For cryptocurrencies to succeed as payment tools, the industry needs to be regulated—*bad actors need to be ferreted out and market confidence needs to be bolstered by rules of law governing this new asset class.*

The underlying technology is much easier to fit into our existing regulatory framework without bespoke rules. For example, tokenized real-world assets can generally be regulated the same way the underlying real-world assets are regulated. Fungible digital assets used as currencies (cryptocurrencies) represent a new asset class that challenges existing regulatory constructs and requires a new bespoke set of regulations. How regulators have chosen to address this challenge has been very different in the United States (and Canada, which tends to follow the United States), as compared to the rest of the world.

Overview of US and International Regulatory Constructs

In the United States, the securities regulator is generally considered to be one of the best-suited regulators to handle novelty, in part because U.S. securities laws have evolved through case law to be applied to the economic substance rather than form. It is common for the U.S. Securities and Exchange Commission (SEC) to step into a regulatory vacuum and assert its jurisdictional authority to regulate based on the inherent flexibility of the definition of "security" under the Howey test for an investment contract. The U.S. capital markets are widely considered among the best in class globally, so it stands to reason that the SEC has a very high status among U.S. regulators. In most other countries, the banking and monetary regulators appear to be driving most of the novel regulations for cryptocurrencies, not the securities regulators. Perhaps this is because in most other countries, whether or not a novel asset class is a security appears to be generally tested based on whether the new asset class has sufficient similarities to traditional securities. Of course, an asset class that has no direct financial return and does not represent ownership of anything, does not look much like a share of stock on the surface. The Howey test, in contrast, would look past the form and say that there is still an investment contract formed, based on the implicit promise of efforts by the issuer to make the asset more valuable in secondary trading. So, we have seen very different results from this basic distinction that exists among the different securities laws around the world.

Most countries, including the United States, treat cryptocurrencies as a form of money and apply their monetary regulations. Only the United States and Canada have securities regulators also trying to regulate cryptocurrencies as securities under existing securities laws. Some countries have begun to adopt crypto-specific regulations designed to address the quasi-security nature of crypto. The EU's Markets in Financial Instruments Directive (MiFID) and Markets in Crypto-Assets Regulation (MiCA) rules are good examples.

- MiCA rules generally require some disclosure by the issuer, but do not go as far as the securities laws would typically require.
- MiFID rules generally apply securities rules to tokenized securities. MiCA appears aimed at the cryptocurrencies that are not obviously securities based on having the same characteristics of traditional securities. This may turn out to be overly broad as tokenized real-world assets begin to emerge, but that should be a relatively simple fix to the MiCA legislation.

Approach To Regulating Cryptocurrencies

So, how should the U.S. regulate crypto? Industry experts in the United States have been calling for the SEC to adopt rules around crypto for many years now. So far, the SEC has elected to regulate by enforcement, but the recent *Ripple Order* shows how potentially unmanageable a set of case law driven rules can be. The *Ripple Order* appears to take the position that each transaction must be analyzed separately from every other transaction to apply the facts and circumstances under the Howey test to see if a particular transaction involves the offer or sale of a security. It is true that the Howey test can be said to lead to this result, but it would seem that a more workable result, equally welcome under the Howey line of cases, would be to look at the aggregate facts and circumstances and determine whether a particular crypto token must be offered and sold as a security for all purposes during a given time period. In this way, the token could be treated as a security for a period of time across all transactions, both primary and secondary, until the aggregate facts and circumstances change sufficiently for the token to stop being treated as a security for all purposes. Of course, while aggregating the facts and circumstances across all transactions would solve some problems of fungibility of securities with nonsecurities in the secondary markets, this solution too is somewhat unworkable if you imagine the token seller conducting a new primary offering of its tokens as a security sometime after the market had thought the token was no longer a security.

It may require an act of Congress, but the SEC does have rulemaking authority that may be better situated to get into details than the U.S. Congress. Still, we may need Congress to force the SEC's hand the way it did with the

Jobs Act, which required the SEC to adopt rules like 506(c) of Regulation D opening up general solicitation conditions for exempt offerings. There are, in fact, several different bills that have been drafted by both U.S. senators and members of the U.S. House of Representatives that are currently being debated in Congress.

So, what should this new regulation cover? The *Ripple Order* gives some interesting insights into the types of transactions that at least the court thinks merits treatment as securities transactions. When the token is being sold to traditional investor types using traditional investment processes and documentation and the investor thesis is clearly to seek appreciation in the token value, then it is apparent that this type of primary sale of tokens should be treated as a securities transaction. But, when the token is trading in highly liquid secondary markets, the regulatory need for exchanges to be regulated like securities markets seems like overkill. Partly, this is because the clearance and settlement of crypto does not have the same complications and pitfalls that traditional securities have. Many of the same anti-fraud rules should be applicable to front-running and other trading abuses, but the need for every participant to be a licensed broker-dealer is a bit much. Despite SEC Chair Gary Gensler's protestations to the contrary, the existing securities laws simply are not workable.

Crypto needs to transact at the speed of the internet to be a successful payment tool. There is a reason we do not buy eggs at the supermarket with shares of oil companies. It is largely the cumbersome broker-dealer rules that stand in the way of that. So, we need to carefully consider a lighter version of the rules applicable to trading venues for cryptocurrency exchanges. Similarly, the primary sale needs special rules. The line-item disclosure requirements under our existing securities laws were developed specifically for either debt or equity securities. They do not fit cryptocurrencies. For example, providing audited financial statements of the issuer to token holders is not just unnecessary, it is affirmatively misleading. It implies that token holders have some sort of participation in the financial results of the company, which they do not. Many of the existing line-item disclosure requirements need significant adjusting based on this fundamental reality that the tokens do not represent a right to anything and the issuer likely has no idea what drives the value of the token. There may well be very limited amounts of asymmetric information, meaning information available only to the management of the token issuer, as compared to token holders or the general public.

These special rules would help set crypto apart from traditional securities, which will help the SEC in its mission to protect the capital markets from systemic risk. It could be said that the SEC has already given crypto too much credibility by declaring tokens to be securities. Crypto needs to exist as a separately regulated asset class, both for the practical reasons that existing regulations are inapposite and for the very real optical reasons around limiting systemic risk to our traditional capital markets. This dichotomy is very similar to the spirit of what the EU has done with its MiFID and MiCA rules. The United States should follow this general template. In fact, it may be easiest for Congress to agree to follow the EU quite specifically, rather than try to innovate given the extreme polarity in Congress. Or, require the SEC to do the innovation and leave it to the professional staff of the SEC to seek comments from industry and get it right.

Ultimately, regulatory arbitrage is inescapable, and the United States needs to pay attention to the new EU rules because the EU is a respected body of smart legislators that has done the hard work to regulate crypto in a novel way. Regulatory clarity is critical to market adoption of a particular regulatory regime. The SEC's perennial desire to keep U.S. securities laws uncertain so that no one walks anywhere near the line, simply will not work this time in the face of better alternatives. The world has become a much smaller place and it is getting smaller every year. People are mobile and remote work has become the norm not the exception. Historically, Silicon Valley venture capitalists were loath to invest in the East Bay, let alone the Far East. Today, Andreessen Horowitz has opened an office in London and moved its next crypto accelerator program to the U.K. That should not go unnoticed by U.S. regulators and legislators charged with keeping the United States competitive globally.

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