

Regulatory Shake-Out on Digital Assets: An Industry Waits for Additional Guidance

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A threshold question in many cryptocurrency inquiries is whether the digital assets qualify as securities under the federal securities laws. If so, then they are [subject to a full suite of federal securities regulations](#). If not, they still may be subject to AML and other DOJ regulations regarding currencies, as well as the Commodity Futures Trading Commission's (CFTC) authority to prosecute manipulation in the spot market for commodities. Without uniform legislation providing guidance on this question, regulators and courts have generally applied the [Howey test](#) to determine whether the digital assets at issue are investment contracts and therefore securities. Rulings in litigated matters this year may serve as catalysts to drive legislative action providing further guidance to the industry.

For example, the outcome of the [SEC's pending case against Ripple Labs Inc.](#) will rest on whether the digital asset XRP is a security. The SEC alleges Ripple raised over \$1.3 billion in an unregistered securities offering of XRP, while Ripple asserts that XRP is a fully-functioning currency. Resolution of the parties' major disputes is expected this year. The outcome may either embolden the SEC in the cryptocurrency space, or provide the industry with ammunition to push back against the SEC's relatively unbroken string of wins in initial coin offering cases.

Meanwhile, the SEC and a group of state AGs [recently obtained a sizeable settlement against a major crypto lending platform](#) relating to its interest-bearing crypto accounts, under the theory that the accounts themselves were unregistered securities and the entity was an unregistered investment company. The [SEC has also proposed regulatory amendments](#) that [appear to draw](#) the definition of a "securities exchange" broadly enough to cover those who create protocols for decentralized exchanges to facilitate crypto trading.

Separately, a Connecticut [jury recently found](#) that various cryptocurrency-related products offered by a crypto mining operation were not securities, although the SEC had previously charged and settled securities fraud claims against the enterprise. Among these products were a virtual currency called paycoin and “hashlets,” units of computing power purportedly for crypto mining. While the case may have had unique facts, the jury’s November 2021 civil verdict is a reminder that a finder of fact may not necessarily agree with the prevailing regulatory sentiment that virtually all crypto offerings are securities.

Federal legislation has the potential to draw clearer definitions, as the November 2021 [Infrastructure Investment and Jobs Act](#) demonstrates that Congress is taking steps towards formal cryptocurrency regulation. The law broadens the Internal Revenue Code’s definition of “cash” to include “digital assets” for the purposes of tax reporting requirements for certain transactions, and defines “digital asset” as “any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology.”

In a recent report, the [Study of the Facilitation of Money Laundering and Terror Finance Through the Trade in Works of Art \(treasury.gov\)](#), the Treasury Department suggested that NFTs (non-fungible tokens) could be considered “virtual assets” subject to regulation by FinCEN and other regulators under AML laws. The Treasury noted that whether NFTs qualify as virtual assets depends on “the nature and characteristics” of the NFT. NFTs that are “unique, rather than interchangeable,” and “used in practice as collectibles rather than as payment or investment instruments” would not be considered virtual assets while NFTs or other digital assets that are “used for payment or investment purposes in practice” may be deemed virtual assets. As a result, the issuers and other service providers of these latter NFTs may well be considered payment processors subject to the Bank Secrecy Act and related anti-money laundering regulations.

The CFTC has also signaled its appetite for issuing regulations and bringing enforcement cases in the crypto space, with the CFTC's Chairman, Rostin Behnam, directly asking Congress for more authority over cash cryptocurrency markets. In recent remarks to the Senate Committee on Agriculture, Nutrition and Forestry, Behnam argued that there should be increased transparency in underlying spot markets for digital asset commodities and that the CFTC needs additional tools to bring the crypto market "into the light," such as increased reporting, order visibility, and new rules around execution, custody, clearing and settlement.

Time will tell whether Congress will provide further regulatory guidance in the crypto space.

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