

IN-DEPTH

Virtual Currency Regulation

USA



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In-Depth: Virtual Currency Regulation (formerly The Virtual Currency Regulation Review) is a country-by-country guide to recent legal and regulatory changes and developments in the field of virtual currencies, which also looks forward to expected global trends in the area. It provides a practical analysis of developing regulatory initiatives aimed at fostering innovation, while at the same time protecting the public and mitigating systemic risk concerning trading and transacting in virtual currencies.

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Introduction

The impact of digital assets – including stablecoins, other cryptocurrencies, non-fungible tokens and other applications supported by blockchain technology – on the global economy is profound. These assets have expanded or transformed the ways in which companies across industries operate, transact and exchange information and value. The market capitalisation of cryptocurrencies alone exceeds US\$2 trillion, having grown from US\$100 billion only three years ago.^[1] In this context, businesses, investors and others who operate in or interact with the digital asset ecosystem would greatly benefit from increased regulatory clarity to help guide and support the explosive growth of the industry.

This chapter explores the current regulatory framework for digital assets in the United States.

Year in review

The past year has underscored the increasing maturity of the digital asset market and the potential for even greater institutional adoption. In particular, the Securities and Exchange Commission (SEC) approved the listing of bitcoin exchange-traded products (ETPs).^[2] Also, lawmakers have made efforts to pass legislation that they believe will stabilise and improve oversight of this developing market.^[3] Recognising increased activity, regulators have battled for primacy over digital assets, with both the SEC and Commodity Futures Trading Commission (CFTC) ramping up their enforcement efforts in the digital asset space,^[4] while the Department of Justice (DOJ) restructured its organisation to devote more prosecutors to enforcing digital-asset related crimes.^[5]

These developments, among others, are discussed in further detail in this chapter.

Legal and regulatory framework

The United States lacks a comprehensive regulatory framework for digital assets, though all three branches of the federal government and several regulatory agencies have actively involved themselves in the space.^[6] In particular, the SEC and the CFTC appear to be vying for primary responsibility to protect digital asset markets.^[7] SEC actions relating to digital assets reached a record frequency in 2023, increasing by more than 50 per cent compared with 2022.^[8] Meanwhile, the CFTC also unveiled its fiscal 2023 enforcement statistics, which showed that nearly 50 per cent of the CFTC's enforcement actions in 2023 involved digital assets, a 20 per cent increase from 2022.^[9]

Ultimately, whether the SEC or the CFTC has authority over a given digital asset transaction depends on how the specific transaction is characterised. The SEC 'regulates the offer and sale of all securities, including those offered and sold by private companies'.^[10] Under the federal securities laws, every offer or sale of securities must be registered with the SEC or qualify for an exemption from registration.^[11] In considering whether a digital asset is a security subject to the SEC's jurisdiction, the SEC considers whether the asset falls under

the catch-all category of securities known as 'investment contracts' under the Securities Act of 1933. In *S.E.C. v. W. J. Howey Co.*, 328 U.S. 293, 301 (1946), the Supreme Court instructed that an investment contract is '(1) an investment of money (2) in a common enterprise (3) with a reasonable expectation of profits to be derived from the efforts of others'.^[12] This 'Howey test' requires a fact-intensive inquiry and has raised concerns that it is neither an appropriate nor a practical means of oversight for what many consider to be a new asset class. The CFTC's regulatory authority covers 'swaps or contracts of sale of a commodity for future delivery'.^[13] The CFTC has stated that certain digital assets – namely, bitcoin and ether – are commodities and thus 'subject to all the same legal protections and regulatory safeguards that you would have if you were trading gold, wheat or oil futures and options'.^[14]

The DOJ has also been active in the digital asset space. The DOJ's Market Integrity and Major Frauds Unit and National Cryptocurrency Enforcement Team (an entity launched in 2021 to investigate crimes involving digital assets) both prosecute digital asset fraud.^[15] In September 2022, the DOJ issued a press release outlining its goals for the digital asset industry, including a design to enhance 'consumer and investor protection' and combat 'illicit finance'. The DOJ added that digital assets provide new avenues for criminality that must be addressed.^[16] And on 20 July 2023, the DOJ announced that it will permanently integrate its National Cryptocurrency Enforcement Team into its Computer Crime and Intellectual Property Section, which will more than double the number of federal prosecutors who can work on digital asset-related crimes.^[17]

Other federal agencies have also stepped into this space. For example, the Federal Reserve is responsible for 'supervising—monitoring, inspecting, and examining—certain financial institutions to ensure that they comply with rules and regulations, and that they operate in a safe and sound manner'.^[18] Hence, the Federal Reserve has been working to improve its oversight of digital assets.^[19] Meanwhile, the Consumer Financial Protection Bureau (CFPB) maintains 'supervisory authority over banks, thrifts, and credit unions with assets over US\$10 billion, as well as their affiliates'.^[20] The CFPB has proposed that Congress expand its authority over major non-bank digital asset companies.^[21] The US Treasury Department also targets crime in the digital asset space through several agencies, including the Financial Crimes Enforcement Network (FinCEN), the Office of Foreign Assets Control and IRS Criminal Investigation.^[22]

Securities and investment laws

In January 2024, the SEC approved Grayscale's application to turn the Grayscale Bitcoin Trust ETF (GBTC) into an exchange-traded fund.^[23] In SEC chair Gary Gensler's associated announcement, he noted that 'Investors today can already buy and sell or otherwise gain exposure to bitcoin at a number of brokerage houses, through mutual funds, on national securities exchanges, through peer-to-peer payment apps, on non-compliant crypto trading platforms, and, of course, through the Grayscale Bitcoin Trust'.^[24] He added that the Commission's action is cabined to exchange-traded products (ETPs) holding a non-security commodity or bitcoin but not any digital asset securities.^[25]

Prior to this approval, GBTC investors had far less liquidity. Grayscale launched the GBTC in 2013 to accredited investors, and the GBTC began to trade publicly in 2015.^[26] In 2016,

Grayscale and its affiliate SecondMarket entered into a settlement with the SEC and agreed to cease and desist from breaching anti-manipulation rules in connection with GBTC redemptions.^[27] Since then, GBTC shares have been irredeemable, although accredited investors could resell their shares in the over-the-counter market after a six-month holding period.^[28]

Accordingly, the GBTC has been seeking to operate as an ETP. In autumn 2021, NYSE Arca proposed listing shares of the GBTC on the exchange as a spot bitcoin ETP. The SEC, however, denied the GBTC's application in June 2022, finding that NYSE Arca's proposed rule change was not 'designed to prevent fraudulent and manipulative acts and practices' and failed to satisfy the SEC's significant market test, which requires the listing exchange to have a surveillance sharing agreement in place with a 'regulated market of significant size'.^[29] After the SEC's denial, Grayscale brought suit in the DC Circuit, arguing that the denial of the GBTC's listing was 'arbitrary and capricious' in light of the SEC's approval of two similar bitcoin futures-based ETPs: Teucrium Bitcoin Futures Fund and Valkyrie XBTO Bitcoin Futures Fund.^[30] The court vacated the SEC's denial, in large part because the SEC failed to distinguish why it approved Teucrium Bitcoin Futures Fund and Valkyrie XBTO Bitcoin Futures Fund.^[31]

Banking and money transmission

Both the Federal Reserve and the CFPB are ramping up their oversight of digital asset payment processing, largely in response to several high-profile bank failures in the digital asset space.

In August 2023, the Federal Reserve implemented the Novel Activities Supervision Program for banking organisations involved in digital asset custody, digital asset collateralised lending, facilitating digital asset trading, and engaging in stablecoin or dollar token issuance or distribution.^[32] The stated goal of the Program is to 'foster the benefits of financial innovation while recognising and appropriately addressing risks to ensure the safety and soundness of the banking system'.^[33] Likewise, in November 2023, the CFPB proposed a digital asset oversight rule that would treat non-bank institutional entities that process over 5 million annual digital asset transfers as banking institutions, thereby triggering CFPB oversight and requiring that they adhere to consumer protection laws.^[34] The proposed rule has been opposed by digital asset industry lobbyists who claim that the CFPB has no authority over their industry, and certain large tech companies – including Apple and Venmo – have also voiced their disapproval.^[35]

Anti-money laundering

Congress, the DOJ and Treasury have focused on anti-money laundering concerns within the digital asset industry, among others.

In July 2023, Senator Elizabeth Warren (D-MA) introduced the Digital Asset Anti-Money Laundering Act.^[36] This Act would make digital asset providers and facilitators 'financial institutions' under the Bank Secrecy Act, requiring them to keep records, file disclosures

and report suspicious activity to federal regulators to aid in detecting money laundering and terrorist financing activities.^[37] It would also direct the Treasury Department's FinCEN to require US persons to report digital asset transactions through foreign accounts of over US\$10,000. Finally, it would require the Treasury Department to establish regulations to mitigate risks for financial institutions handling, using or transacting business with digital asset technologies, and would require the SEC and the CFTC to establish risk examination and review processes for their anti-money laundering programmes.^[38]

¹ Hearings to consider this bill were held on 1 February 2024.^[39]

The DOJ has similarly focused enforcement efforts on money laundering within the digital asset ecosystem. In particular, on 2 November 2023, Sam Bankman-Fried, founder of digital asset exchange FTX, was ordered to pay an US\$11 billion forfeiture and was sentenced to 25 years' imprisonment after being found guilty of various federal violations, including 18 U.S.C. §§ 1343, 371 and 1956.^[40] Although Bankman-Fried represented to customers that deposits into FTX would hold those assets in custody, he instead allegedly used those funds for personal investments and political donations and to repay debts.^[41] Similarly, on 23 November 2023, Binance Holdings Limited agreed to pay a US\$4.3 billion penalty as part of a guilty plea to settle charges brought by the DOJ, which alleged that Binance failed to register with the FinCEN as a money services business and failed to implement a reasonably designed anti-money laundering programme.^[42]

¹ In particular, Binance failed to implement know-your-customer protocols or systemically monitor transactions, while knowing that some customers transacted in sanctioned jurisdictions such as Iran.^[43]

The Treasury Department has also sought to mitigate money laundering within digital asset markets by leveraging its existing procedures. In August 2022, for example, the Treasury Department added Tornado Cash to its Specially Designated Nationals and Blocked Persons (SDN) list.^[44] Tornado Cash allegedly was facilitating transactions without determining their origin or destination, which allegedly aided in money laundering.^[45] Tornado contested its SDN designation in *Van Loon v. Dept. of Treasury*, but the Western District of Texas Court ultimately decided in favour of the Treasury.^[46] Separately, FinCEN proposed a rule to combat money laundering in the digital asset space by targeting convertible virtual currency mixing (CVC mixing).^[47] CVC mixing is a practice whereby a party uses multiple virtual currencies to conceal the transaction source, destination or amount. In particular, FinCEN's proposed rule would 'require covered financial institutions to report information about a transaction when they know, suspect, or have reason to suspect it involves CVC mixing within or involving jurisdictions outside the United States'.^[48]

Regulation of exchanges

The SEC has brought several actions against major digital asset exchanges over the past year as part of what some critics deride as a 'regulation by enforcement' approach:

1. For example, in *SEC v. Binance Holdings Ltd.* (S.D.N.Y. 2023), the SEC alleged that Binance 'intertwine[d] the traditional services of an exchange, broker, and clearing agency without having registered any of those functions with the Commission' in violation of Section 5(a) and 5(c) of the Securities Act of 1933 and Sections 5,

15(a) and 17A(b) of the Exchange Act of 1934.^[49] Among other things, the SEC targeted Binance's staking-as-a-service programme, through which Coinbase pools customers' digital assets, performs blockchain validation services with those pools and generates rewards for customers.^[50] The complaint also alleged that Binance assisted high-value US customers in skirting know-your-customer laws and US documentation requirements, diverted customer funds and artificially inflated the volume of trades on the platform.^[51]

2. Similarly, in *SEC v. Coinbase, Inc.* (S.D.N.Y. 2023), the SEC brought an enforcement action against Coinbase for operating as an unregistered national securities exchange, broker dealer and clearing agency in violation of Sections 5, 15(a) and 17A(b) of the Exchange Act, and for violating Section 5(a) and 5(c) of the Securities Act.^[52] In August, 2023, Coinbase filed a motion for judgement on the pleadings, arguing that the SEC exceeded its authority in attempting to regulate digital assets.^[53] The court dismissed the charge of acting as an unregistered broker, because Coinbase making 'wallets' available to customers did not meet the requirements to be a broker, but the court found the Howey test satisfied as to the digital assets at issue.^[54]

Congress has yet to create a comprehensive system for regulating digital asset exchanges. In May 2024, however, the House of Representatives passed a major statute that would do just that: the Financial Innovation and Technology of the 21st Century Act (FIT 21). This Act, sponsored by Rep Glenn Thompson (R-PA), would 'provide a system of regulation of digital assets by the Commodity Futures Trading Commission and the Securities Exchange Commission'.^[55] If enacted, FIT 21 would designate steps to register with the CFTC as a digital commodity exchange, broker or dealer, and establish regulatory requirements for those registrants.^[56] It would also establish steps to register with the SEC as a digital asset trading system, broker or dealer, and establish requirements for those registrants.^[57] Although the House of Representatives passed FIT 21 in May 2024, SEC chair Gary Gensler and the Office of Management and Budget oppose the bill.^[58]

Regulation of miners

Consistent with the overall lack of a federal regulatory framework on digital assets, federal regulations of digital currency mining are also lacking. However, with rapid growth in digital currency mining over the past few years, there has been a rush of concern relating to miners' energy use.^[59] For example, the White House's March 2023 proposed budget for fiscal year 2024 included a digital asset mining energy (DAME) excise tax. According to the White House, this proposed (but never enacted) 30 per cent tax on electricity used in crypto mining was intended to address 'both long-standing national challenges as well as emerging risks – in this case, the economic and environmental costs of current practices for mining crypto assets'.^[60] Then, on 1 February 2024, the Energy Information Administration (EIA) released a mandatory survey of digital asset miners.^[61] The EIA intended to leverage the information to analyse the energy implications of US-based digital asset mining activities, to identify how the energy demand for digital asset mining is evolving and which geographical areas have the highest growth and necessary quantities

of electricity to meet mining demand. While litigation forced the EIA to suspend the survey, the associated notice and comment period will proceed.^[62]

Several states have enacted their own laws that address digital asset mining, but no consistent approach has emerged:

1. New York: In November 2022, the Empire State suspended digital asset mining operations that use proof-of-work methods to validate blockchain transactions.^[63]
2. Arkansas: In April 2023, Arkansas enacted Act 851, which prohibits local governments from passing ordinances to restrict home digital asset mining or rezoning areas to prevent mining.^[64]
3. Montana: In May 2023, Montana enacted SB178, which prevents local authorities from subjecting mining operations to usually discriminatory taxes or passing laws that impede mining operations, either through imposing requirements that do not generally pertain to data centres, rezoning or prohibiting mining at private residences.^[65]
4. Oklahoma: In May 2024, Oklahoma enacted HB 3594, which prevents state and local authorities from hindering or restricting the use of digital assets for purchases, commercial asset mining or home asset mining.^[66]
5. Virginia: In April 2024, Virginia enacted SB No. 339, which requires the Virginia General Assembly's 'Joint Commission on Technology and Science to conduct an analysis of and make recommendations regarding the use of blockchain technology, digital asset mining, and cryptocurrency in the Commonwealth' no later than 1 December 2024.^[67]

Regulation of issuers and sponsors

Recent case law highlights that the Howey analysis depends heavily on the particular facts and circumstances presented, as well as on the trier of fact.^[68] In *SEC v. Ripple Labs* (S.D.N.Y. 2023), the SEC alleged that Ripple Labs Inc and two of its executives raised over US\$1.3 billion through an unregistered digital asset securities offering of Ripple's token XRP.^[69] As a matter of summary judgement, Judge Torres, however, found that XRP is a security depending on whether particular purchases could maintain a reasonable expectation of profits based on the efforts of others. For instance, the sale of XRP through institutions satisfied this element because reasonable investors would have understood that Ripple would use capital raised to improve the market for and to develop XRP. However, programmatic sales on digital asset exchanges did not satisfy this element because those buyers could not know that their payments were directly funding Ripple's operations.^[70] Just a few weeks later, however, another court in the same district reached a different conclusion. In *SEC v. Terraform Labs Pte. Ltd.*, 684 F. Supp. 3d 170 (S.D.N.Y. 2023), the SEC similarly alleged that Terraform and its chief executive officer failed to register an offer and sale of digital asset securities.^[71] But, when weighing a motion to dismiss, Judge Rakoff rejected Judge Torres' analysis in *Ripple*, noting that 'Howey makes no such distinction between purchasers' and adding that, if the SEC's allegations are true, 'the defendants' [sic] embarked on a public campaign to encourage both retail and institutional

investors to buy their crypto-assets by touting the profitability of the crypto-assets and the managerial and technical skills that would allow the defendants to maximise returns on the investors' coins'.^[72] Judge Rakoff subsequently concluded that the digital assets at issue were securities, noting that whether the buyer purchased the digital assets directly from the issuer or through the secondary market has 'no impact on whether a reasonable individual would objectively view the defendants' actions and statements as evincing a promise of profits based on their efforts'.^[73]

Outlook and conclusions

Over the past year, the digital asset market has taken steps towards maturity – highlighted by the SEC's approval of listing bitcoin exchange-traded products^[74] – and continued to expand its impact on financial markets. Accordingly, regulators such as the SEC and CFTC are expected to continue their efforts to assert primary regulatory oversight of this space, while policymakers and others are considering other avenues to fill regulatory gaps and otherwise bring greater regulatory clarity.

Endnotes

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- 4 Compare SEC Announces Enforcement Results for Fiscal Year 2023, U.S. SEC (Nov. 14, 2023), CFTC Releases FY 2023 Enforcement Results, Release No. 8822-23, CFTC Release (Nov. 7, 2023), <https://www.cftc.gov/PressRoom/PressReleases/8822-23>. ^ [Back to section](#)
- 5 Principal Deputy Assistant Attorney General Nicole M. Argentieri Delivers Remarks at the Center for Strategic and International Studies, DOJ, July 20, 2023. ^ [Back to section](#)

- 6 Paul Tierno, Cong. Rsch. Servs., R47425, Cryptocurrency: Selected Policy Issues (2023) (explaining the lack of regulations and laws specific to cryptocurrency requires regulators to 'apply existing regulations to cryptocurrencies and digital asset exchanges'). [^ Back to section](#)
- 7 In July 2023, Kirsten Gillibrand (D-NY) and Cynthia Lummis (R-WY) reintroduced the Responsible Financial Innovation Act, which was previously introduced a year prior. This Act would provide a regulatory framework for digital assets. Specifically, '[t]he bill, which focuses heavily on consumer protection measures, provides the CFTC with primary jurisdiction over digital asset issuers while giving the SEC a more limited role.' Notably, this bill provides that crypto asset exchanges must register with the CFTC, states penalties for anti-money laundering violations, and 'create[es] mandatory segregation and third-party custody requirements'. [^ Back to section](#)
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- 31** id. [^ Back to section](#)
- 32** Novel Activities Supervision Program, Board of Governors of the Federal Reserve System, Oct. 4, 2023. [^ Back to section](#)
- 33** id. Note that, in March 2023, Rep. Tom Emmer (R-MN) and Rep. Darren Soto (D-FL) proposed a bipartisan Blockchain Regulatory Certainty Act, which aims to 'remove hurdles for "blockchain developers and service providers" such as miners, multisignature service providers and decentralized finance platforms'. This Act would provide much-needed clarification on custody-related issues, which is important to consider when determining how custody-related regulations will apply. [^ Back to section](#)
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- 54** Opinion and Order, SEC v. Coinbase, Mar. 27, 2024, 23 Civ. 4728. ^ [Back to section](#)
- 55** H.R.4763 - Financial Innovation and Technology for the 21st Century Act, Congress.gov (2023-24). ^ [Back to section](#)
- 56** id. ^ [Back to section](#)
- 57** id. ^ [Back to section](#)

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