

## SEC and CFTC Offer Views on Regulation of Virtual Currency

Article By:

Financial Services Practice Group Squire Patton Boggs

---

On February 6, 2018, SEC Chairman Jay Clayton and CFTC Chairman Christopher Giancarlo provided testimony on virtual currencies to the U.S. Senate Committee on Banking, Housing, and Urban Affairs. Their written statements and testimony can be found [here](#). Below we provide a summary of the written statements and testimony and analysis for participants in the virtual currency and blockchain spaces.

### **New Possibilities, New Risks**

**Takeaway:** Both the SEC and CFTC recognize the potential use and value of virtual currency and blockchain technology, but both remain wary of the risks, particularly for investors.

Both Chairmen expressed optimism that developments in financial technology will help facilitate capital formation and provide promising investment opportunities for both institutional and retail investors. SEC Chairman Clayton noted that these developments may assist regulators in monitoring transactions, holdings, obligations, and market characteristics. CFTC Chairman Giancarlo expressed optimism that distributed ledgers have the potential to enhance economic efficiency, mitigate centralized systemic risk, defend against fraudulent activity, and improve data quality and governance. Like Chairman Clayton, Chairman Giancarlo posited that distributed ledger technology could provide assistance to financial market regulators.

At the same time, both Chairmen expressed concern. Chairman Clayton noted that enthusiasm for obtaining a profitable piece of a new technology can attract fraudsters and bad actors, who prey on this enthusiasm. Chairman Giancarlo similarly observed that bad actors historically have invoked the concept of innovation to perpetrate age-old frauds. Both Chairmen repeatedly emphasized the SEC's and CFTC's missions to establish a regulatory environment for investors and market participants that fosters innovation, integrity, and confidence.

### **ICOs as Securities**

**Takeaway:** The SEC considers all or nearly all ICOs to meet the definition of a security and will seek to enforce the federal securities laws as they apply to these ICOs.

The industry has been particularly and rightfully concerned about whether and to what degree the

---

SEC will take the position that ICOs meet the definition of a security. Chairman Clayton provided a strongly worded response in his written testimony, stating that “when investors are offered and sold securities—**which to date ICOs have largely been**—they are entitled to the benefits of state and federal securities laws.” He reasoned that many products labeled as cryptocurrencies or related assets are increasingly being promoted as investment opportunities that rely on the efforts of others (the well-known *Howey* test for determining whether an asset is a security), with their utility as an efficient medium for commercial exchange being a distinct secondary characteristic. He rejected the notion that labeling an asset a “utility token or structuring it to provide some utility” can prevent it from being a security. Chairman Clayton noted that as of today, no ICOs have been registered with the SEC.

Chairman Clayton added that the SEC has ramped up enforcement of securities laws in the cryptocurrency space. It has recently established a new Cyber Unit focused on misconduct involving distributed ledger technology and ICOs and has brought a number of enforcement actions concerning ICOs for alleged violation of federal securities laws.

On a somewhat different topic, Chairman Clayton expressed concern with recent instances of public companies with no meaningful track record in pursuing distributed ledger or blockchain technology changing their business models and names to reflect a focus on such technology without adequate disclosure to investors.

## Virtual Currencies as Commodities

**Takeaway:** U.S. regulation of virtual currency transactions is more limited, as cash or “spot” transactions are largely governed by a patchwork of state money transmission regulations. There remains a limited role for regulation and enforcement by the SEC and CFTC, and that role may grow with future legislation.

CFTC Chairman Giancarlo reiterated the CFTC determination that virtual currencies, such as Bitcoin, meet the definition of a commodity. As such, the CFTC has regulatory and enforcement jurisdiction over derivatives on virtual currencies traded in the United States and enforcement jurisdiction to investigate and initiate civil actions based on fraud and manipulation in virtual currency markets. Indeed, the CFTC has recently taken enforcement action against a number of entities allegedly engaged in fraud, market manipulation, and disruptive trading in the virtual currency markets. But neither the CFTC nor any other U.S. Federal agency has **regulatory** jurisdiction over cash or “spot” transactions in virtual currencies. Thus, the CFTC cannot conduct oversight including imposing registration requirements, surveillance and monitoring, transaction reporting, compliance with personnel conduct standards, customer education, capital adequacy, trading system safeguards, or cyber security examinations. Rather, many U.S.-based cryptocurrency trading platforms have elected to be regulated as money-transmission services, an industry regulated predominately at the state level, without oversight by the SEC or CFTC. SEC Chairman Clayton cautioned that such exchanges may be providing services traditionally associated with securities, commodities, and currency exchanges, such as price quotes. He further noted that the current applicable regulatory framework for cryptocurrency trading was not designed with the type of trading now occurring in mind.

SEC Chairman Clayton did add, however, that the SEC is monitoring the cryptocurrency-related activities of the market participants that it does regulate, including brokers, dealers, investment advisers, and trading platforms. He instructed that those market participants should treat payments and other transactions made in cryptocurrency as if cash were being handed from one party to

another and that they should keep in mind their anti-money laundering and know-your-customer obligations.

He also expressed skepticism about approving financial products linked to underlying cryptocurrencies, such as ETFs. He acknowledged the importance of continued innovation in retail fund space. But he also professed a need for examination and resolution of issues concerning liquidity, valuation, custody, creation, redemption, and arbitrage.

## The Future of Virtual Currency Regulation

**Takeaway:** The SEC and CFTC will continue their enforcement work and likely work with and look to Congress for additional guidance and any expansion of regulatory authority.

Both chairmen posed the question of whether the U.S. government's historical approach to the regulation of sovereign currency transactions is appropriate for the new cryptocurrency markets. As explained above, they both noted that cash or "spot" transactions in virtual currencies are not currently regulated by any U.S. Federal agency and that investors may lack market protections such as rules on best execution, prohibitions on front running, short sale restrictions, and custody and capital requirements. Both chairmen stated that they are open to exploring with Congress whether increased federal regulation of cryptocurrency trading platforms is necessary or appropriate. That said, Chairman Giancarlo expressed more concern that any new regulation (which he admitted may be required) do no harm to the continuing evolution of distributed ledger technology.

## Conclusion

It is clear that both the SEC and CFTC are grappling with how to apply existing law—enacted without today's technology in mind—to the latest innovations in virtual currencies and blockchain technology. Both Chairmen profess to appreciate the value of the new technology while simultaneously acknowledging the risks to investors and the potential need for additional regulation. In the short term, enforcement actions from both agencies will shape the regulatory landscape while in the long term, Congress may intervene with larger changes.

© Copyright 2024 Squire Patton Boggs (US) LLP

---

National Law Review, Volumess VIII, Number 59

Source URL: <https://natlawreview.com/article/sec-and-cftc-offer-views-regulation-virtual-currency>