

## Blockchain+ Bi-Weekly - February 22, 2024

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**The Blockchain Bi-Weekly presented by the Polsinelli Blockchain+ team is a rundown of some of the key stories in the Web3, blockchain and crypto ecosystems curated by our attorneys navigating the intersections of code, smart contracts, and US law.**

Over the past two weeks, many attorneys and regulators focusing on digital assets discussed the implications around the use of digital assets in illicit finance and potential regulations aimed at curbing that use. While any amount of digital assets being used for criminal enterprise is too much, it is worth repeating that the immutable and public nature of blockchain transactions makes it far from the favorite financial tool of criminals. In fact, [leading crypto forensic firms estimate](#) that illicit use of crypto made up approximately 0.14 percent of the total cryptocurrency transaction volume in 2021, 0.42 percent in 2022, and 0.34% in 2023. This pales in comparison to the 2-5% of global GDP which is estimated to be laundered through other means each year.

In other news, the SEC adopted new broker/dealer rules despite stiff opposition from various market participants. SEC-registered digital asset broker-dealer, Prometheus, plans to offer Ether as its first “crypto-asset-security” to be custodied or traded on the platform.

These developments and a few other brief notes are discussed below.

### **SEC’s Newly Adopted Dealer Rules Faced With Dissents by Commissioners: February 6, 2024**

**Background:** The [SEC voted to adopt two](#) rules “that require market participants who engage in certain dealer roles, in particular those who take on significant liquidity-providing roles in the markets, to register with the SEC, become members of a self-regulatory organization (SRO), and comply with federal securities laws and regulatory obligations.”

**Summary:** Commissioners [Peirce](#) and [Uyeda](#) dissented from the rule, with Uyeda stating “The public should be concerned about the immense scope of this claimed jurisdiction. The rule of law means

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that the government should define ex-ante which activities are lawful and which are not. Without such definition, governmental authority can be arbitrary and even tyrannical.” The current Commission has not strayed from ruffling feathers, and these rules which will affect some of the largest financial institutions in the country is yet another example of claims of expanded regulatory authority in the face of staunch opposition.

## **SEC Registered Crypto Broker-Dealer Prometheus Says Ether is a Security: February 7, 2024**

**Background:** Prometheus, the only SEC-registered crypto platform, has stated that the first product they plan to let customers buy and sell is the [native token of the Ethereum network, Ether](#). The CFTC has previously declared Ether to be a commodity, and Prometheus is only authorized to act as a securities custodian/dealer. When Prometheus’s CEO, Ben Kaplan, was asked about this issue, he responded: "The CFTC is not our regulator...When the SEC says to us, 'It's not a security,' then we'll be troubled."

**Summary:** Prometheus’s leaders have previously stated the company plans on offering the trading of “digital asset securities” through the use of Rule 144 exemptions usually reserved for trading restricted stocks. However, to be a tradable asset under Rule 144 the issuing entity needs to abide by certain reporting requirements and...not sure who they plan on being the reporting entity for the Ethereum network. Considering [Gary Gensler himself has stated Ether is not a security](#) in the past, a view shared by former SEC Director of Corporate Finance [William Hinman](#), Prometheus may be signing the SEC up for a fight the agency doesn’t want to be a part of while litigating against various digital asset exchanges.

## **FinCEN Proposes Expansion of Bank Secrecy Act to Investment Advisers: February 13, 2024**

**Background:** FinCEN has [released its proposed rulemaking for Registered Investment Advisors](#) and [it's a doozy](#). In essence, this would expand anti-money laundering and suspicious activity report filing requirements to not only federally registered investment advisers but also to federal exempt reporting advisers. Most investment advisers have long been excluded from the definition of “financial institution” because the people who supply funds and securities to investment advisers – largely banks and registered broker-dealers – are already subject to these requirements.

**Summary:** More compliance requirements (the cost of which will be passed to consumers), more filing of suspicious activity reports that nobody reads, and more financial surveillance. Unlike banks and broker-dealers who are required to have full-time compliance staff, most smaller investment advisers and fund managers don’t have the infrastructure to handle this type of reporting. Further, the expansion to exempt reporting advisers not only vastly increases compliance requirements of many fund advisers, but also would extend substantive requirements to foreign fund managers who have more than a de minimis amount of US investors and thus are required to become exempt reporting advisers while having minimal US nexus, though many of those managers are already subject to local KYC requirements. [House Financial Services Committee](#) Chair Patrick McHenry is [also skeptical of FinCEN’s request](#) for additional authorities.

## **House Financial Services Subcommittee on Digital Assets Holds Hearing Entitled *Crypto Crime in Context Part II: Examining Approaches to Combat Illicit Activity*: February 15, 2024**

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**Background:** The House Financial Services Subcommittee on Digital Assets, Financial Technology, and Inclusion held a [hearing on February 15](#) to discuss issues surrounding [illicit use of digital assets](#). Witnesses included representatives from Circle, Coinbase, Arkntouros, TRM Labs, and Terranet Ventures. This is the same week as a [hearing before the full Financial Services Committee](#) with FinCEN director Andrea Gacki and Office of Terrorism and Financial Intelligence undersecretary Brian Nelson [resulted in many discussions](#) on [the now debunked](#) Washington Journal reporting on the use of cryptocurrency by Hamas.

**Summary:** It seems like lawmakers are finally starting to understand that the immutable and public nature of the blockchain [makes it less likely to be used by criminals](#) rather than more likely. The new concern is the focus on privacy preserving technologies like mixing services. As explained by the TRM labs representative, even when funds are put through mixing services they can often still be traced. It also does not appear that Congress understands how self-hosted wallets work, and how it would be impossible to effectively ban such technologies. More education is needed to open legislators' eyes to the fact that the surveillance state built upon the mandated use of intermediaries does not work in a digital world.

### **Briefly Noted:**

Chamber of Digital Commerce Files Amicus in Trademark Matter: Polsinelli had the honor of filing an [amicus brief in the \*Hermès v. Rothschild\*](#) matter on behalf of [The Chamber of Digital Commerce](#). The Chamber's amicus advocates for protection of Trademark rights in the Metaverse and for digital goods, to ensure that companies can enter and invest in the space without having their brand names put at risk.

Security Alliance Initiative Announced: The [Security Alliance initiative](#) announced this week, which is an effort to provide assistance in protocol exploit scenarios, including a form Whitehat safe harbor agreement and a free 24/7 emergency hotline for help with incident response. Great effort put forward by many leaders in the space.

Previous Detractors Believe Stablecoin Legislation is Close to Vote in House: Congresswoman Maxine Waters thinks the stablecoin bill in the House is "[very, very close — very close](#)." This came during a hearing in which [Secretary of Treasury Janet Yellen testified](#) before the House Financial Services Committee. If you remember, Waters previously tried to walk out and [kill the stablecoin bill in committee](#), so this is certainly an interesting development. Even if it passes in the House, it will face a steep climb in the Senate, which doesn't seem intent to pass any digital asset bill without first beefing up unwarranted federal financial surveillance.

Blockchain Association Opposed Senator Warren's Money Laundering Proposal: The Blockchain Association [wrote a letter](#), signed by many members who are former or current law enforcement or military, advocating against [Senator Elizabeth Warren's proposed anti-money laundering law](#). Digital assets aren't going away, so laws that are impossible to comply with based on technological limitations won't kill it. It will just drive it overseas away from the reach of U.S. regulators.

### **Conclusion:**

It is evident that the digital asset landscape is evolving rapidly, with both challenges and innovations at the forefront. Despite concerns over the illicit use of digital assets, it's crucial to recognize that the vast majority of cryptocurrency transactions are legitimate and that blockchain technology offers

unparalleled transparency. Regulatory developments, including the SEC's new dealer rules and the proposal to expand the Bank Secrecy Act, underscore the importance of a balanced approach that fosters innovation while ensuring robust protections. As the legal and regulatory environment continues to adapt, it's imperative for all stakeholders to stay informed and engaged, ensuring that the potential of digital assets can be realized in a secure and compliant manner.

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