



Cryptocurrencies Part 1 - An Overview Of The Legal Landscape

Part 1 of an overview of the legal landscape, the risks of investing, and the future of the markets

July 18, 2018 | [Financial Regulation](#), [SEC](#), [The GEE Blog](#)



Trace Schmeltz

Partner
Financial and
Regulatory
Litigation Group
Co-Chair, Fintech
Co-Chair

In this two-part blog series, I will be giving an overview of the legal landscape of cryptocurrencies, touch on the biggest risks for those who want to trade cryptocurrency, as well as a look into what the future of this market looks like.

The current legal and regulatory environment for cryptocurrencies

Much has been said about the legal uncertainty around cryptocurrency. Really, understanding what laws apply is quite simple. Complying with multiple states' laws is more difficult, of course. As set out in the U.S. Commodity Futures Trading Commission's (CFTC) "[Background on Oversight of and Approach to Virtual Currency Futures Markets](#)":

US law does not provide for direct, comprehensive Federal oversight of

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underlying Bitcoin or virtual currency spot markets. As a result, US regulation of virtual currencies has evolved into a multifaceted, multi-regulatory approach:

- *State Banking regulators oversee certain US and foreign virtual currency spot exchanges largely through state money transfer laws.*
- *The Internal Revenue Service (IRS) treats virtual currencies as property subject to capital gains tax.*
- *The Treasury's Financial Crimes Enforcement Network (FinCEN) monitors Bitcoin and other virtual currency transfers for anti-money laundering purposes.*
- *The Securities and Exchange Commission (SEC) takes increasingly strong action against unregistered initial coin offerings.*

The CFTC itself has “declared virtual currencies to be a ‘commodity’ subject to oversight under its authority under the Commodity Exchange Act (CEA).” Under this authority, the CFTC regulates exchanges on which leveraged or derivative cryptocurrencies trade occur. And, the CFTC brings enforcement actions when appropriate to enforce registration and anti-fraud requirements of the CEA.

In other words, while the legal landscape is littered with diverse regulators, it is largely not complicated to determine which regulators will be interested in any given aspect of a cryptocurrency. With respect to the question of whether a cryptocurrency is a security or a commodity, of course, there is some nuance. Most of the established cryptocurrencies—like bitcoin and ether—are not securities. But, as the Chairman of the SEC himself has stated, crypto-tokens that are offered as part of an effort to raise money are most likely securities, particularly if it is clear that people expect to profit from the efforts of others.

In late June 2018, we received our first judicial pronouncement on this point. It may not be binding precedent across the land, but it is a reasonably well thought out decision that many courts may look to in the future. The case is *Rensel v. Centra Tech*, in the Southern District of Florida. In it, a Magistrate Judge has recommended that the tokens issued in by Centra Tech—CTRs—were, in fact, securities.

The Court reached this conclusion by applying the factors of the so-called Howey test: (i) an investment of money; (ii) in a common enterprise; (iii) with an expectation of profits; (iv) derived primarily from the efforts of others. In Centra Tech, the court found that the first element was met because individuals had committed resources that could be lost. The court found that there was a common enterprise, as the investors’ ability to make money depended on the efforts of those seeking the investment. And, the court found that Centra Tech’s success also was based on the success of the individuals seeking the investment.

In other words, the CTR token did not allow its purchasers to participate in some form of enterprise themselves—it required that they place their trust in those with whom they had invested and to wait until the enterprise itself bore fruit before making money themselves.

Ultimately, if a token is a security, it must be properly registered or only offered in accordance with the limited exemptions available from registration

under U.S. securities laws. The securities disclosure regime is designed to provide investors with information material to their investment before they decide to invest. To highlight the importance of its regulations, the SEC made a fake initial coin offering—www.howeycoins.com—complete with a white paper that has a complex, yet vague, description of the investment opportunity and a countdown clock intended to “hype” the limited time left to invest in this once in a lifetime deal. The howeycoins parody is intended to demonstrate how easy it is to mislead in an unregulated market.

Internationally, regulators have begun to take more nuanced stances toward cryptocurrency. Some countries, like China, have banned cryptocurrencies, while other countries, like India, have banned banks from accepting cryptocurrencies, making it more difficult for exchanges and businesses to accept this store of value. More recently, however, positions appear to be softening. For instance, in South Korea, although regulatory officials have banned anonymous trading of cryptocurrencies on exchanges, they are exploring making initial coin offerings legal and allowing more freedom to trade cryptocurrencies, albeit in a regulated environment. In Japan, in response to concerns about hacks in cryptocurrency exchanges, exchanges must register with the country’s Financial Services Agency, obtain a license, and be subjected to spot investigations—with significant fines and penalties issued for not meeting the FSA’s requirements.

In short, it would appear that, globally, governments are increasingly accepting of cryptocurrencies, but are imposing regulatory requirements intended to protect investors against many risks, which I will touch on in part two of this blog post, coming tomorrow.