regulator with exclusive jurisdiction and no uniform regulation
• Develop Industry voluntary best practices?
• Regulatory “Sandbox” approach?
• New Federal regulator?
• Strategically embrace regulation
THANK YOU!