A Call for Regulation: The SEC Should Oversee Crypto With its Ever-Growing Similarities in Risk and Opportunity to Securities

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All investments carry some degree of risk, but the supervisory powers of the SEC offer a level of comfort to the general population investing in the market. The SEC wants investors to spread the money they are willing to invest across mediums, but with the integration of cryptocurrency and the increased accessibility to digital wallets, the SEC hesitates to act on their jurisdiction to "protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation" because of their subjective stance regarding the risks inherent to investing in and trading the different cryptocurrencies. The reasons for which the SEC hesitates are the exact reasons for why the SEC should begin to consider heavier regulation over cryptocurrency exchanges. The rise in cryptocurrency investment follows the transformation of cryptocurrency from the utility-based investment it was originally devised to be to an alternative to securities trading on an exchange. Given cryptocurrency's current role in the world of investing, the SEC, if it wishes to keep in line with its mission, should extend its oversight regulation to cryptocurrency exchanges as well. If the SEC fails to act, the SEC leaves

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unsophisticated and vulnerable investors at risk should they choose to invest in crypto rather than in traditional securities. With the gamification of investing, the impact investing now has on our culture, cryptocurrency's ever-growing popularity and hold on the media, the lack of regulation has the potential to result in severe losses for our citizens. This paper explores the reasons why the SEC should explore regulation by analyzing the purpose and risks associated with the purchasing, and investing, in cryptocurrencies to conclude that such regulation would ultimately fall within the goals and purposes of the SEC.

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INTRODUCTION

Since the inception of Bitcoin and the blockchain, cryptocurrencies (hereainafter "crypto") have gradually risen to prominence over the last few years. For example, one in ten people are reported to invest in crypto.[1] About 65% of those investors are relatively new to the concept and a majority cite the ease of being able to purchase crypto as the main reason for deciding to invest.[2] With the increase in crypto's popularity, the rise in crypto exchanges makes sense to help new investors easily purchase these digital currencies.

Congress empowers the Securities and Exchange Commission ("SEC") to make the market a safer place for individual investors,[3] but the SEC has been forced to find a balance. How do we protect investors? Typically, the SEC only protects investors in securities as defined in the Securities Act of 1933.[4] But, presently, an investor has easy access to investment opportunities in both securities and cryptocurrencies, raising the question of what is the SEC's role in protecting investors in crypto in the absence of a clearly stated legal authority to do so.

This paper will analyze cryptocurrencies in light of their inherent investment risks as compared to those the SEC traditionally seeks to protect. Part I will speak to what the SEC considers a "security" for the purposes of investor protections under the Securities Act and Securities Exchange Act. Part II will then speak to the inherent risks associated with investing in traditional securities through exchanges. Part III will review the current state of investing and its gamification, and will compare cryptocurrency and security exchange platforms. Part IV will introduce the current state and issues surrounding regulation of cryptocurrency. Lastly, Part V will analyze why the SEC should consider regulation over exchanges of cryptocurrencies.

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[1] Carmen Reinicke, *1 in 10 people currently invest in cryptocurrencies, many for ease of trading, CNBC survey finds*, CNBC (Aug. 24, 2021, 1:00 PM), https://www.cnbc.com/2021/08/24/1-in-10-people-invest-in-cryptocurrencies-many-for-ease-of-trading.html.

[2] *Id.*

[3] *See The Role of the SEC*, SEC, https://www.investor.gov/introduction-investing/investing-basics/role-sec (last visited Mar. 20, 2022).

[4] *See* Elvis Picardo, *Understanding the SEC*, INVESTOPEDIA (Feb. 23, 2022), https://www.investopedia.com/articles/investing/112914/understanding-sec.asp.

I. THE *HOWEY* TEST AND HOW CRYPTOCURRENCIES FALL IN LINE

For the SEC to have the power to regulate cryptocurrency, a particular cryptocurrency must qualify as a security as defined in the Securities Act of 1933 and the Securities Exchange Act of 1934. Under the former, a security is defined as "any note, stock . . . [or] investment contract . . . ."[5] The Securities Exchange Act defines a security in a slightly different manner,[6] but courts use similar interpretations.[7] Cryptocurrency, a digital asset or currency built on the decentralized blockchain network,[8] does not clearly fall within the definition of a security, raising questions of whether the SEC would have regulatory oversight.

The big issue surrounding cryptocurrency regulation involves the SEC's hesitancy to classify cryptocurrency as a security.[9] To do so, the SEC would need to fit the idea of cryptocurrency under the definition of "investment contract," as Congress intentionally left ambiguity in the term to cover any future financial instrument.[10] In 1946, the Supreme Court first began to define "investment contracts" in *SEC v. W. J. Howey Co*.[11] The Court there determined a list of factors it would use to classify a transaction as a security: (1) whether there is an investment of money; (2) whether there is an expectation of profits from the investment; (3) whether the investment of money is in a common enterprise; and (4) whether any profit comes from the efforts of a promoter or third party.[12]

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[5] Securities Act of 1933 § 2(a)(1), 15 U.S.C. § 77b(a)(1).

[6] Securities Exchange Act of 1934 § 3(a)(10), 15 U.S.C. § 78c(a)(10).

[7] *See, e.g.*, Landreth Timber Co. v. Landreth, 471 U.S. 681, 686 n.1 (1985).

[8] Jake Frankenfield, *What is Cryptocurrency?*, INVESTOPEDIA (Jan. 11, 2022), https://www.investopedia.com/terms/c/cryptocurrency.asp.

[9] *See SEC Commissioner Dissents in Crypto Enforcement Action*, Fenwick (Sept. 20, 2020) https://www.fenwick.com/insights/publications/sec-commissioner-dissents-in-crypto-enforcement-action.

[10] *See* SEC v. W. J. Howey Co., 328 U.S. 293, 297–99 (1946).

[11] *Id.* at 298–99.

[12] *See id.* at 301 ("The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value.").

Importantly, some circuits have incorporated the legislative intent of the Securities Act of 1933 into their analysis of the *Howey* test.[13] The Ninth Circuit specifically did not want the *Howey* test to limit the protections afforded to investors under the Securities Act of 1933.[14] A few decades after *Howey*, the Ninth Circuit stated:

> [I]n light of the remedial nature of the legislation, the statutory policy of affording broad protection to the public, and the Supreme Court's admonitions that the definition of securities should be a flexible one, the word "solely" should not be read as a strict or literal limitation on the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities.[15]

Whether cryptocurrencies fit within the *Howey* test is unclear. First, there is much debate over whether crypto is a form of investment of money.[16] But, not all money put into cryptocurrency is transferred into a utilizable token.[17] For example, initial coin offerings ("ICO") are a method in which investors specifically assist a future cryptocurrency project through crowdsourcing, prior to the release of the coin to the public.[18] ICOs mirror initial public

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[13] *See* SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 480–81 (9th Cir. 1973).

[14] *Id.* at 481–82.

[15] *Id.* at 482.

[16] *See* Han Zhu, *Cryptocurrency and the Howey Test*, ZELL ENTREPRENEURSHIP CLINIC (Feb. 8, 2018), https://entrepreneurship.law.umich.edu/cryptocurrency-and-the-howey-test/#_ftn5 ("[I]f the coin is created for building up a decentralized open source ecosystem then the money you put in should probably be characterized as a "donation", rather than an "investment", which already flunks the first prong of the Howey test.").

[17] *See* SEC, RELEASE NO. 81207, REPORT OF INVESTIGATION PURSUANT TO SECTION 21(A) OF THE SECURITIES EXCHANGE ACT OF 1934: THE DAO (July 25, 2017), https://www.sec.gov/litigation/investreport/34-81207.pdf.

[18] *See* Steven Russolillo, *Initial Coin Offerings Surge Past $4 Billion–and Regulators Are Worried*, WALL ST. J. (Dec. 14, 2017, 4:54 AM), https://www.wsj.com/articles/initial-coin-offerings-surge-past-4-billionand-regulators-are-worried-151323519.

offerings but substitute a stock for a cryptocurrency,[19] and thus are easier to classify as a security. But the ability to use something as an investment is not alone enough to satisfy the first prong. Courts have found that the primary purpose of the investment asset is critical.[20] Thus, the SEC has an issue when a given cryptocurrency has a utility function outside of investment.[21]

The third prong of the *Howey* test is arguably the most difficult for a blanket application of cryptos as a security. With the rise of "stablecoins"—cryptocurrencies that are tied to a reserve asset that offer price stability, such as the U.S. Dollar[22]—it is clear that not all cryptocurrencies are intended to be used as an investment. But now cryptocurrency exchanges are springing up more and more each day, allowing anyone to invest or purchase cryptocurrency.[23] In July of 2021, Coinbase—a leading crypto exchange—announced their "lend" program, where users can expect a 4% interest payment on their value of stablecoin.[24] Arguably, this program may now be considered an investment of money with a clear expectation of profits. But it remains unclear whether the SEC will blanketly oversee such programs.

With these new exchanges available to purchasers, more and more opportunities for investment become accessible and a reasonable expectation of profit is likely to follow. Although each individual cryptocurrency may not fit into the definition of a security under the *Howey* test, their advertisement and use on a certain exchange

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[19] Jake Frankenfield, *Initial Coin Offering (ICO)*, INVESTOPEDIA (Jan. 3, 2022), https://www.investopedia.com/terms/i/initial-coin-offering-ico.asp.

[20] *See* United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 859–60 (1975) (holding acquiring housing as an investment does not satisfy the first prong of the *Howey* test because the primary purpose of purchasing housing is for consumption).

[21] *See* Zhu, supra note 16 (explaining Project Ethereum, and how its coin—ether—provides a programming language for use in smart contracts).

[22] Adam Hayes, *Stablecoin*, INVESTOPEDIA (Jan. 27, 2022), https://www.investopedia.com/terms/s/stablecoin.asp.

[23] *See, e.g., Press Release: NyX Exchange Set To Officially Launch To Disrupt The Crypto Trading Space*, MarketWatch (Apr. 14, 2022), https://www.marketwatch.com/press-release/nyx-exchange-set-to-officially-launch-to-disrupt-the-crypto-trading-space-2022-04-14.

[24] Jeff John Roberts, *Coinbase Jumps Into High-Yield Crypto Game with 4% Interest on USDC*, DECRYPT (June 29, 2021), https://decrypt.co/74770/coinbase-high-yield-usdc.

may meet the necessary criteria for the SEC to step in and regulate such cryptocurrency activity.[25] With the incongruent application of the *Howey* test possible, the SEC should look at regulating dominating exchanges, and mirroring the protections available when investing in traditional securities.

II. THE STORY OF THE SEC AND ASSESSING THE RISKS

Since its origin on June 6, 1934, the SEC has been committed to their mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation.[26] Then-President Franklin D. Roosevelt signed the Securities Exchange Act and created the SEC as a response to the lack of enforcement of security regulations at the federal level,[27] and the development of the SEC has centered around the empowerment of the individual to participate in the economy as an investor.[28]

At that time, right as the dust of the Great Depression began to settle, investors were "protected" by the Blue Sky Laws.[29] These basic disclosure laws were weak in both terms and enforcement, all while comforting new investors with a false sense of security and inviting high-level manipulation of the market.[30] Brokers, market makers, and bankers began forcing prices higher and higher before unloading trading shares on the eager public, and the market ultimately could not withstand the volatility.[31] The public looked to the U.S. government for social programs and reform, as the losses ravaged both domestic and world finances, and Congress responded by passing the Glass-Steagall Act and the Securities Exchange Act.[32]

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[25] *See* Zhu, *supra* note 16.

[26] *What We Do*, SEC. AND EXCH. COMM'N, https://www.sec.gov/about/what-we-do (last visited Mar. 20, 2022).

[27] *See* James Chen, *Securities and Exchange Commission (SEC)*, INVESTOPEDIA (July 15, 2020), https://www.investopedia.com/terms/s/sec.asp.

[28] *See Our Goals*, SEC. AND EXCH. COMM'N, https://www.sec.gov/our-goals (last visited Mar. 25, 2020).

[29] Andrew Beattie, *The SEC: A Brief History of Regulation*, INVESTOPEDIA (Feb. 3, 2022), https://www.investopedia.com/articles/07/secbeginning.asp.

[30] *Id.*

[31] *Id.*

[32] *See SEC: Securities and Exchange Commission*, HISTORY (Dec. 6, 2019), https://www.history.com/topics/us-government/securities-and-exchange-commission.

The legislation passed marked the federal government's commitment to rebuild investor confidence, and the SEC stood at the forefront. The Securities Exchange Act equipped the SEC with the power to register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation's securities self-regulatory organizations.[33] Using their new authority, the SEC implemented major reforms on Wall Street and enforced requirements of greater transparency on corporations.[34] They also went on to challenge the stereotypical investor profile by requiring individuals to prove their financials before investing in more volatile opportunities by shifting the standard for "accredited investors."[35]

Financial risk refers to any uncertainty with respect to a person's investments that has the potential to negatively impact their financial wellbeing.[36] Given such definition, "all investments carry some degree of risk," whether it be risk stemming from market conditions, corporate expansions, mergers and acquisitions, political tension, the liquidity of an investment, or the structure of an investor's portfolio.[37] To summarize, financial markets are constantly responding to "macroeconomic forces, changes to the market interest rate, and the possibility of default by sectors or large corporations,"[38] and the market faces national and global pressures. But now, this market no longer just concerns the trading of stocks and bonds, but also extends to the exchange of cryptocurrency. As the traditional securities marketplace changes, the crypto marketplace follows suit.

In regard to investment decisions, individuals are encouraged to consider the risks and rewards associated with a particular investment or asset class. Investors are generally more willing to buy riskier investments, thus exposing themselves to greater financial loss, should the potential reward of higher returns be worth it. For

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33 *The Laws That Govern the Securities Industry*, SEC, https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry (last visited Mar. 20, 2022).

34 *See* Beattie, *supra* note 29.

35 *Id.*

36 Adam Hayes, *Financial Risk*, INVESTOPEDIA (Mar. 24, 2021), https://www.investopedia.com/terms/f/financialrisk.asp.

37 *The Reality of Investment Risk*, FINRA, https://www.finra.org/investors/learn-to-invest/key-investing-concepts/reality-investment-risk (last visited Mar. 20, 2022).

38 Hayes, *supra* note 36.

example, stocks typically bring the highest return of the historically prevalent investment options—corporate bonds, treasury bonds, cash/cash equivalents—and as an asset class, stocks typically come with the greatest amount of risk.[39] This is not to say that stocks will always outperform bonds or that bonds will never bring more risks than will stocks, as the volatility of the financial market does come with the difficulty of consolidating its movements into an exact pattern, but historically speaking, such is the case.

Additionally, investors practice different investment strategies as a way to respond to the risks inherent in the marketplace. Some traders hope to capitalize on the market's volatility for profit, while more conservative traders favor the long-term buy-and-hold, where the investment holders hope to withstand the fluctuations of the market by maintaining their investments for a longer period of time. Short-term or day traders depend on the "second-to-second, minute-to-minute" movement in the market to optimize their investments and leave with the most money possible.[40] Of course, short-term trading introduces the threat of wide-scale market manipulation that affects all kinds of investors at times unfairly.[41] The SEC has recognized the profitability of stock manipulation to be a problem worth bringing about regulations against, as "when left unchecked, short selling can artificially depress share prices and impair market efficiency."[42] Popular investments, gaining traction at times because of social media's hold on investors, take off randomly, leading to market skews, building and breaking corporations within days or even hours. For example, on January 28, 2021, millions of Reddit users, presumably self-directed investors, spurred market disruption by swarming GameStop, all investing on the stock that was being

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[39] *The Reality of Investment Risk*, *supra* note 37.

[40] Claire Boyte-White, *Volatility From the Investor's Point of View*, INVESTOPEDIA (Nov. 19, 2021), https://www.investopedia.com/ask/answers/010915/volatility-good-thing-or-bad-thing-investors-point-view-and-why.asp.

[41] *See A new theory suggests that day-to-day trading has lasting effects on stockmarkets*, THE ECONOMIST (Aug. 14, 2021), https://www.economist.com/finance-and-economics/2021/08/14/a-new-theory-suggests-that-day-to-day-trading-has-lasting-effects-on-stockmarkets.

[42] John D. Finnerty, *Short Selling, Death Spiral Convertibles, And The Profitability Of Stock Manipulation* 3 (Mar. 2005), https://www.sec.gov/comments/s7-08-08/s70808-318.pdf (comment on proposed rule on "naked" short selling anti-fraud).

heavily bet against by hedge funds who predicted the decline of GameStop's stock prices.[43] This movement resulted in a short squeeze—the value of GameStop stock increased dramatically in a short period of time, forcing traders who followed the hedge funds' prediction to buy the higher priced stock to forestall greater losses.[44] The effects of the GameStop market disruption were great, leading to disastrous financial losses for hedge funds and traders who bet against GameStop—totaling five billion dollars over the course of two weeks.[45]

There is no eliminating investment risk; investors qualify the risks that come with investing based on the potential for financial growth. However, the practice of asset allocation and diversification can help manage both systemic and non-systemic risks.[46] The goal of asset allocation is to reduce the risk of major losses that can result from over-investing in one asset class, such as stocks, bonds, real estate, cash, and now perhaps crypto.[47] And in diversification, the investor divides the money invested in a particular asset class among the different types of investments that belong to said class.[48] The SEC wants investors to spread the money they are willing to invest across mediums, but with the integration of cryptocurrency and the increased accessibility to digital wallets, the SEC hesitates to act on their jurisdiction to "protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation"[49] because of its subjective stance regarding the risks inherent to investing in and trading the different cryptocurrencies.[50]

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[43] Marquis Cardwell, *The Effects of the GameStop Market Disruption*, USC GOULD'S BUS. L. DIG. (May 23, 2021), https://lawforbusiness.usc.edu/the-effects-of-the-gamestop-market-disruption/.

[44] *Id.*

[45] *Id.*

[46] *The Reality of Investment Risk*, *supra* note 37.

[47] *See id.*

[48] *Id.*

[49] *See* Jennifer Schonenberger, *Crypto regulation is coming, just not this year: SEC's Peirce*, YAHOO FINANCE (Feb. 3, 2022), https://finance.yahoo.com/news/crypto-regulation-coming-just-not-this-year-se-cs-pierce-172824069.html; *see also About the SEC*, SEC. AND EXCH. COMM'N (Nov. 22, 2016), https://www.sec.gov/about.shtml.

[50] *See* Todd Phillips, *The SEC's Regulatory Role in the Digital Assets Markets*, CTR. FOR AM. PROGRESS (Oct. 4, 2021), https://www.americanprogress.

III. HOW SEC REGULATES STOCK EXCHANGES IN RESPONSE TO GAMIFICATION OF EXCHANGE

A. *SEC & Securities Exchanges*

The development and popularization of online brokerages that utilize digital engagement practices, with their integration of social networking, games, competition, visual cues, etc., have challenged the SEC to draft new rules and regulations for Wall Street. This "gamification" of stock exchanges obscures the price of investing and the gravity of each investment decision, as the new investor can easily be misled by "rosy projections of profit" set forth by technologies that likely understate the risk of a particular investment or the odds of yielding profit.[51]

These online brokerages have resulted in the democratization of investing, especially with the space becoming more inviting to younger and more diverse individuals simply looking to plan for retirement using no- and low-minimum investment opportunities.[52] This new investor has little to no market knowledge or experience and often looks to its online brokerage for financial advice, which offers its own set of threats if these platforms fail to rise to the demand. In fact, the SEC has already punished online brokerages for their irresponsible engagement with their millions of clients, as overwhelming loads of information are fed to the user unchecked or intentionally incorrect.

For example, on December 17, 2020, the SEC brought a claim against Robinhood alleging that the stock trading app "deciev[ed] customers about how [it] makes money and fail[ed] to deliver the promised best execution of trades."[53] Through gamification

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org/article/secs-regulatory-role-digital-asset-markets/ (urging for SEC regulation in digital asset markets)/.

51 Thomas Franck & Maggie Fitzgerald, *SEC steps up research intro brokers' 'gamification' of trades, Chair Gary Gensler says*, CNBC (Aug. 27, 2021, 12:30 PM), https://www.cnbc.com/2021/08/27/sec-steps-up-research-into-gamification-of-trading-with-online-brokers-gary-gensler-says.html.

52 Mark Lush et al., *Investing 2020: New Accounts and the People Who Opened Them* 2 (Feb. 2021) [hereinafter, "FINRA/NORC Study"], https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf.

53 Maggie Fitzgerald, *SEC Charges Robinhood with Misleading Customers About How it Makes Money*, CNBC (Dec. 17, 2020, 8:57 AM)

strategies and aggressive tactics, Robinhood had successfully manipulated its inexperienced investors, and the SEC challenged them on it.[54] And as a result of "market manipulation" and "gamification tactic" allegations and charges, Robinhood has parted ways with its infamous celebratory confetti graphics that followed each trade made by the user.[55] The confetti was quickly made to be the scapegoat for a greater problem of gamification that still exists, and Robinhood's hold on the investing world has forced security and cryptocurrency exchange platforms alike into this arena that relies heavily on tactics that motivate the user to invest.[56]

B. *Securities vs. Cryptocurrency Exchanges: The evolution of crypto exchanges calls for concern as investments become easier and more accessible*

Online marketplaces like Coinbase, Crypto.com, and Gemini democratize cryptocurrency exchange by capitalizing on the "gamification" stage set forth by securities exchange platforms.[57] The gamification of trading has made cryptocurrency feel less intimidating for new investors.[58] Additionally, the relevance of cryptocurrency in pop culture, particularly through Crypto.com's marketing efforts involving Lebron James and Matt Damon, creates an irresistible urge to get involved in the market.[59] The combination of

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https://www.cnbc.com/2020/12/17/sec-charges-robinhood-with-misleading-customers-about-how-it-makes-money.html.

[54] *See id.*

[55] *See* Nicole Casperson, *Robinhood Drops the Confetti, but Advisers Aren't Convinced*, INV. NEWS (Apr. 6, 2021), https://www.investmentnews.com/robinhood-drops-the-confetti-but-advisers-arent-convinced-204828.

[56] *See id.* ("While removing confetti and other forms of eye candy may be a sop to the regulator, it changes very little . . . If anything, it's the duller-than-dishwater experience of most financial platforms that has opened the door for dynamic and engaging platforms like Robinhood . . . to thrive.").

[57] *See* Casperson, supra note 55.

[58] *See id.*; *see also* Catherine Barkley, *Crypto Novices Learn Quickly Through Gamification*, CRYPTONEWS (Aug. 18, 2021, 6:47 PM), https://cryptonews.com/news/crypto-novices-learn-quickly-through-gamification-11504.htm.

[59] Yvonne Lau, *Crypto.com Hires LeBron James in its $1 Billion Bid to Become as Big as Instagram*, FORBES (Jan. 28, 2022, 3:10 PM), https://fortune.com/2022/01/28/lebron-james-crypto-com-marketing-deal/ ("Basketball star Lebron James is the latest celebrity to team up with cryptocurrency exchange

inexperienced investors and online, independent cryptocurrency exchanges replicate the problem that accompanies the new wave of investing through online securities brokerages that utilize digital engagement practices. The only difference between the two is the SEC's involvement.[60]

Both cryptocurrency and securities investors battle with the urgency conveyed by their platform's user interface that stirs up an "interface-invented stress."[61] The association of color with performance and the line graph that maps performance, along with the ability to zoom into the market's movement over the hour, day, week, month, and year, create a desperation for information and action within the user.[62] Generally, investors who access their accounts primarily through mobile apps report making one to three more trades per month than those who invest through a website.[63] This is not because investing is more attractive to the mobile trader, but because these mobile apps create a marketplace that is addictive and evoke an emotional response.[64] These gamification tactics are under strict scrutiny and review by the SEC for securities exchange,[65] so why are cryptocurrency investors not protected in the same capacity?

Crypto.com on its splashy marketing blitz that already includes actor Matt Damon and naming rights for a Los Angeles sports arena.").

[60] *See* Phillips, *supra* note 50 (urging for SEC regulation in digital asset markets).

[61] *See* Mark Wilson, *How Robinhood Turns Stock Trading into a Game that it Always Wins,* FAST CO. (Feb. 9, 2021), https://www.fastcompany.com/90602455/how-robinhood-turns-stock-trading-into-a-game-that-it-always-wins (describing how Robinhood's user interface, especially the dashboard, creates a "particularly urgent [experience], every time you load the app.").

[62] *See id.*

[63] MARK LUSH ET AL., INVESTING 2020: NEW ACCOUNTS AND THE PEOPLE WHO OPENED THEM 11 (Feb. 2021), https://www.finrafoundation.org/sites/finrafoundation/files/investing-2020-new-accounts-and-the-people-who-opened-them_1_0.pdf [hereinafter FINRA/NORC Study].

[64] *See generally* Wilson, *supra* note 61.

[65] *See SEC Requests Information and Comment on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology*, SEC. AND EXCH. COMM'N (Aug. 27, 2021), https://www.sec.gov/news/press-release/2021-167.

IV. THE MULTI-AGENCY APPROACH TO BLOCKCHAIN ASSET REGULATION

Market participants are primarily interested in the actions of two U.S. regulatory agencies—the SEC and the Commodity Futures Trading Commission ("CFTC")—that are expected to shape the future of blockchain regulation, but both have yet to provide substantial regulatory compliance guidance.[66] However, the SEC and the CFTC are not alone in this regulatory pursuit. Several other agencies have signaled intent to engage with this regulatory framework, including the Financial Crimes Enforcement Network ("FinCEN"),[67] the Office of the Comptroller of the Currency ("OCC"),[68] and even the Federal Reserve System.[69] Each agency is expected to carve out a section of the regulatory regime. While the following generalizations are painting with a broad stroke, we can infer the kinds of regulations that each agency may deploy based on its current objectives. The SEC enforces securities laws, while the CFTC regulates futures and swaps markets.[70] Below we provide examples of how both agencies have approached regulating digital assets. On the other hand, FinCEN focuses on money service businesses and anti-money laundering laws.[71] FinCEN's involvement may implicate

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[66] *See* John Joy, *The Race to Regulate Crypto: CFTC vs. SEC*, JURIST (Nov. 24, 2021, 7:44 AM), https://www.jurist.org/commentary/2021/11/john-joy-crypto-sec/ ("There is no shortage of interested parties with both the [SEC] and the [CFTC] vying for the role of new crypto-sheriff in town.").

[67] S*ee* Evan Weinberger, *Treasury to Wrap Crypto Anti-Money Laundering Rules by Fall*, BLOOMBERG L. (June 11, 2021, 1:28 PM), https://news.bloomberglaw.com/securities-law/treasury-to-wrap-crypto-anti-money-laundering-rules-by-fall (describing FinCen and the Federal Reserve's joint rules that "would clarify that the definition of 'money' under the Bank Secrecy Act applies to virtual currencies").

[68] *See OCC Clarifies Bank Authority to Engage in Certain Cryptocurrency Activities and Authority of OCC to Charter Nation Trust Banks*, OFFICE OF THE COMPTROLLER OF CURRENCY (Nov. 23, 2021), https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-121.html# ("[banks] must demonstrate that they have adequate controls in place before they can engage in certain cryptocurrency, distributed ledger, and stablecoin activities.").

[69] *See* Weinberger, *supra* note 67.

[70] *See* Joy, *supra* note 66 (describing the regulatory power wielded by the SEC and the CFTC, respectively).

[71] *See* 31 U.S.C. § 310(b)(2)(A)–(J) (laying out the role and duties of FinCEN).

large exchange platforms that currently offer brokerage services to retail investors. The OCC regulates banks that operate within the country,[72] while the Federal Reserve System may focus on the payments industry.[73]

There are few examples of regulatory action in this space. In 2018, the SEC filed a complaint against Blockvest, seeking injunctions and the return of ill-gotten gains in addition to interest and penalties because the company falsely claimed that its initial coin offering was SEC approved.[74] In a 2017 investigation report, the SEC provided loose guidance to different kinds of important blockchain market participants including companies engaged in initial coin offerings, decentralized autonomous organizations, and exchanges.[75] The agency stressed that such "registration requirements are designed to provide investors with procedural protections and material information necessary to make an informed investment decision."[76] In fact, security regulations on initial coin offerings have extended even to the celebrity who advertises the initial coin offerings.[77]

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[72] *See What We Do*, OFFICE OF THE COMPTROLLER OF CURRENCY, https://www.occ.treas.gov/about/what-we-do/index-what-we-do.html# (last visited Mar. 24, 2022) ("The OCC ensures that national banks and federal savings operations operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations.").

[73] *See* BD. OF GOVERNORS OF THE FED. RESERVE SYS., MONEY AND PAYMENTS: THE U.S. DOLLAR IN THE AGE OF DIGITAL TRANSFORMATION 1 (Jan. 2022) ("The Federal Reserve . . . works to maintain the public's confidence in fostering monetary stability, financial stability, and a safe and efficient payment system.").

[74] *See SEC Stops Fraudulent ICO That Falsely Claimed SEC Approval*, SEC. AND EXCH. COMM'N (Oct. 11, 2018), https://www.sec.gov/news/press-release/2018-232.

[75] *See SEC Stops Fraudulent ICO That Falsely Claimed SEC Approval*, SEC (Oct. 11, 2018), https://www.sec.gov/news/press-release/2018-232; *SEC Issues Investigative Report Concluding DAO Tokens, a Digital Asset, Were Securities*, SEC (July 25, 2017), https://www.sec.gov/news/press-release/2017-131; SEC, *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The Dao* (July 25, 2017), https://www.sec.gov/litigation/investreport/34-81207.pdf.

[76] *See id.*

[77] *See* Floyd Mayweather Jr., Release No. 33-10578, 2018 WL 6266203, at *2 (Nov. 29, 2018) (describing Mayweather's involvement in social media advertising of initial coin offerings and charging him with violating § 17 (b) of the Securities Act).

However, as discussed previously, the SEC is not the only sheriff in town. In fact, "[u]ntil Congress clarifies the matter, the CFTC has concurrent authority, along with other state and federal administrative agencies, and civil and criminal courts, over dealings in virtual currency."[78] Specifically, the "CFTC may exercise its enforcement power over fraud related to virtual currencies sold in interstate commerce."[79] This is because "virtual currencies are [considered to be] commodities subject to the CFTC's regulatory protections."[80] Regarding derivative contracts, the CFTC has implemented a self-certification process for exchanges offering bitcoin derivatives.[81] The CFTC maintains a monitoring role, analyzing market development, changes in positions over time, open interest, stress-testing positions, and other technical indicators.[82] Despite this hands-off approach, the regulatory agency has continued to warn investors of high volatility and risk involved in this trading activity.[83] The CFTC's hands-off monitoring and analysis position seems characteristic of current macro U.S. regulatory trends regarding sophisticated burgeoning crypto technologies and financial products.

Agencies have yet to begin widespread regulation of such digital assets but have been warning of risks for some time. The CFTC identified several categories of key risks back in 2017.[84] Some risks that the CFTC highlights include market manipulation, lack of transparency and governance issues, illicit transactions, cybersecurity, systems failures, macroprudential economic risk, and resource

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[78] Commodity Futures Trading Comm'n v. McDonnell, 287 F. Supp. 3d 213, 217 (E.D.N.Y.), *adhered to on denial of reconsideration*, 321 F. Supp. 3d 366 (E.D.N.Y. 2018).

[79] *Id.*

[80] *Id.* at 229.

[81] *See CFTC Backgrounder on Self-Certified Contracts for Bitcoin Products*, CFTC, https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/bitcoin_factsheet120117.pdf (last accessed Mar. 25, 2022) (outlining the self-certification process and "the CFTC's role in oversight of virtual currencies.").

[82] *See id.*

[83] *See CFTC Announces Bitcoin Derivatives Self-Certification Process and New Bitcoin Contracts on Three Futures Exchanges* (Dec. 5, 2017), Practical Law w-011-9547.

[84] *A CFTC Primer on Virtual Currencies*, CFTC 15–20 (Oct. 17, 2017), https://www.cftc.gov/sites/default/files/idc/groups/public/documents/file/labcftc_primercurrencies100417.pdf.

competition.[85] However, the CFTC is also quick to recognize the "significant potential" that digital assets offer, including transaction speed, efficiency, democratization of markets, enhanced security, and greater asset liquidity.[86] Like the CFTC, the SEC has also issued several warnings to investors on the widespread risks inherent in cryptocurrency investing. The agency even went so far as to create their own mock initial coin offering on a HoweyCoin.com website, promising a too good to be true investment opportunity.[87]

Large consumer friendly exchanges, like Coinbase, have taken affirmative steps to mitigate some risks identified by the CFTC and other agencies. These exchanges are selective in the cryptocurrency projects they list, oftentimes requiring that the projects meet certain criteria prior to listing.[88] Coinbase has made clear their standard listing evaluation framework, which includes legal, compliance, and technical security eligibility requirements.[89] Coinbase's key concerns include projects comprised of complex code that has not undergone a security audit from a reputable auditing firm, projects associated with prohibited businesses, and projects with a significant degree of centralization.[90] Such private industry "regulation" can mitigate market risks of governance issues, cybersecurity, systems failures, market manipulations, and even illicit transactions. Further, leading cryptocurrency exchanges, such as Coinbase, EToro, and Bittrex, are members of the Crypto Rating Council, which provides blockchain market participants with tools and analysis in navigating the nascent and mostly uncharted regulatory regime in this sector.[91]

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[85] *See id.*

[86] *See* CFTC, DIGITAL ASSETS PRIMER 15 (Dec. 2020), https://www.cftc.gov/media/5476/DigitalAssetsPrimer/download.

[87] *See The SEC Has an Opportunity You Won't Want to Miss: Act Now!*, SEC (May 16, 2018), https://www.sec.gov/news/press-release/2018-88 (describing that the website was set up to "mimic a bogus coin offering to educate investors about what to look for before they invest in a scam").

[88] *See A Guide to Listing Assets on Coinbase*, COINBASE (May 3, 2021), https://blog.coinbase.com/a-guide-to-listings-assets-on-coinbase-2556fee4efa6 (describing Coinbase's listing criteria).

[89] *See id.*

[90] *See id.*

[91] *See About Us*, CRYPTO RATING COUNCIL, https://www.cryptoratingcouncil.com/ (last visited Mar. 25, 2022).

V. MARKET PARTICIPANT SENTIMENT TOWARDS REGULATION

U.S. regulatory action may well prove an asset for market participants in the blockchain space. On CNBC's show "Squawk Box," the Chief Executive Officer of Binance explained that regulation could lead to mass adoption of crypto technologies and can elevate his company to be among the most valuable in the world.[92] The Binance Exchange has been centralizing its organization, hiring former regulators, and setting up regional offices and branches to prepare for incoming regulation.[93] Although Binance is only one large exchange of many, Binance's welcoming attitude towards U.S. regulatory action is not unique. The Foley & Lardner LLP 2018 Cryptocurrency Survey found that 84% of cryptocurrency industry insiders indicated that "initial offerings of cryptocurrencies should be regulated by the federal government, states, or both."[94] Additionally, 89% of respondents agree that the industry should implement formal self-regulation standards, "with most believing that any model of self-regulation should be subject to regulatory oversight."[95] Lack of legal certainty emerged as a widespread concern as 72% of respondents held the belief that the "industry does not have a well-grounded understanding of existing federal and state regulation of financial markets or financial services."[96] Therefore, industry insiders appreciate the value that comes with regulation and welcome federal government action and oversight in the blockchain space.

V. JUSTIFICATION FOR THE EXTENSION OF EXCHANGE REGULATION OVER CRYPTOCURRENCIES

The comparison of the inherent risk of both crypto and traditional exchanges speaks to why the SEC should consider regulation over the exchange of crypto. Moreover, "[w]hen it comes to risk,

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92 *See Squawk Box: Regulation Is Good for the Crypto Industry* (CNBC television broadcast Nov. 15, 2021), https://www.cnbc.com/video/2021/11/15/regulation-is-good-for-the-crypto-industry-says-binance-ceo.html.

93 *See id.*

94 FOLEY & LARDNER LLP, 2018 CRYPOTCURRENCY SURVEY 2 (2018), https://www.foley.com/en/files/uploads/Foley-Cryptocurrency-Survey.pdf.

95 *Id.*

96 *Id.*

here's a reality check: All investments carry some degree of risk."[97] The level of inherent risk associated with cryptocurrency exchange is similar to any other traditional market or exchange and is, therefore, enough to warrant the SEC's attention.[98] One can argue that there is either a greater or lesser risk accompanying the exchange of cryptocurrencies; however, the inevitability of some level of risk remains. This inevitable risk signals a need for regulation, especially when considering the responsibility of our governmental agencies to protect the public.

The risks of crypto do tend to fall in line with securities; and therefore, crypto should fall under the regulatory scope of the SEC.[99] Since Congress empowers the SEC to make the market a safer place for individual investors, the SEC must determine its own balanced approach to regulating crypto in a way that makes sense for exchanges, investors, and the public. While it has been discussed that investors are generally willing to buy riskier investments in traditional markets, thus exposing themselves to greater financial loss in exchange for higher opportunity, the same applies in the case of cryptocurrencies.[100] Therefore, regulatory agencies should be equally concerned with investors spreading money across cryptocurrency exchanges as they would be in traditional markets.

For example, we can look at crypto exchange platforms like Coinbase and Crypto.com and compare them with traditional trade and currency exchanges, like Robinhood. Both are user-friendly and bring an aspect of gamification to the investment and exchange of currencies.[101] So why can one set of users expect governmental protection through regulation while the other cannot? Investors in both crypto and traditional securities are utilizing tools that are being gamified in similar ways. Thus, regulation by the SEC should extend to crypto in a similar way.

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[97] Hayes, *supra* note 36.

[98] Compare *id.* (describing the different types of risk that traditional investments are exposed to including market risk, business risk, political risk, currency risk, and concentration risk) *with* DIGITAL ASSETS PRIMER, *supra* note 86, at 15 (presenting the risks associated with digital assets including market risk, disclosure risk, compliance risk, political risk, and currency risk).

[99] *See supra* note 98 and accompanying text.

[100] *See supra* note 35 and accompanying text.

[101] *See supra* Part III.B.

Agencies have been warning of risks of investing in digital assets for some time,[102] but these agencies have yet to begin to enact widespread regulation. As discussed, there is a potential that the CFTC and other agencies are waiting for crypto exchanges and crypto uses to unfold before hastily exercising their abilities or rights to regulate.[103] The "significant potential" that digital assets offer, including transaction speed, efficiency, democratization of markets, enhanced security, and greater asset liquidity, are all still developing day by day and may be altered by the interference of regulatory bodies.[104] While the SEC has yet to act on their jurisdictional power to "protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation,"[105] perhaps now is the time to take a more firm approach to the objective risks that the public is encountering given the risks that are growing in the sphere of crypto investing.[106]

CONCLUSION

In light of the inherent investment risks now associated with investing in crypto as compared to those which the SEC traditionally seeks to protect, as well as the growing congruency between exchanges for securities and crypto, the SEC should begin to consider heavier regulation over crypto exchanges.[107] The rise in crypto investment has transitioned crypto from the utility-based investment it was originally devised to be to an alternative to securities trading on an exchange.[108] As such, the SEC, if it wishes to keep in line with its purpose and goals, should extend its oversight regulation to crypto exchanges as well. If not, the SEC leaves the growing number of unsophisticated and vulnerable investors at risk should they choose to invest in crypto rather than in traditional securities. With the ever-growing popularity and buzzworthiness of crypto, the lack

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102 *See supra* nn. 84–87.

103 *See supra* Part IV.

104 *A CFTC Primer on Virtual Currencies, supra* note 81, at 15–20.

105 *About the SEC*, SEC. AND EXCH. COMM'N (Nov. 22, 2016), https://www.sec.gov/about.shtml.

106 *See* Mihailis E. Diamantis, *The Light Touch of Caveat Emptor in Crypto's Wild West*, 104 IOWA L. REV. ONLINE 113, 115–16, 119 (2020).

107 *See supra* Part III.

108 *See supra* Part I.

of regulation has the potential to result in severe losses for our citizens.