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PIFS



Implementing an Effective Cryptoasset Regulatory Framework in the United States

JUNE 2024



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This report was prepared by Hal Scott, Chairman and President of PIFS, and John Gulliver, Executive Director of PIFS. Connor Kortje and Jessie Stefanik, Senior Research Fellows at the Committee on Capital Markets Regulation, assisted in the preparation of the report.

In addition, PIFS assembled an advisory committee on cryptoasset market structure and regulation in the Unites States, the members of which assisted in the preparation of this report by reviewing drafts and providing commentary and insight to our team. The members of the advisory committee are listed on the next page.

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INTRODUCTION

This report is the second in a series of two reports by the Program on International Financial Systems dedicated to cryptoassets. The first report in this series was published in February 2023 ("Phase I Report") and overviewed the regulation of cryptoassets in the United States.[1] This report describes how other jurisdictions have begun to implement more effective regulatory frameworks for the issuance, trading, and custody of cryptoassets, identifies the costs to US markets and investors stemming from the lack of an effective framework in the US, and recommends reforms that can reposition the US as a leader in cryptoasset regulatory structure.

The US government has recognized that the rise of cryptoassets creates an opportunity to reinforce American leadership in global financial markets and at the technological frontier.[2] Providing regulatory clarity to the cryptoasset sector will help to ensure cryptoasset market participants from the US and around the world continue to entrust their resources to the private sector of the US economy, as the number and types of available cryptoasset products expand over time.

The report consists of three parts:

Part I compares the status of cryptoasset regulation in the United States with four major jurisdictions that have taken significant steps toward dedicated cryptoasset regulatory structures: (1) Japan, (2) the European Union, (3) Hong Kong, and (4) the United Kingdom. It also briefly reviews three other jurisdictions that have taken meaningful steps toward similar frameworks: (1) Australia, (2) Canada, (3) Singapore, and (4) the United Arab Emirates. The comparison shows that the US has fallen far behind other jurisdictions in implementing a regulatory structure that facilitates the efficient issuance, trading, and custody of cryptoassets while protecting cryptoasset investors and customers of cryptoasset service providers.

Part II identifies the current and future costs for US markets arising in part from the absence of an effective cryptoasset regulatory framework. We present data indicating that the share of global cryptoasset trading activity that occurs on US trading platforms and the share that is denominated in US-issued assets lag far behind traditional financial markets and are declining, limiting the ability of US cryptoasset investors and businesses to participate in those markets and lessening the ability of US policymakers and regulators to supervise and regulate them. We show that the US has lost and will continue to lose cryptoasset-related jobs and businesses, tax revenue, and other economic benefits associated with cryptoasset-related activities as a result in part of the ongoing regulatory

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[1] PROGRAM ON INTERNATIONAL FINANCIAL SYSTEMS ["PIFS"], A REVIEW OF CRYPTOASSET MARKET STRUCTURE AND REGULATION IN THE UNITED STATES (2023), https://www.pifsinternational.org/cryptoasset-market-structure-and-regulation-in-the-u-s/ ["PIFS Phase I Report"].

[2] Exec. Order No. 14067, Ensuring Responsible Development of Digital Assets, 3 C.F.R., 2022 Comp., 345, 347 (2023).

uncertainty in the US. We also show that despite the presence of domestic cryptoasset trading platforms and other service providers that comply with US laws, including anti-fraud, anti-money laundering, and relevant state law regimes, and that voluntarily implement additional rigorous customer protections, many US investors have relied on service providers that take advantage of regulatory gaps and that do not adhere to similar standards, suffering losses from fraud and mismanagement.

Part III recommends reforms that can reposition the US at the forefront of cryptoasset regulatory structure. These reforms include the creation of a workable framework for the registration and operation of cryptoasset trading platforms, clarifying the regulatory status of cryptoassets, and implementing workable custody requirements. Although some of our recommendations could require new legislation, we include recommendations for how US regulators can begin to address the most pressing problems pending the passage of necessary legislation.

I. A CROSS-JURISDICTIONAL COMPARISON OF CRYPTOASSET REGULATORY FRAMEWORKS

This Part I compares the status of cryptoasset regulation in the US with four major jurisdictions that have taken significant steps toward the establishment of cryptoasset regulatory frameworks: Japan, the European Union, Hong Kong, and the United Kingdom. In each case we review the regulation of (i) cryptoasset trading platforms, (ii) broker-dealers that execute transactions in cryptoassets, (iii) the issuance of new cryptoassets to investors and users, and (iv) cryptoasset derivatives. We also briefly highlight certain significant steps taken toward the establishment of similar frameworks by four additional jurisdictions: Australia, Canada, Singapore, and the United Arab Emirates. The comparison shows that the US has fallen far behind in establishing an effective cryptoasset regulatory framework.

1. The United States

The Phase I Report comprehensively described the status of cryptoasset regulation in the US. We review here the most significant issues and highlight important developments since the publication of the Phase I Report.

a. Trading platforms

There is no workable regulatory framework at the federal level for the registration or operation of cryptoasset trading platforms in the US, whether for securities, commodities, or payment instruments, with the exception of the Commodities Futures Trading Commission's ("CFTC") regulation of trading platforms for cryptoasset derivatives discussed in subpart (d) below. As a result, trading platforms operate under significant legal uncertainty and cryptoasset users and investors are subject to heightened risks of loss and fraud.

As discussed in the Phase I Report, the most important cryptoassets by market capitalization and trading volume – bitcoin and ether – as well as many other cryptoassets, are commodities and not securities under US law. Whereas securities exchanges are subject to the comprehensive enforcement and rulemaking authority of the SEC, spot commodities exchanges are not subject to the comprehensive regulatory jurisdiction of any US federal financial regulators. And even if a cryptoasset trading platform were to attempt to register as a securities exchange, it would be practically impossible for the platform to meet the registration requirements or the ongoing compliance requirements necessary to do so.[3] As only one of several examples of this problem, securities exchanges can only allow registered broker-dealers direct access to their platforms. But most cryptoasset trading platforms provide direct access to

[3] COMMITTEE ON CAPITAL MARKETS REGULATION ["CCMR"], *Cryptoasset Trading Platforms Cannot Register as Securities Exchanges* (2023), https://capmktsreg.org/wp-content/uploads/2023/06/CCMR-Crypto-Exchanges-Cannot-Register-With-the-SEC-06-06-23.pdf.

customers, and registered broker-dealers are effectively barred from executing transactions in cryptoassets due to the unworkable compliance requirements discussed in subpart (b) below.[4]

The policies of US regulators have exacerbated this situation. Initially, SEC Chair Gensler acknowledged that cryptoasset trading platforms are not subject to the regulatory framework for securities exchanges and that there is currently no regulatory framework for cryptoasset trading platforms.[5] But the SEC has not taken steps toward the establishment of such a framework. On the contrary, since the publication of the Phase I Report, the SEC has pursued enforcement actions against several cryptoasset trading platforms alleging that they are operating as unregistered securities exchanges,[6] despite the practical impossibility of a cryptoasset trading platform registering as such, and continued lack of clarity over which assets may be securities. Indeed, SEC Commissioner Peirce recently criticized the SEC for its unwillingness to provide interpretive guidance with respect to cryptoasset and its continued threats of enforcement actions.[7]

Furthermore, SEC rules and guidance from banking regulators impose major limitations on the provision of cryptoasset custody services by third party custodians. In particular, SEC staff accounting guidance (Staff Accounting Bulletin 121 ("SAB 121")) in effect requires major banks and broker-dealers to account for any cryptoassets that they hold as custodian as assets on their own balance sheets, which results in higher capital requirements.[8] This is a significant and unexplained departure from the accounting treatment of all other types of custodied assets, which are not recorded on the custodian's balance sheet. As Commissioner Peirce noted in a recent speech, the practical impact of this deviation from historical practice has been to limit institutions with expertise in safely custodying financial assets, particularly banks and registered broker-dealers, from offering cryptoasset custodial services at scale. It will also make it more likely that the customer's cryptoassets could be subject to the claims of the custodian in bankruptcy.[9] The Office of the Comptroller of the Currency ("OCC") has also stated that it will apply "heightened scrutiny" to the provision of cryptoasset custody services by OCC-supervised banks.[10] Major banks have cited this stance as another significant impediment to the

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[4] *Id*.
[5] *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide*, Part III, Virtual Hearing Before the Committee on Financial Services, U.S. House of Representatives 12 (May 6, 2021), https://www.govinfo.gov/content/pkg/CHRG-117hhrg44837/pdf/CHRG-117hhrg44837.pdf.
[6] *See, e.g.*, SECURITIES & EXCHANGE COMMISSION ["SEC"] Press Release, *SEC Charges Coinbase for Operating as an Unregistered Securities Exchange, Broker, and Clearing Agency* (June 6, 2023), https://www.sec.gov/news/press-release/2023-102.
[7] Hester M. Peirce, Comm'r, Sec. & Exch. Comm'n, Remarks at SEC Speaks: At the SEC: Nothing but Crickets (Apr. 2, 2024) (transcript available at https://www.sec.gov/news/speech/peirce-remarks-sec-speaks-040224).
[8] PIFS Phase 1 Report, *supra* note 1 at 45.
[9] Peirce, *supra* note 7.
[10] PIFS Phase 1 Report, *supra* note 1 at 44.

provision of cryptoasset custody services and, indeed, any services in the cryptoasset sector.[11] While various cryptoasset trading platforms have undertaken voluntarily to design and implement rigorous custody practices, others have not, and customers cannot rely on the market-wide standards that prevail in securities markets and therefore must assess platforms' practices individually. Barring traditional custodians from providing cryptoasset custody services unnecessarily increases the risks to customers, particularly retail customers, that stem from improper custody practices. Further, the SEC and OCC's current stance creates a competitive advantage for less regulated cryptoasset firms in the US, as well as foreign banks and broker-dealers.

b. Broker-dealers

The customer protection standards that govern securities broker-dealers do not apply to broker-dealers that route or execute transactions in the most valuable and commonly traded cryptoassets. As a result, these broker-dealers are not subject to the duty of best execution, qualified custodian requirements, or prohibitions on front running, that apply to an SEC-registered broker that routes or executes a transaction in a security for its customer. They are also not subject to the minimum margin requirements that apply to brokers who allow their customers to incur leverage. As discussed in Part III, while it may not be necessary to apply the same version of these standards in cryptoasset markets, currently customers have no overarching federal standards to rely on, though certain states, such as New York, have enacted custody requirements for brokers and other service providers.[12]

Furthermore, SEC rules have effectively prevented registered securities broker-dealers from handling any cryptoasset transactions. In particular, SEC guidance—the special purpose broker dealer ("SPBD") guidance—provides that a broker-dealer trading in cryptoasset securities must obtain permission to do so and limit its business activities solely to cryptoasset securities.[13] A registered broker-dealer therefore could not handle cryptoasset security transactions for its customers unless it refrained from engaging in any other business activities including transacting in stocks, bonds, and non-security cryptoassets. The broker-dealer could also be subject to unworkable capital requirements resulting from SEC guidance that requires public reporting companies to record a liability for custodied cryptoassets on their balance sheets. And, as there are very few cryptoasset securities presently registered with the SEC, a registered broker-dealer approved to handle cryptoasset securities would have virtually no assets to trade. Indeed, only one

[11] *Id.* at 45.
[12] 23 C.R.R.-N.Y. § 200.9, *Custody and protection of customer assets* (June 15, 2022), https://govt.westlaw.com/nycrr/Document/I85908c7d253711e598dbff5462aa3db3?viewType=FullText&originationContext=documenttoc&transitionType=CategoryPageItem&contextData=(sc.Default)&bhcp=1.
[13] Custody of Digital Asset Securities by Special Purpose Broker-Dealers, 86 Fed. Reg. 11,627 (Feb. 26, 2021); *see also* Jesse Hamilton, *Prometheum, the Only U.S.-Registered Crypto Platform, Picks Ether as Its First Product*, COINDESK (Feb. 7, 2024), https://www.coindesk.com/policy/2024/02/07/prometheum-the-only-us-registered-crypto-platform-picks-ether-as-its-first-product/.

broker-dealer has undergone the registration process, and it has yet to become operational.[14] The lack of cryptoasset securities available to trade is due to the lack of a workable registration and reporting framework for cryptoasset securities. And, as described in subpart (c) below, the SEC has not made clear which cryptoassets are securities, and as a result market participants wanting to rely on the SPBD guidance are left to decipher old guidance and conflicting court cases to determine if a particular cryptoasset is a security. Indeed, the one qualified SPBD recently announced it would provide custody services for ether, resulting in controversy and confusion. In the past, the SEC has recognized ether as a non-security,[15] which would mean registered SPBDs may not custody that asset. However, the SEC has more recently been sending signals that it has changed its stance and has not clarified its position despite recent calls from Congress to do so.[16]

c. Issuances

Issuers of securities to the public are subject to comprehensive disclosure and conduct requirements designed to protect investors and securities markets. However, cryptoassets have unique technical aspects that challenge the traditional categorization criteria for securities, and neither the SEC nor lawmakers have promulgated clear and legally binding criteria to determine which cryptoassets are securities. And even if a cryptoasset can be clearly classified as a security, the requirements that apply to the issuance and trading of securities often cannot be coherently applied to cryptoasset securities, and would omit information that is useful to cryptoasset investors. Furthermore, the offering and use of certain cryptoassets and the networks on which they operate have a tendency to evolve as they become decentralized, and there are no clear criteria under US law or regulations for determining how or when their regulatory treatment should change as this transition occurs.

Since the publication of the Phase I Report, a US court issued a summary judgment in a dispute between the SEC and a cryptoasset issuer regarding the status of a cryptoasset—XRP—as a security, finding direct sales of XRP were securities transactions while secondary sales were not.[17] However, a judge in a separate suit rejected this distinction,

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[14] Hamilton, *supra* note 13.
[15] *Financial Services, Agriculture Republicans Demand SEC Clarify Position Regarding Prometheum's Custody of Ethereum's Ether*, U.S. HOUSE COMMITTEE ON FIN. SERVICES (Mar. 26, 2024), https://financialservices.house.gov/ news/documentsingle.aspx?DocumentID=409210.
[16] *Id.*; *see also, e.g.*, Katherine Ross, *SEC Seeks to Regulate ETH as a Security, Consensys Alleges in Lawsuit*, BLOCKWORKS (Apr. 25, 2024, 2:22 PM), https://blockworks.co/news/ consensys-files-lawsuit-against-sec.
[17] *See, e.g.*, Alex Drylewski et al., *Ripple Effects: Developments Following Groundbreaking Decision in SEC v. Ripple Labs*, REUTERS (Dec. 5, 2023, 9:47 AM), https://www.reuters.com/legal/legalindustry/ripple-effects-developments-following-groundbreaking-decision-sec-v-ripple-labs-2023-12-05/.

finding certain additional cryptoassets to be securities.[18] While the decisions provide some guidance to market participants on applying the definition of security to cryptoassets, the decisions are complex, do not reach consistent conclusions, and remain subject to appeal.[19] More generally, relying on court decisions to apply existing securities law to cryptoassets is unlikely to generate comprehensive and easily applied criteria in the short term.

d. Derivatives

In contrast to cryptoasset spot markets, the trading of cryptoasset derivatives has generally been incorporated effectively into the existing framework for the trading of commodities derivatives, which includes custody protections and rules prohibiting abusive trading platforms, as well as the comprehensive enforcement and rulemaking authority of the CFTC. As such, when the trading platform FTX went bankrupt in 2022, in contrast to US customers of the FTX spot platform, US customers of the derivatives platform did not lose access to their funds. Six years after the launch of cryptoasset futures products on CFTC-regulated commodity futures exchanges,[20] cryptoasset commodity futures markets are deeper and more liquid, transparent and well-regulated. The CFTC actively polices fraud and manipulation through enforcement.[21] The relative success of cryptoasset commodities markets in the US suggests that a similarly effective framework for spot markets is possible.

2. Japan

Beginning in 2017, Japan has implemented a comprehensive regulatory structure that facilitates the trading of cryptoassets on centralized trading platforms, the issuance of new cryptoassets, and cryptoasset brokerage and custody services, while maintaining investor protections. It has done so by amending and supplementing its existing statutes and regulations to incorporate cryptoasset-specific provisions and by creating a

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[18] *See, e.g.*, *Federal Court Holds Terraform Crypto Assets Are Securities Including Stablecoin in Combination with Related Yield Protocol*, BARNES & THORNBURG LLP (Feb. 1, 2024), https://btlaw.com/en/insights/alerts/2024/ federal-court-holds-terraform-crypto-assets-are-securities-including-stablecoin

[19] Jody Godoy, *Ripple Labs notches landmark win in SEC case over XRP cryptocurrency* REUTERS (July 13, 2023), https://www.reuters.com/legal/us-judge-says-sec-lawsuit-vs-ripple-labs-can-proceed-trial-some-claims-2023-07-13/; Alexander C. Drylewski, et al., *Ripple Labs: District Court Holds That Direct Digital Token Sales Constituted Investment Contracts Under Howey, but Other Transactions Did Not* SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (July 17, 2023), https://www.skadden.com/insights/publications/2023/07/ripple-labs.

[20] *See, e.g.*, Evelyn Cheng, *Bitcoin Debuts on the World's Largest Futures Exchange, and Prices Fall Slightly*, CNBC (Dec. 17, 2017, 5:44 PM), https://www.cnbc.com/2017/12/17/worlds-largest-futures-exchange-set-to-launch-bitcoin-futures-sunday-night.html.

[21] *See, e.g.*, Ian McGinley, Dir., Commodity Futures Trading Comm'n, Keynote Speech at PLI White Collar Crime Conference: Enforcement by Enforcement: The CFTC's Actions in the Derivatives Markets for Digital Assets (Sept. 11, 2023) (transcript available at https://www.cftc.gov/PressRoom/SpeechesTestimony/opamcginley1).

cryptoasset-specific self-regulatory organization. Japan's regulators have periodically updated and refined these provisions since their initial adoption. The effectiveness of Japan's regulatory structure was exemplified by the protection of Japanese customers of the global cryptoasset trading platform FTX. When FTX collapsed in 2022, Japan's regulatory regime ensured that Japanese customers retained access to their assets, whereas customers in other jurisdictions, including the US, experienced significant losses.[22] Japan has also created a specialized framework for the issuance and trading of stablecoins, which is not discussed herein as the series of PIFS reports do not focus on stablecoins.[23]

a. Trading platforms

In 2017, Japan implemented a mandatory registration system and regulatory regime under Japan's Payment Services Act (the "PSA") for cryptoasset trading platforms that facilitate trading in non-security cryptoassets, including bitcoin, ether, and most other major cryptoassets.

The supervisor of cryptoasset trading platforms is the Financial Services Agency (the "FSA"), which is the agency also responsible for the supervision of securities exchanges, banks, and insurance providers.[24] Cryptoasset trading platforms must register with the FSA as "Crypto Asset Exchange Service Providers" ("CAESPs") and comply with the PSA rules applicable to CAESPs. The FSA is authorized to issue business improvement orders to trading platforms that fail to adhere to these requirements and to require those that do not comply to suspend their operations.[25] Trading platforms are also supervised by an FSA-certified self-regulatory organization (the Japan Virtual and Crypto Assets Exchange Association (the "JVCEA")).[26] The JVCEA issues additional rules governing the operation of cryptoasset trading platforms and the listing of cryptoassets.

The registration requirement applies to both domestic providers as well as foreign entities that seek to provide services in Japan. To qualify for registration, a cryptoasset trading

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[22] Kazuaki Nagata & Elizabeth Beattie, *Both hurt and saved by regulations, what is next for crypto in Japan?* (Jan. 4, 2023), THE JAPAN TIMES, https://www.japantimes.co.jp/news/2023/01/04/business/tech/japan-crypto-2022-review-regulation-future/.; Emily Parker, *Japan Embraces Web3 As Global Regulators Grow Wary of Crypto*, COINDESK (Jan. 26, 2023), https://www.coindesk.com/consensus-magazine/2023/01/26/japan-embracing-crypto-industry-web3-dao-nft/.

[23] Chihiro Ashizawa, *Japan to Have World's First Clear Regulatory Framework for Stablecoins*, CLIFFORD CHANCE (June 24, 2022), https://www.cliffordchance.com/insights/resources/blogs/talking-tech/en/articles/2022/06/japan-to-have-world-s-first-clear-regulatory-framework-for-stabl.html.

[24] Tomoko Amaya, *Regulating the Crypto Assets Landscape in Japan* FINANCIAL SERVICES AGENCY (Dec. 7, 2022), https://www.fsa.go.jp/en/news/2022/20221207/01.pdf.

[25] *See* Nagata & Beattie, *supra* n.9 (discussing FSA's issuance of business improvement orders in wake of crypto exchange hack).

[26] Takeshi Nagase, Tomoyuki Tanaka, & Takato Fukui, *GLI Blockchain & Cryptocurrency Regulations 2024: Japan*, (Nov. 2023), ANDERSON MORI & TOMOTSUNE, https://www.amt-law.com/asset/res/news_2023_pdf/publication_0027426_ja_001.pdf at 374-75.

platform must be a domestic Japanese company or have an office and representative in Japan. It must then obtain FSA preapproval of its organizational structure, operational systems, and compliance mechanisms.[27]

Following registration, trading platforms must provide specified disclosures to their customers, including a balance sheet and income statement, detailed information about the features and risks of the cryptoassets that can be traded on the platform, and information about transaction fees. Platforms must implement and maintain operational security measures, adhere to anti-money laundering rules, and adhere to advertising restrictions.[28]

Japan permits direct retail access to trade on cryptoasset trading platforms without the intermediation of a broker, which is in contrast to exchange trading of traditional financial assets, where broker intermediation is required.

Registered cryptoasset trading platforms are permitted to custody customer cryptoassets in accordance with cryptoasset-specific custody requirements. Specifically, the platform must (1) segregate customers' cryptoassets from the operator's assets by holding them in separate wallets, (2) hold at least 95% of custodied customer cryptoassets in cold wallets (i.e., wallets not connected to the internet), (3) hold enough of the platform operator's cryptoassets in cold wallets to cover any customer cryptoassets held in hot wallets (i.e., wallets connected to the internet) and provide customers with the right to be repaid from those operator assets in the case of loss, theft, or insolvency.[29] Trading platforms must also engage a public accountant for annual audits of their custody practices.[30] However, in no event may cryptoasset trading platforms custody customer fiat currency, which must instead be held with a third-party qualified custodian.[31]

Before a trading platform admits a cryptoasset for trading, the platform must conduct an assessment of the cryptoasset showing that the cryptoasset can be securely traded on the platform and submit the assessment to the JVCEA for approval. Each trading platform that seeks to admit a particular cryptoasset must conduct its own new assessment until the cryptoasset has been admitted to trading on at least three other registered platforms, at which point the assessment requirement is lifted for all other trading platforms. The precise criteria for this assessment are opaque and the approval process can be lengthy. This has reportedly led to a significant backlog in the JVCEA's approval process, resulting in delays in the admission of cryptoassets to trade across multiple platforms. The FSA and JVCEA are therefore considering a new rule that would lift the assessment

[27] *Id.* at 376.
[28] Amaya, *supra* note 24, at 5.
[29] Nagase, et al., *supra* note 26, at 375-76.
[30] *Id.* at 376.
[31] Payment Services Act (June 24, 2009, as amended Nov. 17, 2023), https://www.japaneselawtranslation.go.jp/en/laws/view/4477 at Art. 63-11(1)&(2), Art. 62-14(1),

requirement once a cryptoasset has undergone an assessment and is admitted to a single trading platform.

If a trading platform facilitates the trading of a cryptoasset security (i.e., cryptoassets that provide the holder with ownership rights or a share of the profits in a business or investment enterprise), it must obtain the same registration status as a traditional securities exchange or securities broker.[32]

Japan has not enacted any regulatory framework for decentralized trading platforms.[33]

b. Broker-dealers

A broker-dealer that executes transactions on behalf of its clients in cryptoassets must register with the FSA as a CAESP. Cryptoasset broker-dealers must therefore fullfil the same registration criteria as a trading platform and comply with the same ongoing disclosure, operational security, anti-money laundering, and custody requirements that apply to cryptoasset trading platforms, as outlined above. Cryptoasset broker-dealers are also subject to the same duty of best execution that applies to broker-dealers in traditional securities markets.[34]

c. *Issuance*

Japan's cryptoasset specific self-regulatory organization has created a specialized framework for the issuance of new cryptoassets to investors and users.[35] These rules require (1) JVCEA approval of the issuer's business structure, (2) the disclosure of specified information to offerees, including information on the offered cryptoasset, the issuer's business, and the issuer's proposed use of the offering proceeds, (3) segregation of the offering proceeds from the issuer's other assets, (4) adherence to typical accounting standards, and (5) JVCEA approval of the issuer's valuation of the offered cryptoasset.[36] The issuer must also demonstrate that it will be able to ensure the secure operation of the underlying blockchain and wallet tool used to hold the cryptoasset.[37] These requirements apply only if the creator receives money in exchange for the issuance of the cryptoasset – that is, they do not apply to gratuitous issuances (frequently referred to as "air drops").

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[32] The registration status is as a "Type 1 financial instruments business operator." Ken Kawai, Takeshi Nagase, and Huan Lee Tan, *The Virtual Currency Regulation Review: Japan* (Sept. 4, 2023), ANDERSON MORI & TOMOTSUNE, https://www.amt-law.com/asset/res/news_2023_pdf/publication_0027175_ja_001.pdf.
[33] *Id.*
[34] Amaya, *supra* note 24, at 17.
[35] Nagase, et al., *supra* note 26, at 374-75.
[36] *Id.* at 375.
[37] Kawai, et al., *supra* note 32.

Once issued, cryptoassets may only be sold by or through a registered trading platform or broker-dealer.[38]

Japan has incorporated a specialized framework for the issuance of cryptoasset securities into the broader framework that governs the issuance of traditional securities.[39] In general, if the cryptoasset security's code requires that the issuer approve the transfer of the cryptoasset and limits ownership to institutional investors, the cryptoasset security is subject to the less stringent disclosure requirements that apply to private issuances of traditional securities to institutional investors. If the cryptoasset security is not subject to these transfer and ownership restrictions, it is subject to the more comprehensive disclosure requirements that apply to public securities issuance, including the requirement to file a registration statement with the FSA and issue a prospectus to potential investors.[40]

Japan's regulators have also promulgated clear and comprehensive criteria for distinguishing cryptoasset securities and non-securities. The criteria are based primarily on whether the cryptoasset token gives the holder ownership rights or a right to share in the profits of a business or investment enterprise.

d. Derivatives

Japan has amended its financial regulatory statutes to incorporate the trading of cryptoasset derivatives into the framework for the trading of derivatives on traditional financial assets.[41] Trading platforms and broker-dealers that facilitate trading in cryptoasset derivatives must therefore register with the FSA, and information regarding over-the-counter trading of cryptoasset derivatives must be reported to the FSA.

3. The European Union

In June 2023, the European Union enacted a specialized regulatory framework for cryptoasset trading platforms, broker-dealers, and issuers known as the "Markets in Crypto-Assets Regulation" ("MiCA"). MiCA takes effect on December 30, 2024. MiCA's requirements apply to any person that provides cryptoasset services to EU residents, regardless of whether the service provider is located inside or outside the EU.[42].

Consistent with the EU's approach to the regulation of traditional financial instruments, administration and enforcement of MiCA will be the primary responsibility of the national

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[38] Nagase, et al., *supra* note 26, at 374.
[39] Kawai, et al., *supra* note 32.
[40] *Id*.
[41] Ichiro Oya, et al., *Derivatives Laws and Regulations: Japan 2023* NAGASHIMA OHNO & TSUNEMATSU (June 26, 2023), https://iclg.com/practice-areas/derivatives-laws-and-regulations/japan.
[42] Richard Stebbing & Haider Farooq, *MiCA Compliance – key issues and what they mean for a crypto business operating in the EU.*, WITHERSWORLDWIDE (Oct. 12, 2023), https://www.withersworldwide.com/en-gb/insight/read/mica-compliance-key-issues-and-what-they-mean-for-a-crypto-business-operating-in-the-eu.

authorities in EU member states. However, the EU's financial markets regulator and supervisor (the European Securities and Markets Authority ("ESMA")) is empowered to issue guidelines for member states' application of MiCA.[43]

MiCA applies to non-security cryptoassets, such as bitcoin and ether, as well as stablecoins.[44] It does not apply to cryptoasset securities or other cryptoasset-related financial instruments, such as cryptoasset investment funds or cryptoasset derivatives. Instead, the EU has clarified that these cryptoassets and related products are subject to the EU's existing financial regulations, notably the Markets in Financial Instruments Directive ("MiFID II").[45] MiCA includes provisions that harmonize the new framework for cryptoassets with MiFID II's application to cryptoasset securities and other cryptoasset-related financial instruments, as explained further below. MiCA's stablecoin provisions are not discussed herein.

MiCA also excludes NFTs and decentralized trading platforms.[46] However, the EU expects to issue an initial legislative proposal on the regulation of decentralized trading platforms and NFTs by the end of 2024.[47]

a. Trading platforms

Cryptoasset trading platforms must be licensed by the national regulator in the EU jurisdiction where the platform is based. To qualify for a license, the platform must demonstrate to the regulator that the platform has in place basic operating policies, governance arrangements, asset segregation and custody practices, and complaints-handling procedures. Once licensed in one EU member state, the platform may subsequently operate throughout the EU upon notice to their licensing authority.[48]

Licensed trading platforms are permitted to custody customers' cryptoassets according to cryptoasset-specific custody rules.[49] In particular, (i) customer cryptoassets must be operationally and legally segregated from the platforms assets, including in bankruptcy, (ii) the platform may not use customer cryptoassets for its own account, and (iii) the platform must have written policies designed to minimize the risk of theft or loss of custodied cryptoassets, including from fraud or cyberattack.[50]

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[43] Parliament and Council Regulation (EU) 2023/1114, Preamble (3), 2023 O.J. (L 150) 40, Art. 85, at 140 [hereinafter "MiCA"]; *id.* Ch. 4, at 161-65.
[44] *Id*. Arts. 45, 58, at 104-05, 114.
[45] *Id.* Art. 2(4)(a), at 62; *see also* Parliament and Council Directive 2014/65/EU, art. 4(1)(15), Annex I § C, 2014 O.J. (L 173) 349, 382, 481-82 [hereinafter "MiFID II"].
[46] MiCA, Art. 3(1)(5), at 63; Art. 2(4), at 62-63; Art. 2(3), at 62; Preamble (13), Art. 2(2), at 43, 62; Preamble (22), at 45.
[47] *Id.* Art. 142, at 180.
[48] *Id*. Art. 65, at 123.
[49] XReg Consulting & Zodia Custody, *Crypto Custody in the Time of MiCA*, XREG CONSULTING (Sept. 6, 2023), https://www.xreg.consulting/articles/crypto-custody-in-the-time-of-mica.
[50] MiCA, Arts. 70(1), 75(3), (7).

Before admitting a cryptoasset to trading, the trading platform must (i) ensure that a compliant disclosure document containing information about the cryptoasset's characteristics (referred to as a "white paper") has been published either by the cryptoasset's issuer or the trading platform itself, and (ii) conduct its own assessment of the technical design of the cryptoasset, the issuer and its development team, and its potential connections to illicit or fraudulent activities.[51]

Trading platforms must adhere to ongoing customer protection rules, including a prohibition on an operator trading on its own platform, as well as pre- and post-trade transparency requirements, which require the publication of bid-ask spreads, depth of trading interests, and the price, volume, and time of each transaction conducted on the platform.[52]

Within these requirements, trading platforms have considerable flexibility to facilitate trading in a variety of cryptoassets and offer multiple services to their customers. The framework also facilitates the provision of cryptoasset-related services by providers that are registered under existing financial regulatory regime without undergoing a separate licensing process, though they are required to adhere to the same ongoing compliance rules as newly licensed providers.[53] Furthermore, the same trading platform is permitted to facilitate transactions in both non-security cryptoassets and security cryptoassets provided it is licensed under both MiCA and MiFID II.[54]

Cryptoasset trading platforms are also permitted to allow customers direct access to trade non-security cryptoassets without the intermediation of a broker. [55] This contrasts with the trading of traditional financial assets, which bar retail investors from trading without the intermediation of a broker.[56] Currently, platforms cannot allow retail customers to trade cryptoasset securities without the intermediation of a broker. However, the EU is conducting a pilot regime that allows certain trading platforms to permit retail investors to directly trade a limited number of cryptoasset securities.[57]

MiCA streamlines the licensing process for operators of traditional securities exchanges, which can automatically qualify for cryptoasset trading platform license by notifying the

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[51] *Id.* Art. 76(2).
[52] *Id.* Arts. 76(5), 76(8)-(9).
[53] Woldemar Haring, Karsten Wockener, & Dr. Cristina Freudenberger, *MiCA Regulation: New regulatory framework for Crypto-Assets Issuers and Crypto-Asset Services Providers in the EEA*, WHITE & CASE (July 4, 2023), https://www.whitecase.com/insight-alert/mica-regulation-new-regulatory-framework-crypto-assets-issuers-and-crypto-asset.
[54] *Id*. Arts. 60(3)(d), at 116, 60(3)(b), (6), at 115, 116.
[55] Consultation Paper of the European Secs. & Mkt. Auth., *Technical Standards Specifying Certain Requirements of Markets in Crypto Assets Regulation (MiCA) - Second Consultation Paper*, ¶ 117, ESMA75-453128700-438, EUROPEAN SECURITIES & MARKETS AUTHORITY ["ESMA"] (Oct. 5, 2023), https://www.esma.europa.eu/sites/default/files/2023-10/ESMA75-453128700-438_MiCA_Consultation_Paper_2nd_package.pdf.
[56] MiFID II, Art. 19(2), 53(3), at 402, 438.
[57] Parliament and Council Regulation (EU) 2022/858, Preamble (26), 2022 O.J. (L 151) 1, 6.

regulator in their home jurisdiction, though they are subject to the same ongoing compliance requirements as newly licensed platforms.[58]

b. Broker-dealers

Cryptoasset broker-dealers are, like trading platforms, required to be licensed by the national regulator in the broker-dealer's home jurisdiction by undergoing the same licensing process. Once licensed, the broker-dealer is permitted to hold custody of its customers' cryptoassets in accordance with the same cryptoasset-specific custody rules that apply to licensed trading platforms. Cryptoasset broker dealers are also subject to the same duty of best execution as securities broker-dealers. As in the case of trading platforms, a registered securities broker-dealer can be automatically licensed to handle transactions in non-security cryptoassets.[59]

c. Issuance

Before a cryptoasset may be issued to the public or admitted to trading on a trading platform, the issuer must publish and submit to the relevant national regulator a "white paper" containing detailed information about the issuer, the cryptoasset, the underlying blockchain technology, and risks to the investor. The issuer must also adhere to restrictions on the content and timing of marketing communications.

These issuance requirements do not apply to (1) offerings where no money is received (*e.g.*, "air drops"), (2) cryptoassets created automatically as reward tokens for the maintenance of a blockchain network or transaction validation, (3) utility tokens giving access to an existing product or service or that can only be exchanged for goods and services in a limited network of merchants or (4) "fully decentralized" offerings (i.e., offerings that are not controlled by the issuer, offeror, or other small group of people but rather a decentralized community of users.[60]

The public issuance and admission to trading of security-type cryptoassets are subject to the same regulations that apply to traditional securities.[61] These rules require publication of a prospectus before the security-type cryptoasset is offered to the public or is traded on a trading platform. However, unlike in the case of non-security cryptoassets, regulatory approval is necessary before a cryptoasset security can be offered or listed.

ESMA has issued detailed guidance articulating the criteria for whether a cryptoasset is classified as a security (i.e., a "financial instrument") or non-security.[62] These criteria

[58] MiCA, Art. 60, at 115-17.
[59] *Id*. Art. 60(3)(d), at 116.
[60] *Id*. Art. 4(3), at 67.
[61] Parliament and Council Regulation (EU) 2017/1129, 2017 O.J. (L 168) 12.
[62] Laurent Collet, Thibault Chollet, & Marijana Vuksic, *ESMA clarifies which crypto-assets might qualify as financial instruments in the EU*, DELOITTE (Feb. 14, 2024), https://www2.deloitte.com/lu/en/pages/investment-management/articles/ESMA-clarifies-which-crypto-assets-might-qualify-as-financial-instruments-in-the-EU.html.

consider whether, for example, the cryptoasset entitles the holder to security-like rights, such as the right to dividends or the right to vote on the issuer's decisions.[63]

d. Derivatives

ESMA has issued guidance clarifying that cryptoasset derivatives are subject to the existing MiFID II securities regime, regardless of whether the underlying cryptoasset is a security or not.[64] Cryptoasset derivatives will therefore be treated like securities under the existing regime—the same as most non-cryptoasset derivatives,[65] which can be traded, in most cases, by both institutional and retail investors.[66]

4. Hong Kong

Throughout 2022 and 2023, Hong Kong enacted a dedicated regulatory framework for cryptoasset trading platforms, broker-dealers, issuers, and derivatives by amending its financial regulation statute (the "Securities and Futures Ordinance" ("SFO")) to incorporate cryptoasset-specific provisions and issuing cryptoasset-specific regulatory guidance.[67] The framework is administered by the Hong Kong securities regulator (the Securities and Futures Commission (the "SFC")).[68]

a. Trading platforms

Cryptoasset trading platforms that operate in Hong Kong or that market their services to Hong Kong residents must register as "virtual asset trading platforms" ("VATPs").[69] A VATP license permits a platform to facilitate transactions in non-security cryptoassets, such as bitcoin and ether, but does not extend to cryptoasset securities.

Once registered, a VATP must comply with comprehensive customer protection and other compliance requirements covering governance, disclosure, due diligence of listed

[63] Id.
[64] *See*, *e.g.*, Collet, et al., *supra* note 62.
[65] *Id*.
[66] ESMA, *Enhanced protection for retail investors: MiFID II and MiFIR* (June 30, 2014), https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-726_enhanced_protection_for_retail_investors_-_mifid_ii_and_mifir.pdf.
[67] Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Ordinance 2022, Ord. No. 15 of 2022, A785 et seq., https://www.legco.gov.hk/yr2022/english/ord/2022ord015-e.pdf. [hereinafter "AMLO"]; SFC, "Guidelines for Virtual Asset Trading Platform Operators" (June 2023), https://apps.sfc.hk/edistributionWeb/api/consultation/conclusion?lang=EN&refNo=23CP1 [hereinafter "SFC Guidelines"].
[68] *See id.* (giving SFC authority over "virtual assets"); *see also* SFC Guidelines (giving SFC authority over "security tokens").
[69] AMLO at Sched. 3B.

cryptoassets, and anti-money laundering.[70] Trading platforms may permit retail investors to trade directly on the platform without the intermediation of a broker.[71]

Trading platforms must provide customers with specified information on the cryptoassets that trade on the platform including information on the management and development team that designed a cryptoasset, and the terms, features, and risks of the cryptoasset.[72]

Trading platforms are permitted to custody customer cryptoassets provided that the custodied assets are held in a wholly owned subsidiary that limits its activities to custody and that adheres to specified custody rules. Specifically, the custodian must hold at least 98% of customers' cryptoassets in cold wallets.[73] It must have an arrangement that is approved by the SFC, and that compensates customers for the loss of up to 50% of their cryptoassets that the custodian holds in cold wallets and 100% of their cryptoassets that the custodian holds in hot wallets.[74] Customer fiat currency must be held in a segregated account maintained with a bank and not pledged or otherwise encumbered.[75] The bank must be located in Hong Kong unless client money is received outside Hong Kong and the SFC approves alternate arrangements.[76]

To facilitate transactions in cryptoasset securities, the operator must obtain a license to operate a securities exchange under Hong Kong existing regulatory framework for securities exchanges.[77] However, Hong Kong has harmonized its new framework for VATP with this existing framework by allowing a trading platform that has both a VATP license and a license to operate a securities exchange to combine trading of both categories of assets on the same platform. In addition, although the application processes for these licenses are currently separate, Hong Kong plans to introduce a single application process to streamline the framework.[78]

Hong Kong's framework does not cover decentralized trading platforms.[79]

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[70] Sara S. M. Or, *Hong Kong SFC Concludes Consultation on Regulation of Virtual Asset Trading Platforms* MAYER BROWN (May 29, 2023), https://www.mayerbrown.com/en/perspectives-events/publications/2023/05/hong-kong-sfc-concludes-consultation-on-regulation-of-virtual-asset-trading-platforms.
[71] *Id.*
[72] SFC Guidelines at § 9.28, Schedule 2(c).
[73] *Id.* at § 10.
[74] *Id.*
[75] Simon Hawkins & Adrian Fong, *New Era Dawns for Hong Kong's Virtual Assets Sector* LATHAM & WATKINS (May 30, 2023), https://www.lw.com/admin/upload/SiteAttachments/New-Era-Dawns-for%20Hong-Kong%E2%80%99s-Virtual-Assets-Sector.pdf.
[76] *Id.*
[77] SFC Guidelines at Part II (143).
[78] *Id.* at (144).
[79] Raymond Oh & Felicity Wong, *Hong Kong Virtual Asset Trading Platform Operators Licensing Regime: Dual Licensing Regime and Key Personnel Requirements* SIDLEY AUSTIN LLP (May 31, 2023), https://www.sidley.com/en/insights/newsupdates/2023/5/hk-vatp-licensing-regime-1-dual-licensing-regime-and-key-personnel-requirements.

b. Broker-dealers

Broker-dealers that execute transactions in cryptoassets for customers in Hong Kong are required to register and obtain a license as "virtual asset service providers" ("VASPs"). They are subject to equivalent custody and disclosure requirements as VATPs. Additionally, those acting as fund managers are subject to a duty of best execution.[80] Broker-dealers that execute transactions in cryptoasset securities are subject to the same registration requirements and customer protection standards as broker-dealers for traditional securities.[81]

c. Issuance

Hong Kong has enacted a framework for the issuance of new cryptoassets to the public that builds on its existing framework for traditional securities.[82] In the case of cryptoassets that are not securities, issuers are not subject to any direct disclosure requirements.[83] Instead, Hong Kong requires trading platforms, broker-dealers, and custody providers "to take all reasonable steps to ensure the product specific information they disclose is not false, biased, misleading or deceptive."[84]

Issuers of cryptoasset securities are subject to the same requirements as issuers of traditional securities, including the requirement to issue a prospectus and the requirement to obtain approval from the securities regulator before the offering.[85] These requirements apply to any public offering of cryptoasset securities to Hong Kong investors, whether or not the issuer is based in Hong Kong or another jurisdiction.[86] Hong Kong's regulators have stated in guidance that a cryptoasset security is generally defined by granting the

[80] Gaven Cheong, et al., *GLI Blockchain & Cryptocurrency Laws and Regulations 2024 | Hong Kong*, TIANG & PARTNERS (2024), https://www.globallegalinsights.com/practice-areas/blockchain-laws-and-regulations/hong-kong; Hong Kong Newsletter, Issue 459, *Hong Kong SFC Issues Crypto Fund Licensing Conditions for Hong Kong Crypto Fund Managers*, CHARLTONS (Oct. 30, 2019), https://www.charltonslaw.com/hong-kong-sfc-issues-crypto-fund-licensing-conditions-for-hong-kong-crypto-fund-managers/.
[81] Cheong, et al,, *supra* n.80.
[82] SFC Guidelines at Part I (A)(27).
[83] *Id.*
[84] *Id.* at (29).
[85] *See, e.g.*, *id.* at § 7.7.
[86] Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), https://www.elegislation.gov.hk/hk/cap32.

holder an ownership interest in a business enterprise or investment product of the issuer.[87]

d. Derivatives

Hong Kong does not permit the trading of cryptoasset derivatives by either retail or institutional investors.[88] However, the SFC is considering regulations that would allow for the trading of cryptoasset derivatives by institutional investors.[89]

5. The United Kingdom

Currently, the UK only regulates cryptoasset securities, which it defines as a cryptoasset that provides "rights and obligations" akin to "a share or a debt instrument."[90] However, in 2023, the United Kingdom enacted legislation that creates the groundwork for a comprehensive cryptoasset regulatory framework that includes non-security cryptoassets.[91] The details of this framework will require the adoption of additional "secondary" legislation to be proposed by the UK Treasury ("HM Treasury") and the UK's main financial markets regulator (the Financial Conduct Authority (the "FCA"). HM Treasury and the FCA have set a goal of proposing secondary legislation before the end of 2024.[92]

a. Trading platforms

HM Treasury has described the broad outlines of the framework that will govern cryptoasset trading platforms. In general, cryptoasset trading platforms will be subject to the UK's existing rules for traditional financial services, such as banking and investment advisory services (the "Regulated Activities" regime).[93] They will also be required to obtain

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[87] Circular on intermediaries engaging in tokenised securities-related activities https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=23EC53.
[88] SFC Guidelines at § 7.25.
[89] Julianne Doe & Didi Chan, *Hong Kong's new licensing regime for virtual asset trading providers takes effect,* DENTONS (June 5, 2023), https://hongkong.dentons.com/en/insights/articles/2023/june/5/hong-kongs-new-licensing-regime-for-virtual-asset-trading-providers-takes-effect.
[90] GOV.UK Policy Paper, *Factsheet: cryptoassets technical* (Oct. 26, 2023), https://www.gov.uk/government/publications/economic-crime-and-corporate-transparency-bill-2022-factsheets/fact-sheet-cryptoassets-technical#how-are-cryptoassets-regulated-in-the-uk
[91] Huw Jones, *Britain to Push Ahead with Rules for Cryptoassets*, REUTERS (Oct. 30, 2023), https://www.reuters.com/world/uk/britain-push-ahead-with-rules-cryptoassets-2023-10-30/.
[92] HIS MAJESTY'S TREASURY, *Future Financial Services Regulatory Regime for Cryptoassets: Response to the Consultation and Call for Evidence* (Oct. 2023), at 26 ["HM Treasury Response"].
[93] HIS MAJESTY'S TREASURY, *Future financial services regulatory regime for cryptoassets: Consultation and call for evidence* (Feb. 2023), at § 2.7, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1133404/TR_Privacy_edits_Future_financial_services_regulatory_regime_for_cryptoassets_vP.pdf [hereinafter "HM Treasury Consultation"]; Thomson Reuters, *Glossary: Regulated Activity* (2023), PRACTICAL LAW UK 1-107-7125, https://uk.practicallaw.thomsonreuters.com/1-107-7125?transitionType=Default&contextData=(sc.Default)& firstPage=true.

an FCA license to operate.[94] Within this framework, cryptoasset trading platforms will be permitted to facilitate the exchange of cryptoassets for fiat currency, other cryptoassets, and other assets, such as commodities.[95] The FCA will be empowered to create more detailed regulations that apply specifically to cryptoasset trading platforms.[96]

The UK has also stated that it intends to regulate "safeguarding and/or administration (custody) activities," for cryptoassets by cryptoasset trading platforms and "lending, borrowing and leverage activities," such as "operating a cryptoasset lending platform."[97] The UK currently permits direct retail investor access to cryptoasset trading platforms and has not indicated that it intends to prohibit such direct access in the future.[98]

The UK has already fully implemented legislation regulating the marketing of cryptoasset-related services, including cryptoasset trading platforms, to UK customers by incorporating these services into its existing financial services marketing regime (the "Financial Promotion" regime).[99] For example, marketing and financial promotions by trading platforms are prohibited from offering customers incentives (*e.g.*, "refer a friend" or "new joiner" bonuses) to trade on their platforms.[100]

b. Broker-dealers

Like trading platforms, it is expected that cryptoasset broker-dealers will fall under the Regulated Activities regime and thus subject to FCA licensure, but the exact contours of the framework will be set by future rulemaking.[101] Additionally, cryptoasset broker-dealers are already subject to the same marketing restrictions under the Financial Promotion rules that apply to cryptoasset trading platforms, discussed above.[102]

c. Issuance

The UK intends to regulate the public offering of a cryptoasset and the admittance of a cryptoasset to a trading venue under either the Regulated Activities regime or a newly created regime that is subject to either FCA or HM Treasury regulation but not FCA

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[94] HM Treasury Consultation at § 2.7.
[95] Dr. Adrian Yeo, et al., *The Financial Services and Markets Act 2023 – Reform of Cryptoassets Regulation*, DENTONS (July 25, 2023), https://www.dentons.com/en/insights/newsletters/2023/july/25/the-financial-services-and-markets-act-2023/the-financial-services-and-markets-act-2023-reform-of-cryptoassets-regulation.
[96] HM Treasury Consultation at § 2.7.
[97] Yeo, et al., *supra* n.95.
[98] *See, e.g.*, Steve Johnson, *UK looks increasingly isolated in its anti-crypto ETF stance*, FIN. TIMES (Jan. 29, 2024), https://www.ft.com/content/df0a8ab8-0c1e-495b-9983-729ead67b73d.
[99] FCA, *Financial Promotion Rules for Cryptoassets*, Policy Statement PS23/6 (June 2023), at § 1.1, www.fca.org.uk/publication/policy/ps23-6.pdf [hereinafter "PS23/6"].
[100] *Id.* at §§ 3, 3.14.
[101] HM Treasury Consultation at §§ 5.11, 7.
[102] PS23/6 at § 1.1.

licensure (the "Designated Activities" regime).[103] The details of the framework will be set by future rulemaking.

Issuers that market cryptoassets to UK investors and users will be required to adhere to the same marketing restrictions as those discussed with trading platforms above.[104] Notably, cryptoasset issuers will not be able to rely on exemptions for high-net worth and sophisticated investors that are available for traditional securities offerings.[105] The new framework also adjusts the Financial Promotion regime by bringing "qualifying cryptoassets" into its regulatory parameters.[106] These rules will apply to all cryptoassets that are both fungible and transferable, such as bitcoin and ether, but will exclude CBDCs and utility tokens with limited functions.[107]

The legislation also provides the UK and HM Treasury with the authority to designate a cryptoasset as "systemic" if it is widely used for payment in the UK.[108] Upon designation by HM Treasury,[109] a cryptoasset would become subject to the supervision of the Bank of England, the UK's central bank, and the Payment Systems Regulator.[110]

d. Derivatives

The UK only permits retail trading in derivatives of cryptoassets if the underlying cryptoasset is a security and thus already subject to the UK's existing financial regulations. The UK has banned retail trading in derivatives on cryptoassets that are not securities.[111]

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[103] Yeo, et al., *supra* n.95.
[104] PS23/6 at § 1.1.
[105] *Id.* at § 1.17.
[106] The Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) Order, 2023, S.I. 2023/612 ["FPO Amendment"]; *see also* PS23/6.
[107] FPO Amendment at § 9.
[108] HIS MAJESTY'S TREASURY, *Update on Plans for the Regulation of Fiat-backed Stablecoins* (Oct. 2023), at 6, 8, https://assets.publishing.service.gov.uk/media/653a82b7e6c968000daa9bdd/Update_on_Plans_for_Regulation_of_Fiat-backed_Stablecoins_13.10.23_FINAL.pdf.
[109] *Id.* at 18.
[110] *Id.* at 15.
[111] Jonathan Gilmour & Elinor Samuel, *Derivatives Laws and Regulations 2023: England & Wales*, at § 3.3 (2023), TRAVERS SMITH LLP, https://iclg.com/practice-areas/derivatives-laws-and-regulations/england-and-wales. Financial Policy Committee, *Financial Stability in Focus: Cryptoassets and Decentralised Finance*, BANK OF ENGLAND (Mar. 24, 2022), www.bankofengland.co.uk/financial-stability-in-focus/2022/march-2022; Simon Toms, Azad Ali, & Abigrail B. Reeves, *UK Imposes Restrictions on the Sale of Cryptoassets and Related Products*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Oct. 12, 2020), https://www.skadden.com/insights/publications/ 2020/10/uk-imposes-restrictions.

Comparative Status of Cryptoasset Regulation in Five Major Jurisdictions

Framework Characteristic	**Japan**	**EU**	**HK**	**UK**	**US**
Status of legislation or regulation establishing a framework for cryptoassets.	Implemented	Legislation passed, entering into force in 2024.	Partially implemented; additional frameworks forthcoming.	Initial legislation passed; additional legislation expected in 2024.	No legislation or regulation passed. .
Is there a registration process for cryptoasset trading platforms?	Yes	Yes	Yes	Legislative proposal expected for 2024.	No*
Is there a comprehensive regulatory category for non-security cryptoassets?	Yes	Yes	Yes	Yes	No*
Can cryptoasset intermediaries combine services for security and non-security cryptoassets?	Yes	Yes	Yes	Anticipated yes	No
Is there a cryptoasset-specific custody regime?	Yes	Yes	Yes	To be determined by forthcoming secondary legislation.	No
Can retail investors access cryptoasset intermediary services?	Yes, but certain cryptoassets are limited to sophisticated investors.	Yes, but certain cryptoassets are limited to sophisticated investors.	Yes, subject to certain user safeguards.	Yes	Yes

*With the exception of CFTC-regulated cryptoasset commodity derivatives.

6. Singapore, Australia, Canada, and the United Arab Emirates

a. Singapore

Singapore's integrated financial services regulator (the Monetary Authority of Singapore ("MAS")) has issued a proposed regulatory framework under the Payment Services Act ("PSA") for cryptoasset trading platforms and other cryptoasset intermediaries that facilitate trading in cryptoassets that are not considered securities, which implements various operational requirements and customer protection measures.[112] Under this proposal, which will take effect from mid-2024, cryptoasset trading platforms are required to obtain a license to offer their services in Singapore. Platforms are prohibited from offering retail customers margin trading or any incentives to trade. As a condition of listing a cryptoasset, platforms must disclose potential conflicts of interest, publish the criteria that govern the listing, and establish customer dispute procedures.[113]

MAS has also issued rules addressing the issuance, custody, and trading of cryptoasset securities. Singapore has also amended aspects of its banking and payments legislation to address stablecoins.

More specifically, the MAS has issued rules indicating that cryptoasset securities are generally subject to Singapore's existing financial markets regulatory statute for securities and derivatives (the Securities and Futures Act of 2021 (the "SFA")).[114]

The MAS guidance (1) trading platforms and broker-dealers facilitating or executing transactions in cryptoasset securities are required to register as "Approved Exchanges" or "Recognized Market Operators" respectively, (2) providers of custodial services for cryptoasset securities must obtain a capital markets service license and are subject to requirements for the safekeeping of client assets and (3) issuers of cryptoasset securities are, like issuers of traditional securities, required to file a prospectus with the MAS.[115]

b. Australia

Australia has yet to implement a comprehensive regulatory framework for cryptoassets, but its regulators have issued proposals outlining such a framework and are in the process of soliciting public comments on those proposals.

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[112] *See* MONETARY AUTHORITY OF SINGAPORE ["MAS"], Strengthening Regulatory Measures for Digital Asset Payment Token (DPT) Services (2023), https://www.mas.gov.sg/-/media/mas/news/media-releases/2023/mas-infographic---strengthening-regulatory-measures-for-dpt-services-high-res.pdf.
[113] Amitoj Singh, *Singapore Central Bank Rules to Discourage Crypto Speculation, Ease Investment Qualifications* COINDESK (Nov. 23, 2023), https://www.coindesk.com/policy/2023/11/23/singapore-central-bank-rules-to-discourage-crypto-speculation-ease-investment-qualifications/.
[114] *See* Securities and Futures Act 2001 (2020 Rev Ed) Pt. 1, s 2(1), https://www.mas.gov.sg/regulation/acts/securities-and-futures-act.
[115] MAS, *A Guide to Digital Token Offerings*, (Explainer, 26 May 2020) at ¶¶ 2.1, 2.9-2.11; *see also* Securities and Futures Act 2001 (2020 Rev Ed).

More specifically, in October 2023, the Australian Treasury issued a draft proposal for a licensing regime for cryptoasset trading platforms and other cryptoasset service providers. The proposal would subject such services to customer protections and other compliance requirements, including custody requirements.[116]

With respect to custody, many of these standards are in line with custody requirements for traditional financial products and services.[117] However, cryptoasset custody providers would be subject to additional safeguarding requirements to avoid commingling customer and company funds.[118] In addition, platform operators offering additional functions such as staking in digital assets that are not financial products will be subject to separate requirements.[119]

Draft legislation implementing the proposal is expected to be issued in 2024.[120]

c. Canada

Canada's financial regulators have sought to integrate cryptoassets into Canada's existing financial regulatory statutes by broadly interpreting existing statutory definitions under Canada's securities legislation to cover many cryptoassets, including cryptoassets such as bitcoin and ether, that are not governed under securities legislation in the US or other jurisdictions.

Specifically, Canada's national securities regulators (the Canadian Securities Administrators ("CSA"), which functions as an umbrella organization of Canada's securities regulators,[121] and the Canadian Investment Regulatory Organization ("CIRO"),[122] which acts as a self-regulatory organization for the investment industry) have issued guidance stating that while such cryptoassets may not themselves be securities, the contractual relation between a customer trading such a cryptoasset and the trading platform is a security and thus causes the securities regulatory framework to apply.

Canada's regulators have released joint guidance interpreting and applying the requirements of Canadian securities law to cryptoasset trading platforms, The guidance differentiates between platforms that permit direct access by customers to the trading

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[116] The Australian Government the Treasury, *Regulating Digital Asset Platforms*, Proposal Paper (Oct. 16, 2023), at 9, 12 https://treasury.gov.au/sites/default/files/2023-10/c2023-427004-proposal-paper-finalised.pdf.
[117] The Australian Government the Treasury, *Payments System Modernisation (Licensing: Defining Payment Functions)*, Consultation Paper (June 2023), at 13-15, https://treasury.gov.au/sites/default/files/2023-06/c2023-403207-cp.pdf.
[118] *Id.* at 30.
[119] *Id.* at 14-15.
[120] https://treasury.gov.au/sites/default/files/2023-10/c2023-427004-proposal-paper-finalised.pdf.
[121] Alix d'Anglejan-Chatillon, et al., *Blockchain & Cryptocurrency Laws and Regulations 2024 | Canada*, (6th ed., 2023), STIKEMAN ELLIOTT LLP, https://www.globallegalinsights.com/practice-areas/blockchain-laws-and-regulations/canada.
[122] References to CIRO are used in place of certain references to IIROC, its predecessor organization, herein for readability.

book ("Marketplace Platforms") and those that limit direct participation to registered broker-dealers ("Dealer Platforms").[123]

The guidance permits direct retail investor access to cryptoasset platforms so long as the platform does not provide any recommendations or advice to participants.[124] Further, it recognizes that flexibility may be required to assess yet-to-be developed custody models and specifies some principles to manage risk, including segregation of clients' assets and keys from those of the trading platform.[125] However, cryptoasset trading platforms may not combine trading in cryptoassets such as bitcoin and ether that are not themselves securities with cryptoasset securities, (e.g., tokenized versions of stocks or bonds) on the same platform.[126]

The guidance contemplates the provision of custody services by platforms provided the platform adheres to specified customer protection requirements.[127] These requirements include keeping client property segregated, a prohibition against the pledge, rehypothecation, or other use of client property, and a requirement to hold cryptoassets in a "designated trust account" or in a designated account with an acceptable third-party custodian.[128]

d. United Arab Emirates

The United Arab Emirates ("UAE") is a federation consisting of seven emirates, including Dubai and Abu Dhabi. The UAE's federal financial regulator, the Securities and Commodities Authority ("SCA") is responsible for regulating cryptoassets other than stablecoins. There are also two "Financial Free Zones" in the UAE—the Abu Dhabi Global Market ("ADGM") and the Dubai International Financial Centre ("DIFC")—which are not subject to federal civil and commercial law.[129]

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[123] CSA & IIROC, *Guidance for Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements*, Staff Notice 21-329 (Mar. 29, 2021) at 1, https://www.securities-administrators.ca/uploadedFiles/Industry_Resources/JointCSAIIROCNotice21-329(March29_2021).pdf [hereinafter "Trading Platforms Guidance"].

[124] *See id.* at 17; *see also* IIROC, *Guidance on Order Execution Only Services and Activities*, Guidance Notice 18-0076 (Apr. 9, 2018), at § 1, https://www.iiroc.ca/news-and-publications/notices-and-guidance/guidance-order-execution-only-services-and-activities.

[125] Trading Platforms Guidance at 14.

[126] CSA, *Crypto Asset Trading Platforms: Pre-Registration Undertakings Changes to Enhance Canadian Investor Protection*, Staff Notice 21-332 (Feb. 22, 2023), at 9 ("subject to the potential exclusion noted in respect of Value-Referenced Crypto Assets . . . CTPs are prohibited from permitting Canadian clients to enter into crypto contracts to buy and sell any crypto asset that is itself a security and/or a derivative"), https://www.osc.ca/sites/default/files/2023-02/csa_20230222_21-332_crypto-trading-platforms-pre-reg-undertakings.pdf.

[127] *Id.*

[128] *Id.* at 5-7.

[129] *The Virtual Currency Regulation Review: United Arab Emirates*, CHARLES RUSSELL SPEECHLYS (Oct. 24, 2023), https://www.charlesrussellspeechlys.com/en/insights/expert-insights/litigation--dispute-resolution/2022/the-virtual-currency-regulation-review-united-arab-emirates/.

In 2020, the SCA enacted an initial framework regulating the offering, issuing, listing and trading of cryptoassets.[130] The UAE then enacted legislation in 2022 establishing an activities-based licensing regime to be administered by the SCA (the "Virtual Asset Regime").[131] The regime covers cryptoassets which "can be used for investment purposes."[132] The law provides a list of activities subject to licensing, including operating a trading platform, exchange, transfer, brokerage, and custody services.[133]

Responsibility to license and regulate under the Virtual Asset Regime has been delegated to the Virtual Assets Regulatory Authority ("VARA") in the emirate of Dubai.[134] In February 2023, VARA passed the Virtual Assets and Related Activities Regulations 2023,[135] alongside four compulsory and eight activities-based rulebooks, including exchange, custody, and broker-dealer services, as well as cryptoasset issuance.[136] The activities are designed to be "modular," such that a service provider, "may apply for multiple activities and aggregate them under a single overarching license provided there is no specific need to segregate any of those activities."[137] Notably, retail investors may also be permitted to access virtual asset services.[138]

The Financial Free Zones have also been very active. In the ADGM, the Financial Services Regulatory Authority ("FSRA") issued wide-ranging regulations in 2018 to become "the first jurisdiction in the region to introduce a comprehensive and bespoke regulatory framework for the regulation of spot virtual asset activities, including those undertaken by multilateral trading facilities, brokers, custodians, asset managers and other intermediaries."[139] Such intermediaries are required to be licensed or approved by the FSRA.[140] Cryptoasset services, including access to trading platforms, may be accessed by retail investors.[141] The FSRA's framework carves out cryptoasset securities, which are deemed to be subject to existing securities regulation in the ADGM, though the FSRA has also published separate guidance in relation to cryptoasset securities activities

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[130] Decision No. (23/ Chairman) of 2020 Concerning Crypto Assets Activities Regulation
[131] Cabinet Decision No. 111/2022 On the Regulation of Virtual Assets and Their Service Providers
[132] Id. at Art. 1, 3/2.
[133] Id. at Art. 5.
[134] Cabinet Decision No. 112/2022 On Delegating Certain Competencies related to the Regulation of Virtual Assets
[135] *Regulatory Framework*, VARA, https://rulebooks.vara.ae/ (last visited Apr. 25, 2024).
[136] *Rulebooks*, VARA, https://rulebooks.vara.ae/rulebook/rulebooks (last visited Apr. 25, 2024).
[137] The Virtual Currency Regulation Review: United Arab Emirates, *supra* note 129.
[138] *See*, *e.g.*, Adam Lucente, *What Binance's New Dubai License Means for UAE Cryptocurrency Sector*, AL-MONITOR (Apr. 19, 2024), https://www.al-monitor.com/originals/2024/04/what-binances-new-dubai-license-means-uae-cryptocurrency-sector.
[139] *Digital Asset Activities Regulated by ADGM*, ABU DHABI GLOBAL MARKET, https://www.adgm.com/setting-up/digital-assets/overview (last visited Apr. 25, 2024).
[140] Financial Services Regulatory Authority, *Guidance – Regulation of Digital Securities Activities in ADGM* 7 (Feb. 24, 2020).
[141] *See*, *e.g.*, *id.* at para. 47; Financial Services Regulatory Authority, *Guidance – Regulation of Virtual Asset Activities in ADGM* 7 para 131(c)(ii), para 153(a) (VER05.181223).

and offerings.[142] Further, the FSRA allows intermediaries to provide services in both cryptoasset securities and non-securities, provided they obtain the proper approval.[143]

In the DIFC, the Dubai Financial Services Authority ("DFSA") has also introduced regulatory frameworks for cryptoasset securities and derivatives ("Investment Tokens")[144] and for other types of cryptoassets ("Crypto Tokens"), excluding CBDCs, NFTs and utility tokens.[145] Under the Crypto Tokens regime, anyone providing financial services in Crypto Tokens must be licensed by the DIFC.[146] Existing licensees may apply to vary their licenses to provide Crypto Token services.[147] Arrangers, dealers and platform operators may provide services to retail investors provided they have conducted an appropriateness test.[148] Further, the DFSA has established specific cryptoasset custody requirements, applicable to both Investment Tokens and Crypto Tokens.[149]

[142] Digital Asset Activities Regulated by ADGM, *supra* note 133; *see also* The Virtual Currency Regulation Review: United Arab Emirates, *supra* note 129, at II/ii.
[143] Guidance – Regulation of Digital Securities Activities in ADGM, *supra* note 140, at para 62.
[144] DFSA Introduces Regulatory Framework for Investment Tokens, DUBAI FIN. SVCS. AUTH. (Oct. 25, 2021 10:35 AM), https://www.dfsa.ae/news/dfsa-introduces-regulatory-framework-investment-tokens.
[145] Dubai Financial Services Authority, *Feedback Statement on CP143 Regulation of Crypto Tokens* para. 12 (Oct. 17, 2022).
[146] *Id.* at para. 38.
[147] *Id.* at para. 102.
[148] DFSA Rulebook COB 15.6.2 (2022).
[149] The Virtual Currency Regulation Review: United Arab Emirates, *supra* note 129, at III/ii.

II. THE COSTS OF THE INEFFECTIVE US CRYPTOASSET REGULATORY FRAMEWORK

Part II identifies the costs to US investors and markets arising in part from the lack of an effective regulatory framework for cryptoassets. We highlight three principal categories of costs. First, the percentage of global cryptoasset transaction volume that takes place in the US and the percentage of cryptoasset transaction volume that is denominated in US-issued assets lag far behind other financial markets. The percentage of volume that is denominated in US-issued assets is declining further. This has limited the ability of US investors and businesses to participate in domestic cryptoasset market activities, and caused many to invest in foreign cryptoasset markets, where US authorities lack regulatory and supervisory authority. Second, the US has forgone cryptoasset-related jobs, tax revenue, and other beneficial economic activity attributable to cryptoasset trading, investment, and innovation. Third, despite the presence of domestic cryptoasset trading platforms and other service providers that comply with prevailing anti-fraud and criminal laws and that voluntarily implement additional customer protections, many US investors have been driven to rely on service providers that take advantage of regulatory gaps and that do not adhere to similar standards, exposing investors to greater risk of loss and fraud. These developments suggest that the costs of US regulatory inaction and complacency are both increasingly apparent and on the rise.

1. Cryptoasset investors and users are avoiding US markets.

The lack of an effective regulatory framework is increasingly contributing to avoidance of US markets, instead pushing cryptoasset activity into foreign markets. The loss of domestic market share lessens the ability of US investors and businesses to participate in the global cryptoasset market ecosystem and restricts the ability of US regulators, who lack extraterritorial authority, to supervise and regulate cryptoasset markets.

A strong and flexible US regulatory framework for traditional financial assets has helped attract a large share of global issuance and trading activity to US markets. In addition to factors such as a strong US economy, a large institutional investor base, and highly liquid markets, many foreign companies choose to issue and list their shares on US markets in part because of the strength of US financial regulation, which leads to increased investor trust and company value.[150] In contrast, despite the attractiveness of the US economy and the fact that a majority of cryptoasset investment funds are located in the US,[151] US cryptoasset markets are being avoided. This suggests that the US cryptoasset regulatory structure is discouraging cryptoasset-related activity, not attracting it.

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[150] *See, e.g.*, George Calhoun, *Why do Chinese Companies List their Shares in New York?,* FORBES (Aug. 14, 2020, 11:49 PM), https://www.forbes.com/sites/georgecalhoun/2020/08/14/why-do-chinese-companies-list-their-shares-in-new-york/?sh=60171ee81f1b.

[151] *2023 Q4 Crypto Fund Quarterly Report*, CRYPTO FUND RESEARCH 5 (Mar. 22, 2024), https://cryptofundresearch.com/q4-2023-crypto-fund-report/.

Further bolstering this notion, past examples show how market participants can quickly and significantly shift their financial activities across jurisdictions in response to regulatory changes. For instance, it is estimated that within one year of the finalization of the CFTC's 2013 rule limiting US banks' domestic exposure to swap markets, 95% of domestic swap market volume had shifted to other jurisdictions.[152] We present our evidence below. We begin by focusing on two principal quantitative metrics that show the scale at which cryptoasset market activities are taking place outside the US: (a) the share of cryptoasset transaction volume occurring on US trading platforms, and (b) the share of cryptoasset trading denominated in US-issued assets. We then present data from the market for bitcoin exchange traded funds ("ETFs") showing that once the US courts invalidated the SEC's effective prohibition on these funds, US-based bitcoin ETFs quickly attracted substantial investment and took the lead as the largest in the world. These data provide strong evidence that cryptoasset market activity flows into the US quickly when effective regulatory structures are implemented.

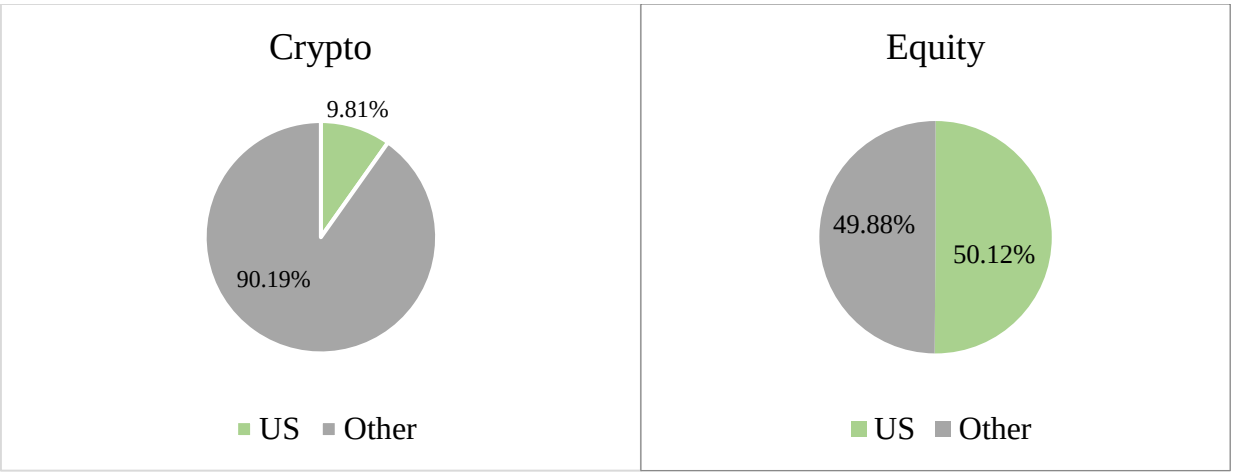
a. The share of global cryptoasset transaction volume on US trading platforms lags behind other markets.

The share of global cryptoasset trading volume that occurs in the US lags far behind other markets, as well as the US share of trading volumes in traditional financial markets.

Figure 1 below compares the estimated percentages of global trading volume that occurs in US venues for both cryptoasset centralized trading platforms and exchange-traded equity markets, in each case over the 2018-2023 period. US-based platforms hosted approximately **10%** of global on-platform cryptoasset transactions. By comparison, US exchanges hosted on average **50%** of transaction volume in exchange-traded equities over the same period. The US's share of exchange trading in equities markets was the largest in the world and was around five times greater than its share of cryptoasset trading platform volume.

[152] Charles Levinson, *U.S. Banks Moved Billions of Dollars in Trades Beyond Washington's Reach* BLOOMBERG (Aug. 21, 2015), https://www.reuters.com/investigates/special-report/usa-swaps/.

Figure 1: Percent of Global Trading Volume Occurring in US Venues –Cryptoasset Trading Platforms vs. Equity Exchanges (2018-2023)[153]



A recent analysis of stablecoin transaction activities underscores the predominance of offshore trading venues: Specifically, it finds that as of 2023, 54.6% of stablecoin deposits by investors in North America were to offshore cryptoasset trading platforms.[154]

The predominance of offshore trading venues in cryptoasset markets limits the ability of US customers to access cryptoasset markets, since many such venues exclude US customers. To the extent US customers are able to access these venues (either because they are permitted to do so, or because they are able to circumvent measures intended to exclude them), they are at risk from less reliable customer protection standards that often prevail in the jurisdictions where those venues are based. Further, when cryptoasset platforms are based offshore, the ability of the US government to oversee cryptoasset markets becomes limited.[155] Indeed, a recent report from the Congressional Research Service studying terrorist financing in light of the October 7, 2023, Hamas attacks on Israel have noted the significantly greater failure of foreign-based cryptoasset platforms to comply with US anti-money laundering laws compared to domestic platforms, even when those foreign platforms conduct business with US persons.[156] And Deputy

[153] THE BLOCK, *Cryptocurrency Monthly Exchange Volume* (2018-2024 data), https://www.theblock.co/data/crypto-markets/spot/cryptocurrency-exchange-volume-monthly; WORLD FEDERATION OF EXCHANGES, *Statistics Portal* (2018-2023 data), https://statistics.worldexchanges.org/.
[154] Chainalysis Team, *North America Leads World in Crypto Usage Despite Ongoing Regulatory Questions, While Stablecoin Activity Shifts Away from U.S. Services*, CHAINALYSIS (Oct 23, 2023), https://www.chainalysis.com/blog/north-america-cryptocurrency-adoption/.
[155] *Id.*
[156] Liana W. Rosen, Paul Tierno, & Rena S. Miller, *Terrorist Financing: Hamas and Cryptocurrency Fundraising*, CONG. RESEARCH SERV. (Nov. 27, 2023), https://crsreports.congress.gov/product/pdf/IF/IF12537.

Secretary of the Treasury Adeyemo recently noted that Russia has sought to use Tether, an offshore stablecoin, to subvert US sanctions.[157]

b. The share of cryptoasset transaction volume denominated in US-issued assets lags behind other markets and is declining.

The US dollar is the dominant currency in traditional financial markets and the dominant global reserve currency. This lowers the cost of capital for the US government and private businesses and enables the US government to impose sanctions and enforce anti-money laundering restrictions globally.[158]

The situation in cryptoasset markets is significantly different. As explained in the Phase I Report, cryptoasset markets are distinguished from traditional financial markets in that they allow trades to be denominated in both fiat currencies (crypto-to-fiat trading) as well as cryptoassets (crypto-to-crypto trading). Thus cryptoasset transactions that are nominally denominated in US dollars can consist of crypto-to-fiat trades where actual US dollars are traded for a cryptoasset, or crypto-to-crypto trades where a US-dollar stablecoin (a cryptoasset intended to track the value of the US dollar) is traded for another cryptoasset.

In current cryptoasset markets crypto-to-crypto trades involving US dollar stablecoins predominate. However, this US dollar-denominated volume primarily consists of stablecoins issued by offshore entities. In particular, the US-dollar Tether stablecoin ("USDT") has been involved in over 60% of cryptoasset trading volume at all times since 2019. The issuer of USDT is registered in Hong Kong, and its parent company is based in the British Virgin Islands. By comparison, the largest domestically issued USD-denominated stablecoin – Circle's USDC – is involved in just 5% of cryptoasset trading volume.[159]

Figures 2A and 2B below illustrate the extent to which foreign issued stablecoins have displaced actual US dollar transactions in cryptoasset markets. Figure 2A compares current volumes in foreign exchange markets with cryptoasset markets. Whereas in October 2023 the US dollar was involved in close to **90%** of trading volume in foreign exchange spot markets, crypto-to-fiat trades involving US dollars constituted only **13.4%** of cryptoasset trading volume and crypto-to-crypto trades involving foreign-issued stablecoins constituted 78.5% of trading volume. Figure 2B illustrates how this disparity has increased over the past five years. In 2018 crypto-to-fiat trades involving actual US dollars still constituted over **30%** of cryptoasset trading volume and crypto-to-crypto

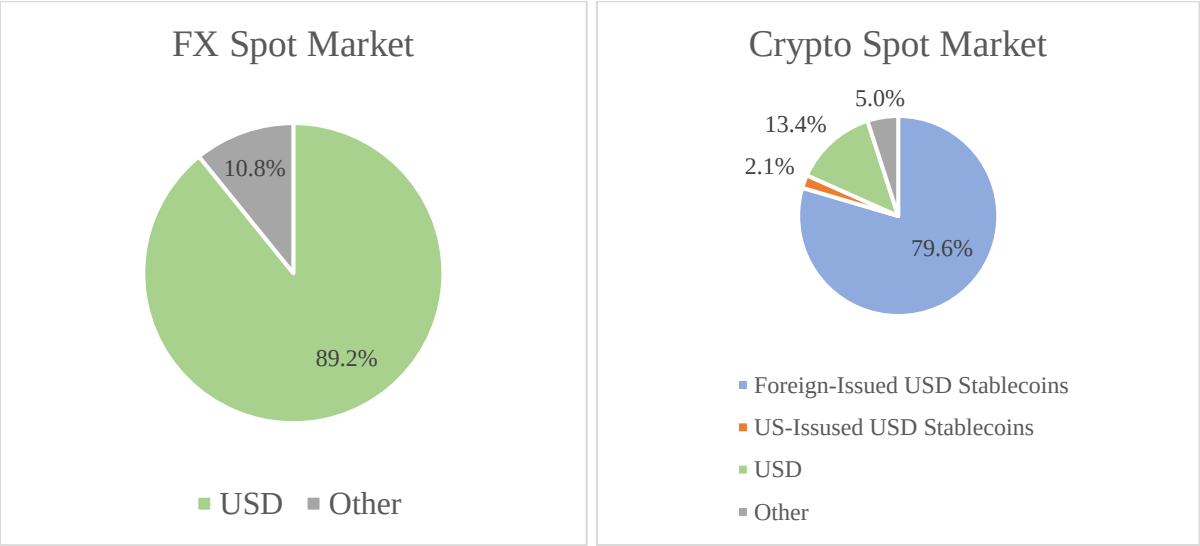
[157] https://home.treasury.gov/news/press-releases/jy2243

[158] *See, e.g.*, Paul Vigna, *Brace for the Digital-Money Wars*, WALL ST. J. (Dec. 7, 2019), https://www.wsj.com/articles/brace-for-the-digital-money-wars-11575694806.

[159] Olga Kharif, et al., *Stablecoin USDC's Slide Makes Circle's Proposed IPO a Hard Sell*, BLOOMBERG (Nov. 14, 2023), https://www.bloomberg.com/news/articles/2023-11-15/circle-ipo-usdc-loss-to-tether-may-complicate-listing-plans-usdc-usdt.

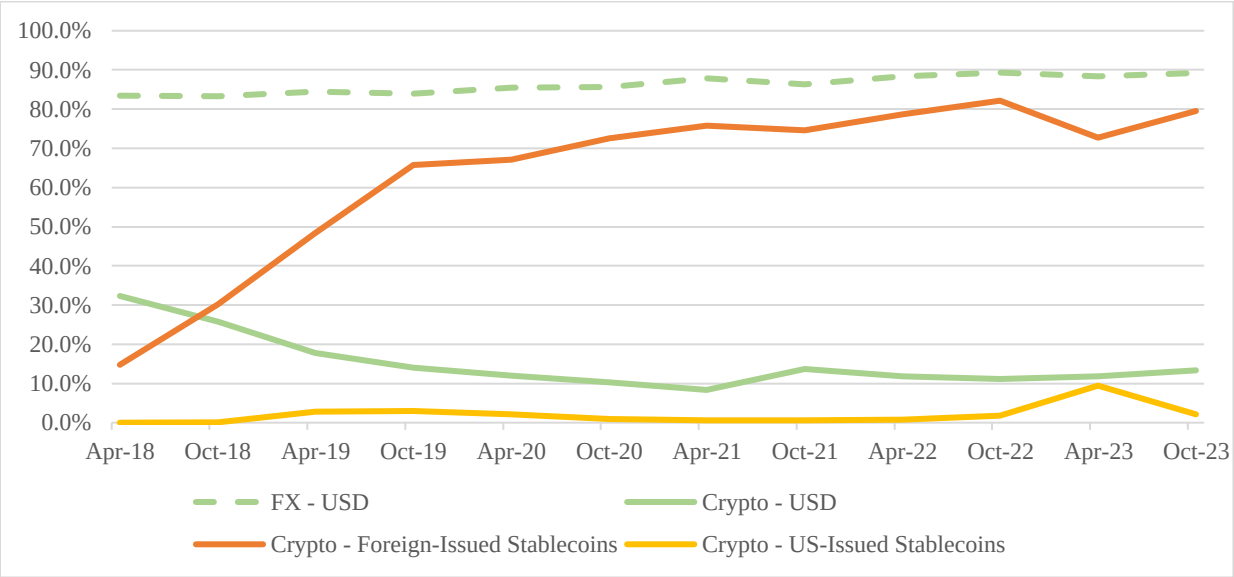
trades involving foreign issued stablecoins constituted only **15%**. Since then, US dollar usage has declined whereas foreign issued stablecoins have continued to become more prominent.

Figure 2A: Percentage share of trading volume denominations – Foreign exchange spot markets vs. cryptoasset spot markets (Oct. 2023)[160]



[160] FOREIGN EXCHANGE COMMITTEE, FED. RESERVE BANK OF N.Y., *FX Volume Survey* (Oct. 2023 Survey), https://www.newyorkfed.org/medialibrary/Microsites/fxc/files/2024/octfxsurvey2023xls.xlsx; THE BLOCK, *Share of Trade Volume by Pair Denomination* (Oct. 2023 data), https://www.theblock.co/data/crypto-markets/spot/share-of-trade-volume-by-pair-denomination.

Figure 2B: Percentage share of trading volume denominations – Foreign exchange spot markets vs. cryptoasset spot markets (historical trend 2018-2013)[161]



The preeminence of the US dollar is not itself undermined by these trends. However, the ability of the US to regulate financial markets is curbed where crypto-to-dollar trades rely on foreign-issued stablecoins, since, for example, the US does not regulate foreign issuance and registration schemes for these stablecoins.

c. Cryptoasset market activity can quickly flow into the US when regulatory issues are resolved.

As discussed in the Phase I Report, the SEC previously prohibited the offering of exchange-traded funds ("ETFs") holding spot positions in bitcoin or other cryptoassets to US investors. The SEC claimed that the businesses applying to offer spot bitcoin ETFs had failed to show that the bitcoin market was sufficiently resistant to manipulation. However, the SEC did not articulate any criteria that applicants could use to demonstrate sufficient resistance to manipulation.

In August 2023, the DC Circuit Court of Appeals ruled that the SEC's rationale for refusing to approve bitcoin ETFs was "arbitrary and capricious," thus paving the way for the offering of such funds to US investors.[162] Since then, eleven US-based bitcoin ETFs have

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[161] FOREIGN EXCHANGE COMMITTEE, FED. RESERVE BANK OF N.Y., *FX Volume Survey* (2018-2023 data), https://www.newyorkfed.org/medialibrary/Microsites/fxc/files/2024/octfxsurvey2023xls.xlsx; THE BLOCK, *Share of Trade Volume by Pair Denomination* (2018-2023 data), https://www.theblock.co/data/crypto-markets/spot/share-of-trade-volume-by-pair-denomination.

[162] *Grayscale Investments, LLC v. SEC*, U.S. Court of Appeals for the D.C. Circuit (Aug. 29, 2023) https://www.cadc.uscourts.gov/internet/opinions.nsf/32C91E3A96E9442285258A1A004FD576/$file/22-1142-2014527.pdf.

launched and have immediately attracted substantial investment. By February 2024 and within 6 months of the launch of the first US bitcoin ETF, US bitcoin ETFs already constituted 83% of the total assets of all bitcoin ETFs globally, surpassing the prior leader, Canada, which previously accounted for 46% of total assets.[163] The rapid growth of US bitcoin ETFs following the DC Circuit's ruling indicates that US investors value the option to invest in a US-regulated investment vehicle – when a regulatory impediment is resolved, cryptoasset market activity can quickly flow into to the US. The swiftness with which bitcoin ETF activity has flourished in the US also underscores the potential immediate benefits of addressing outstanding regulatory issues in the near term.

2. The US has lost cryptoasset-related jobs and businesses, tax revenue, and other cryptoasset-related economic benefits.

There is significant evidence that the lack of an effective cryptoasset regulatory framework and the resulting regulatory uncertainty are leading to substantial losses of cryptoasset-related jobs and businesses, tax revenue, and other economic benefits.

a. Loss of cryptoasset-related jobs and businesses

Cryptoasset-related jobs are departing the US in substantial numbers. According to one estimate, 74% of cryptoasset developers are located outside the US,[164] and the US has lost approximately 3% of the global population of developers each year since 2018.[165] In contrast, Africa, India and other parts of Asia have increased their shares substantially.[166] Furthermore, the US could lose up to one million jobs over the next seven years due to the overseas relocation of cryptoasset and blockchain technology businesses.[167] Another recent analysis indicates that there has already been an observable decline in cryptoasset-related job postings in major US cities.[168] It also shows that the number of monthly cryptoasset-related startup births in the US has declined from a peak of 125 in 2018 to less than 10 in 2022,[169] despite the fact that a majority of cryptoasset investment funds do business in the US, as discussed in subpart (b).

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[163] Lim Yu Qian, *US Captures 83% of Spot Bitcoin ETF Market, Overtaking Canada* COINGECKO (Feb. 19, 2024), https://www.coingecko.com/research/publications/spot-bitcoin-etfs-worldwide.
[164] Electric Capital, *2023 Crypto Developer Report*, ELECTRIC CAPITAL 172 (Jan. 17, 2024), https://www.developerreport.com/ developer-report.
[165] *See id.* at 173.
[166] *See id.* at 174, 176.
[167] Electric Capital, *The U.S. Must Move Quickly to Preserve Preeminence in Financial Markets & Related Technologies*, ELECTRIC CAPITAL (Mar. 2023), https://www.developerreport.com/developer-report-geography.
[168] Tonantzin Carmona, Mark Muro, & Sifan Liu, *Crypto Crashes and Job Slashes: Lessons for Local Leaders on Building an Innovation Ecosystem*, BROOKINGS INST. (2023), https://www.brookings.edu/articles/crypto-crashes-and-job-slashes-lessons-for-local-leaders-on-building-an-innovation-ecosystem/.
[169] *Id*.

There have already been numerous reports of cryptoasset businesses expanding overseas in lieu of the US.

- In June 2023, the blockchain developer "a16z" announced it will open its first ex-US office in London, stating that blockchain "can only succeed with a clear regulatory regime";[170]

- Cryptoasset trading platform Bullish indicated it plans to register in Hong Kong as a result of its developed cryptoasset framework while refraining from any commercial activity in the US due to the relative regulatory uncertainty.[171]

- New York-based cryptoasset trading platform Gemini has announced multiple overseas expansion plans including a technology development center in India, expanding its employee headcount in Singapore to over 100 and plans to obtain a license to operate in the United Arab Emirates.[172]

- Coinbase, the largest US cryptoasset trading platform, has announced plans to expand in Singapore, Australia, Brazil, Canada, and Europe, citing the increased certainty provided by the efforts to implement effective cryptoasset regulatory frameworks in those jurisdictions.[173]

b. Loss of investment

Total annual investment fundraising in cryptoasset-related businesses has grown substantially over the past four years, but the share of that fundraising that flows to the US is declining. This is despite the fact that recent reports find a slight majority of cryptoasset investment funds have a primary office in the US,[174] and that US venture

[170] Chris Dixon, *Expanding to the UK*, A16ZCRYPTO (June 11, 2023), https://a16zcrypto.com/posts/article/expanding-uk-andreessen-horowitz/.
[171] Sidhartha Shukla & Suvashree Ghosh, *Crypto Seeks Lifeline in Asia as US Crackdown Spurs More Layoffs*, BLOOMBERG (Sept. 13, 2023), https://www.bloomberg.com/news/articles/2023-09-13/crypto-seeks-lifeline-in-asia-as-sec-us-crackdown-spurs-layoffs.
[172] Pravjit Tiwana, *Gemini to Expand Global Engineering & Operations Teams With New Office in Gurgaon, India,* GEMINI (Apr. 20, 2023), https://www.gemini.com/blog/gemini-to-expand-global-engineering-and-operations-teams-with-new-india-office; Team Gemini, *Gemini Announces Plans for UAE Crypto License*, GEMINI (May 31, 2023) https://www.gemini.com/blog/gemini-announces-plans-for-uae-crypto-license; Team Gemini, *Gemini Announces Expansion Plans in APAC*, GEMINI, (June 19, 2023), https://www.gemini.com/blog/gemini-announces-expansion-plans-in-apac.
[173] Jamie Crawley, *U.S. is 'Losing' the Bitcoin Movement: Cathie Wood*, COINDESK (May 24, 2023), https://www.coindesk.com/policy/2023/05/23/us-is-losing-the-bitcoin-movement-cathie-wood/; Jamie Crawley, *Coinbase Targets Regulatory Clarity in International Expansion Plan*, COINDESK (Sept. 8, 2023), https://www.coindesk.com/business/2023/09/08/coinbase-targets-regulatory-clarity-in-international-expansion-plan.
[174] 2023 Q4 Crypto Fund Quarterly Report, *supra* note 151 , at 5.

capital firms represent approximately 70% of assets under management of the top 50 cryptoasset-focused venture capital firms.[175]

More specifically, total cryptoasset-related fundraising grew six-fold from approximately $3 billion in 2020 to $22.63 billion in 2023.[176] However, each year, the share of fundraising deals reported to occur in the United States has fallen. In 2020 approximately 36% of total cryptoasset investment deals were reported as occurring in the US.[177] This percentage has since continually declined, to 35% in 2021, 31% in 2022 and 25% in 2023.[178] While fundraising can be cyclical and reflect market conditions, numerous reports attribute this decline to the ongoing regulatory uncertainty in the US relative to other jurisdictions.[179]

c. Loss of innovation

Several studies have shown that blockchain technology has the potential to unlock billions in cost savings and provide increased transparency to financial markets. According to one estimate, blockchain-related technologies drove cost savings for banks of $301 million on cross-border settlements in 2021 and such technologies have the potential to generate $10 billion in additional savings by 2030.[180]

Other reports estimate that blockchain technology could result in $15-20 billion in annual cost savings for the banking industry by lowering cross-border payment costs and securities trading and regulatory compliance costs.[181] Blockchain technology also potentially offers benefits with regard to financial inclusion, supply chain management, and market surveillance, among other benefits.[182]

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[175] *The Top 50 Crypto VC's in 2023*, FINTECH NEWS AM. (Mar. 18, 2023), https://fintechnews.am/fintech-usa/49081/the-top-50-crypto-vcs-in-2023/ (last updated Mar. 11, 2024).
[176] *Global Crypto Fundraising Overview*, COINCARP, https://www.coincarp.com/fundraising/statics/ (last visited Apr. 16, 2024).
[177] *Id.*
[178] *Id.*
[179] *See, e.g.*, Michael Adams, *How Will Cryptocurrency Regulation Affect Crypto Prices?*, U.S. NEWS & WORLD REPORT (June 29, 2022), https://money.usnews.com/investing/cryptocurrency/articles/will-cryptocurrency-regulation-affect-crypto-prices; *see also* Emma Newbery, *Do We Need More Crypto Regulation? Two Sides of the Story*, MOTLEY FOOL (Oct. 21, 2021), https://www.fool.com/the-ascent/cryptocurrency/articles/do-we-need-more-crypto-regulation-two-sides-of-the-story/.
[180] Sam Smith, *Blockchain to Facilitate Savings of $10 Billion Globally in Cross-border Payments*, JUNIPER RESEARCH (Nov. 8, 2021), https://www.juniperresearch.com/press/blockchain-to-facilitate-savings-of-10bn/.
[181] Jane Wild, Martin Arnold, & Philip Stafford, *Technology: Banks seek the key to blockchain*, FIN. TIMES (Nov. 1, 2015), https://www.ft.com/content/eb1f8256-7b4b-11e5-a1fe-567b37f80b64?segid=0100320#axzz3qK4rCVQP.
[182] Brian Brooks & Sujit Raman, *Misunderstanding Crypto and Terror Financing Leads to Bad Policy*, BLOOMBERG LAW (Nov. 15, 2023), https://news.bloomberglaw.com/us-law-week/misunderstanding-crypto-and-terror-financing-leads-to-bad-policy; Robert Greenfield, IV, *Poor Crypto Regulation Will Make the U.S. Dollar Irrelevant in 10 years*, MEDIUM (June 11, 2023), https://robertgreenfieldiv.medium.com/poor-crypto-regulation-will-make-the-u-s-dollar-irrelevant-in-10-years-433925dfa44c.

However, according to recent reports, the US share of blockchain developers has been falling every year since 2018, from 40% to 26% in 2023.[183] By contrast, the share of developers in Asia increased from 9% to 19% between 2017 and 2022.[184] The loss of this technical expertise and businesses threaten the potential for US financial markets to benefit from the efficiencies provided by blockchain technology.

d. Loss of tax revenue

Capital gains income from cryptoasset holdings and transactions has the potential to generate billions of dollars in tax revenue for the US government. Indeed, US lawmakers estimate that cryptoasset trading could generate billions of dollars in income tax revenue over the next decade.[185] However, if US persons decrease the extent to which they hold and trade cryptoassets, the amount of these income tax revenues will decrease. Furthermore, to the extent cryptoasset transaction activity continues to migrate to offshore venues, the ability of US authorities to monitor and collect income tax with respect to the cryptoasset transactions of US persons will be diminished. Income taxes are distinct from a financial transaction tax on cryptoasset transactions occurring on US trading venues, which should not be implemented. The tax revenue raised by a financial transaction tax would be minimal, because it would cause cryptoasset transaction activity to continue to move from US venues to offshore venues.

3. US customers and investors are at greater risk of fraud and loss.

As described in the Phase I Report, despite the absence of a comprehensive federal regulatory framework for cryptoassets, US cryptoasset trading platforms and other cryptoasset intermediaries are subject to anti-fraud and anti-market manipulation rules under the Commodity Exchange Act, as well as federal anti-money laundering and "know your customer" laws. Moreover, certain states have enacted limited regulatory frameworks with customer protection requirements for cryptoasset service providers. Numerous domestic cryptoasset trading platforms and other service providers comply with such laws and have voluntarily implemented rigorous customer protections, including custody.

However, the lack of a comprehensive federal regulatory framework for cryptoassets exposes US customers and investors to greater risk of fraud and loss, in two ways. First, gaps in existing regulation—particularly the lack of a registration framework for cryptoassets and the lack of a workable custody regime—directly put customers at risk. Second, as cryptoasset businesses seek to avoid the US regulatory landscape, many US investors have relied on offshore intermediaries that do not comply with similar laws to

[183] Electric Capital, *supra* note 164, at 173.
[184] Electric Capital, *supra* note 167, at 13.
[185] Richard Rubin & Paul Kiernan, *Crypto Rules Delay Puts Billions in Tax Revenue at Risk*, WALL ST. J. (Aug. 2, 2023), https://www.wsj.com/articles/crypto-rules-delay-puts-billions-in-tax-revenue-at-risk-4bb9d7b5.

those described above, nor implement adequate customer protection standards. The Phase I Report discussed how the threat of enforcement actions by US regulators has caused certain offshore intermediaries to deny access to US customers. However, some US persons have reportedly evaded access restrictions put in place by offshore trading venues and, as detailed below, many offshore service providers have not excluded or indeed have sought out US customers.

This has resulted in the loss of or placed at risk billions of dollars of those investors' assets. Despite anti-fraud enforcement actions against some of these noncompliant intermediaries, the risk of further losses remains. At the same time, the actions of the SEC and other regulators have hindered the ability of domestic market participants and cryptoasset service providers who seek to comply with the law and implement additional customer protection standards to offer their services to US customers and thus to mitigate these risks.

We identify here the most significant examples of how the lack of effective regulatory framework has pushed US customers and investors to rely on noncompliant, primarily offshore, cryptoasset trading platforms and other service providers with inadequate customer protection standards, and the costs that have resulted:

- **FTX (2022): $166 million+ in potential US customer losses from abusive trading practices and improper custody practices.** The Bahamas-based cryptoasset trading platform FTX operated two spot cryptoasset trading platforms until its bankruptcy in November 2022. The larger global platform was officially closed to US customers, but some US persons were reportedly able to circumvent those restrictions and trade on the platform. A smaller US-based platform was open to US customers.[186] Neither platform was registered as a securities exchange or broker-dealer. FTX also operated a separate US cryptoasset derivatives trading platform under CFTC oversight, the rules of which prevented customer losses.

  FTX engaged in practices that are prohibited under the US securities framework and that resulted in the loss of customer assets. In particular, on its spot platforms, FTX commingled customers' assets with the assets of other customers and the assets of FTX and its affiliates. It loaned customer assets to affiliated firms without customers' permission.[187] It permitted an affiliated proprietary trading firm, Alameda Research, to trade on FTX platforms and engage in front running and

[186] PIFS, *supra* note 1 at 43-44.
[187] Alexander Saeedy & Danny Dougherty, *Here's How FTX Executives Secretly Spent $8 Billion in Customer Money*, WALL ST. J. (Oct. 7, 2023), https://www.wsj.com/finance/regulation/sbf-trial-ftx-customer-money-missing-6ba13914.

wash sales that artificially increased trading volume.[188] When the extent and significance of these activities became public, FTX froze customer withdrawals and declared bankruptcy. Globally an estimated 1 million customers lost access to billions of dollars of their assets.[189] It remains unclear how much of these assets will be returned to customers. US customers may permanently lose access to $166 million in assets.[190] Furthermore, the bankruptcy settlement may only entitle customers to receive the US dollar equivalent of the market value of their deposited cryptoassets as of the date of the day FTX become insolvent, such that customers would also lose the benefit of any appreciation in the market value of those assets.

- **Celsius (2022): Trading platform customers lose access to $4 billion in deposits.** Celsius was a cryptoasset trading platform available to US customers that also offered customers interest-bearing cryptoasset deposit accounts and personal loans secured by cryptoassets.[191] However, it used customer deposits to fund its own operations and make high-risk investments. The company's actions resulted in bankruptcy and a settlement with the Federal Trade Commission.[192] It remains unclear how many of their over $4 billion in assets Celsius customers will recover in the bankruptcy proceedings.

- **Bitfinex (2018): $850 billion in trading platform customer deposits placed at risk.** Bitfinex, a British Virgin Islands-based cryptoasset trading platform and custody service open to US customers, used a Panama-based payments processor to handle customer deposits and withdrawals. [193] When the payments

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[188] Caitlin Ostroff, *Alameda Amassed Crypto Tokens Ahead of FTX Listings, Public Data Shows*, WALL ST. J. (Nov. 14, 2022), https://www.wsj.com/livecoverage/stock-market-news-today-11-14-2022/card/alameda-amassed-crypto-tokens-ahead-of-ftx-listings-public-data-shows-z6KFN051ToEpFohTXA89; Matthew Goldstein, et al., *How FTX's Sister Firm Brought the Crypto Exchange Down*, NY TIMES (Nov. 18, 2022), https://www.nytimes.com/2022/11/18/business/ftx-alameda-ties.html.

[189] Elizabeth Howcroft & Medha Singh, *FTX Customers Are Still Grappling with Crypto Platform's Collapse*, REUTERS (Oct. 6, 2023), https://www.reuters.com/technology/ftx-customers-are-still-grappling-with-crypto-platforms-collapse-2023-10-05/.

[190] Shaurya Malwa, *FTX Plans to Return 90% of Customers Funds, But There's a Catch*, COINDESK (Oct. 17, 2023), https://www.coindesk.com/policy/2023/10/17/ftx-plans-to-return-90-of-customer-funds-but-theres-a-catch/.

[191] Nicholas Biase, *Celsius Founder And Former Chief Revenue Officer Charged In Connection With Multibillion-Dollar Fraud And Market Manipulation Schemes*, U.S. ATTORNEY'S OFFICE, SOUTHERN DIST. OF N.Y. (July 13, 2023), https://www.justice.gov/usao-sdny/pr/celsius-founder-and-former-chief-revenue-officer-charged-connection-multibillion?fbclid=IwAR2ex17biCawWH3k8mj1Qr_BL3O0_Fb1PI2sbVlZ6T5G9JaIwM4gKUJHb8A.

[192] Juliana Gruenwald Henderson, *FTC Reaches Settlement with Crypto Platform Celsius Network; Charges Former Executives with Duping Consumers into Transferring Cryptocurrency into their Platform and then Squandering Billions in User Deposits*, FED. TRADE COMM'N (July 13, 2023), https://www.ftc.gov/news-events/news/press-releases/2023/07/ftc-reaches-settlement-crypto-platform-celsius-network-charges-former-executives-duping-consumers.

[193] *In the Matter of iFinex Inc., BFXNA Inc., and BFXWW Inc.*, CFTC Docket No. 22-5 (Oct. 15, 2021), https://www.cftc.gov/media/6651/enfbfxnaincorder101521/download.

processor had its assets frozen by various governments Bitfinex lost access to $850 billion in customer deposits and yet continued to use the payments processor to accept new customer deposits.[194] Bitfinex was only able to cover customer withdrawals via a payment of $625 million from its affiliate, the stablecoin issuer Tether.[195] This payment included assets that Tether had represented as providing 100% US dollar backing for the stablecoin.[196] Bitfinex and Tether settled claims of fraud brought by the New York Attorney General and the CFTC.[197]

Had the US implemented a workable registration framework for cryptoasset spot trading platforms and custody providers, US customers of FTX and the other platforms noted above would likely not have borne these losses or faced these risks. This is evidenced by the protection of customers of FTX's CFTC-regulated US derivatives platform and the protection of Japanese customers of FTX, where a customized regulatory framework for trading platforms and cryptoasset custody ensured that customers did not lose access to their deposits.

The risk of further losses remains.[198] According to SEC allegations, Binance, the largest global cryptoasset trading platform has engaged in many of the same activities that led to such significant losses for FTX customers, including the commingling of custodied customer assets, the diversion of up to $20 billion in customer assets to affiliated entities, and the use of affiliated entities to engage in wash trading to artificially boost trading volume.[199]

III. IMPLEMENTING AN EFFECTIVE CRYPTOASSET REGULATORY FRAMEWORK IN THE US

This Part III identifies guiding principles and specific reforms that can reposition the US as a leader in cryptoasset regulatory structure, building upon our strong traditions of commercial law leadership, protection of property rights, and financial and technological innovation. While some of these recommendations may require new legislation, we identify steps US financial regulators can take now to address the most pressing problems with the status quo in the US pending the enactment of legislation. Part III concludes with

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[194] *Id.*; *see also In the Matter of Tether Holdings Limited, et al.*, CFTC Docket No. 22-04 (Oct. 15, 2021), https://www.cftc.gov/media/6646/enftetherholdingsorder101521/download.
[195] *In the Matter of iFinex Inc., et al.* (Feb. 17, 2021), https://ag.ny.gov/sites/default/files/2021.02.17_-_settlement_agreement_-_execution_version.b-t_signed-c2_oag_signed.pdf.
[196] *Id.*
[197] *Id.*; *see also* Commodity Futures Trading Comm'n, *CFTC Orders Tether and Bitfinex to Pay Fines Totaling $42.5 Million*, Release No. 8450-21 (Oct. 15, 2021), https://www.cftc.gov/PressRoom/PressReleases/8450-21.
[198] *Id.*
[199] *SEC v. Binance Holdings Ltd., et al.*, Civil Action No. 1:23-cv-01599, Complaint (D.D.C. June 5, 2023), https://www.sec.gov/files/litigation/complaints/2023/comp-pr2023-101.pdf.

a summary comparison of three legislative proposals put forth by US lawmakers that assesses the extent to which they would or would not adhere to our recommendations.

1. **Establish a workable registration framework for cryptoasset trading platforms, broker-dealers, and custody providers.**

As described in Part I, there is no comprehensive regulatory framework under US law for cryptoassets, the platforms that facilitate trading in cryptoassets, broker-dealers that execute transactions in cryptoassets, or custody providers for cryptoassets.

As discussed in the Phase I Report, a "cryptoasset" may represent various distinct types of blockchain-based tokens. Although certain cryptoassets may fit the legal definition of a security or other existing asset class, basic aspects of current US regulation are incompatible with the effective regulation of the blockchain-based versions of these assets. Securities regulation provides a stark example. Existing regulation covering securities exchanges assumes a centralized and intermediated financial system. Attempting to regulate cryptoasset trading platforms as securities exchanges is unworkable, as such platforms offer decentralized and peer-to-peer trading. And SEC policies have made it impracticable for broker-dealers and custodians of securities to extend their services to cryptoassets. The SEC has nonetheless pursued a regulation by enforcement approach alleging that cryptoasset trading platforms are operating as unregistered securities exchanges, effectively preventing such platforms from operating with legal certainty in the US.[200] While many at the SEC view "regulation by enforcement" as simply "enforcing the SEC's existing regulations," it is an inefficient and ineffective way of regulating. It involves incrementally providing feedback to the market on the contours of permissible legal structures and developing a piecemeal framework via settlement decrees and court holdings instead of via notice-and-comment rulemaking with industry feedback.

The US is now an outlier among major jurisdictions for its failure to craft any rules for cryptoasset markets. Indeed, each of the other jurisdictions reviewed in Part I have either begun to implement or have proposed dedicated registration frameworks and specialized requirements for cryptoasset trading platforms, broker-dealers, and custody providers, which provide these intermediaries a pathway to compliance and customers with necessary protections.[201] These frameworks also leverage, rather than stifle, the growth of cryptoasset markets by creating regulatory structures that are more flexible than existing securities laws without sacrificing customer protection to do so. The necessity of

[200] *See* Part I.1, *supra*.
[201] *See* Part I.2-6, *supra*.

such a framework is also recognized in IOSCO's Policy Recommendations for Crypto and Digital Asset Markets: Final Report (the "IOSCO Principles").[202]

US policymakers must create a comparably effective framework for the registration and regulation of cryptoasset trading platforms, broker-dealers, and custody providers. If they do not, cryptoasset trading will be increasingly driven offshore, to the detriment of US-based customers, businesses, and regulators. Critical aspects of this framework should include:

- **Requiring adherence to rigorous cryptoasset-specific custody standards** (See Recommendation 2 below).

- **Permitting the provision of services for cryptoassets that are securities and cryptoassets that are not securities by the same providers, subject to appropriate safeguards and licensing requirements** (See Recommendation 3 below).

- **Permitting un-intermediated trading (i.e., retail access to cryptoasset trading platforms)** (See Recommendation 4 below).

- **The implementation of cryptoasset-specific disclosure requirements** (See Recommendation 6 below).

2. **Create rigorous and flexible cryptoasset-specific custody requirements.**

Part I illustrates how other jurisdictions have proposed customized frameworks for cryptoasset custody that combine necessary protections from the realm of traditional financial assets with the flexibility required by cryptoassets' underlying blockchain technology, which underlies the issuance, trading, and transfer of cryptoassets. The necessity of the establishment of a cryptoasset-specific custody regime that enables rather than stifles cryptoasset markets is also acknowledged in the IOSCO Principles. As illustrated in Part II, the lack of such a framework in the US is arguably the greatest contributing factor to the losses borne by US customers stemming from the insolvency and illiquidity of cryptoasset intermediaries.

The US must therefore enact a comparable framework for cryptoasset custody, including consideration of reforms to related bodies of law. Critical aspects of this framework should include:

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[202] THE BOARD OF THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, POLICY RECOMMENDATIONS FOR CRYPTO AND DIGITAL ASSET MARKETS: FINAL REPORT (Nov. 16, 2023), FR11/2023 OCV-IOSCO, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD747.pdf [hereinafter "IOSCO Final Report"].

- *Withdrawal of SAB 121*: SEC accounting guidance (SAB 121) requires SEC-registered custodians of cryptoassets, including all publicly traded banks, broker-dealers, and cryptoasset trading platforms, to record their customers' cryptoassets on their own balance sheets. This is inconsistent with the custody of traditional financial assets and makes cryptoasset custody extremely costly, particularly for banks and broker-dealers that are subject to stringent capital requirements. This inconsistency does not appropriately reflect the custodial nature of these assets and further raises questions about the rationale for treating cryptoassets differently. Furthermore, requiring a custodian to place custodied cryptoassets on its balance sheet increases the risk that customer assets will be subject to creditor claims if a custodian becomes insolvent. Given the substantial impact on custodians' policies and operations, the Government Accountability Office ("GAO") found that SAB 121 should have been treated as a formal rule subject to Congressional review,[203] underscoring procedural deficiencies in the SEC's approach. The SEC should therefore withdraw SAB 121 as a first step in rationalizing the approach to cryptoasset custody in the US that does not require new legislation.

- *Create a qualified custodian regime that accommodates custody by third parties and trading platforms as well as self-custody:* In traditional financial markets, qualified custodian requirements protect the assets that customers entrust to intermediaries and generally require that a custodian of customer securities be a registered broker-dealer or a bank, such that customer assets cannot be held by a centralized exchange. And it would simply be impracticable for investors to hold physical custody of their own stocks or bonds and efficiently trade them. However, the technological innovations of blockchain technology have allowed individual investors to hold physical custody of their own cryptoasset while retaining access to active markets for those assets. It has also enabled faster clearing and settlement procedures that could be unduly impeded by limiting the provision of custody to third-party banks and broker dealers. The qualified custodian regime that applies in cryptoasset markets should take account of these developments and permit trading platforms to custody customer cryptoassets provided they adhere to the same requirements and safeguards as third-party custodians. Such a regime has already been implemented at the state level in New York, where the state's prudential regulator has imposed analogous custody requirements on all entities engaged in virtual currency activities, including those licensed under its "virtual currency" framework as well as to those limited purpose trust companies under New York Banking Law which have been approved to engage in virtual

[203] SEC, B-334540, 2023 WL 7183855 (Comp. Gen. Oct. 31, 2023).

currency custody services.[204] Customers should also be permitted to hold custody of their own assets, provided that retail customers receive adequate disclosures about the risks of doing so, for example as provided by the interface which enabled them to purchase the cryptoasset upon accessing the platform.

- *Segregation, disclosure, and operational requirements*: Whenever a customer entrusts custody of a cryptoasset to a third party, whether a trading platform, broker-dealer, or otherwise, the custodian should be required to segregate customer assets from those of the custodian in a manner that shields customer assets from the creditors of the custodian in the event of insolvency. The custodian should be required to design and implement operational security measures and provide disclosure to customers about those procedures and more generally about the relative risks and benefits of entrusting custody to an intermediary versus retaining custody of one's own cryptoassets.

- *Reform related bodies of law required to support the custody regime:* Regulators should also consider what reforms in related areas of law—including commercial, property, and bankruptcy law—are necessary to ensure the smooth functioning of the custody regime. The Uniform Law Commission passed amendments to the Uniform Commercial Code in 2022 to incorporate digital assets and account for technological developments, including blockchain, which have already been introduced or adopted in more than half of the states.[205] The amendments aim to provide clarity on the transfer of property and use of property as security as these subjects relate to cryptoassets.[206] The remaining states should be encouraged to adopt the amendments. On the other hand, the US Bankruptcy Code has not been amended to account for cryptoassets, and many regulatory gaps have been identified, including cryptoasset valuation and whether cryptoassets are subject to automatic stay upon the bankruptcy filing.[207] Addressing such gaps will help custodians provide guidance and assurance to customers regarding their ownership rights.

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[204] Guidance on Custodial Structures for Customer Protection in the Event of Insolvency, NY DEPT. FIN. SVCS. (Jan. 23, 2023), https://www.dfs.ny.gov/industry_guidance/industry_letters/il20230123_guidance_custodial_structures#_ftn2

[205] *UCC, 2022 Amendments to*, UNIFORM LAW COMM'N, https://www.uniformlaws.org/committees/community-home?CommunityKey=1457c422-ddb7-40b0-8c76-39a1991651ac (last visited Apr. 25, 2024).

[206] Xavier Foccroulle Ménard et al., *Bringing the UCC into the digital age*, NORTON ROSE FULBRIGHT (Nov. 1, 2022), https://www.nortonrosefulbright.com/en/knowledge/publications/8d95e2ed/bringing-the-ucc-into-the-digital-age-review-of-the-2022-ucc-amendments.

[207] Tara Pakrouh & Eric Monzo, *Bankruptcy Courts' Role in Shaping Crypto's Legal Framework*, MORRIS JAMES (Apr. 5, 2024), https://www.morrisjames.com/newsroom-articles-Bankruptcy-Courts-Role-In-Shaping-Crypto-Legal-Framework.html.

3. **Permit combined services for cryptoasset securities and non-securities.**

Multi-asset trading platforms offer investors a consolidated trading venue within a single interface, eliminating the need for investors to navigate multiple exchanges or wallets, thereby reducing transaction costs and complexity. Cryptoasset investors can swiftly respond to market changes and adjust asset allocations, facilitating more accessible, secure, and efficient trading environments. In volatile markets, agility is crucial, as timing and ability to act on information significantly impacts investment outcomes.

However, current US market structure rules fundamentally inhibit multi-asset cryptoasset trading functionality, by requiring businesses that provide trading, custody, and brokerage services for cryptoasset securities to refrain from providing services with respect to cryptoasset non-securities, and vice versa. While trading of cryptoasset securities may involve certain distinct risks (e.g., heightened financial risk in comparison to utility tokens) and require certain additional disclosures, service providers for cryptoasset non-securities should also be able to fulfil these requirements for cryptoasset securities. The EU's MiCA regime exemplifies how regulators can integrate the provision of services for both categories of cryptoassets by creating a dual licensing structure that allows a single service provider that obtains both licenses to accommodate trading in both cryptoasset securities and non-securities.[208] Such a regime could include a regulatory exam for professionals acting as cryptoasset brokers, in much the same way as professionals in traditional securities are required to pass exams.

Any regime allowing for the simultaneous provision of services in multiple types of cryptoassets will necessarily require close coordination and cooperation between the various regulatory bodies responsible for each type of cryptoasset. For example, the SEC's ability to regulate cryptoasset securities should not be exercised in such a restrictive way that cryptoasset service providers are necessarily required to apply the SEC's requirements to non-security cryptoassets. Instead, the SEC should be required to cooperate on a cross-agency basis and recognize and accept the potentially different legal treatment of other types of cryptoassets provided in the same package of services.

4. **Allow for un-intermediated trading with safeguards.**

The technological innovations underlying cryptoassets—facilitating transactions occurring around the clock, with immediate clearing and settlement, on a peer-to-peer basis—have allowed for direct trading of cryptoassets by customers without the intermediation of broker-dealers. Each of Japan, the EU, and Hong Kong has accommodated this innovative aspect of cryptoasset markets by allowing investors to continue to access cryptoasset trading platforms without the intermediation of a broker-dealer in the case of cryptoassets that are not securities. Furthermore, the EU is pursuing

[208] *See* Part I, *supra*.

a pilot program that will allow retail investors direct access to trade certain cryptoasset securities. A cryptoasset regulatory framework in the US should permit customers, including retail customers, to continue to access trading platforms without the intermediation of a broker-dealer provided they receive necessary disclosures from the trading platform about the risks of doing so. Mandating the interposition of an additional intermediary where none is necessary is likely to increase trading costs and delays for investors and introduce unnecessary complexity into a trading process.[209]

5. **Clearly define which cryptoassets require regulation, which set of regulations apply, and the parameters for determining if regulatory treatment may change over time.**

As highlighted by the varied approaches to creating a legal framework for cryptoassets in Part I, cryptoassets may fall into many different categories, including payment instruments, securities, commodities, non-fungible tokens, governance tokens, and utility tokens with a limited use case. A prerequisite to any coherent legal regime is defining a clear taxonomy of cryptoassets, identifying which types of cryptoassets should be subject to regulation, and which body of law and regulation applies to each. As the technology which facilitates transactions in cryptoassets is dynamic, it is also important to recognize that the regulatory treatment of a given cryptoasset may change over time and to set parameters for identifying when this occurs. The regulation of cryptoassets that are securities provides a prominent example, as we explain below.

As discussed in the Phase I Report, US cryptoasset trading platform operators must undertake costly, uncertain, and case-by-case analyses of each cryptoasset they intend to list to determine whether a cryptoasset is a security under US law. The only guidance available to identify cryptoasset securities are the non-binding and non-exhaustive principles issued by the SEC FinHUB's Framework and the results of litigation between the SEC and cryptoasset creators and intermediaries.[210] These are insufficient to create the necessary degree of legal certainty to foster efficient cryptoasset markets. By contrast, other jurisdictions, including Japan, the EU, Hong Kong, and Canada, have by legislation, regulation, or regulatory guidance, articulated cryptoasset-specific criteria to determine whether a cryptoasset is a security and, therefore, subject to the relevant securities regulatory framework. The greater legal uncertainty in the US has driven trading activity and cryptoasset-related businesses out of the US into offshore markets.[211]

The US cannot continue to rely on litigation and unchecked regulatory discretion to close the gap with these other jurisdictions. Lawmakers should articulate clear criteria for the identification of cryptoasset securities. These criteria should account for the potential for

[209] Markus K. Brunnermeier et al, The Digitalization of Money (2019), https://www.bis.org/events/confresearchnetwork1909/brunnermeier_2.pdf
[210] PIFS, *supra* n.1 at 30.
[211] *See* Part II, *supra*.

certain cryptoassets that qualify as securities at their initial creation to evolve via decentralization into assets that no longer qualify as securities and include criteria for determining when such a transition should occur. Crucially, exiting the regulatory regime for cryptoasset securities should be based on objective criteria and not be conditioned on a regulator's pre-approval.

Defining the contours of a cryptoasset classification is complex. In recognition of this fact, regulators around the world have been implementing experimental, time-limited "sandboxes," where cryptoasset innovators can develop their products under the supervision of regulators, but without fear of legal repercussions.[212] Such an approach has been proposed by Commissioner Peirce under the securities framework as a three-year safe harbor for cryptoasset developers, which would exempt developers from the registration requirements of the securities laws while they work toward decentralization, or "network maturity."[213] If maturity is reached by the end of the period, transactions on the network would no longer be securities transactions. Commissioner Peirce's definition of "network maturity"—when a network is "[n]ot economically or operationally controlled . . . or unilaterally changed by any single person, entity, or group of persons or entities under common control"—is thus a proposal for identifying when an asset should no longer receive regulatory treatment as a security.[214] However, this definition is not met where "the Initial Development Team owns more than 20% of Tokens or . . . the means of determining network consensus."[215] A second aspect of a US regulatory sandbox could be exempting "airdrops," where cryptoassets are distributed for no monetary consideration, from securities regulation. Airdrops are often conducted in order to build toward decentralization, by expanding the network.[216] Launching a regulatory sandbox with such features would allow US regulators to immediately begin regulating cryptoassets in a flexible way and use the experience gained during the limited period to inform the future long-term parameters of a cryptoasset regulatory framework.

6. Create cryptoasset-specific disclosure rules.

The US disclosure rules for securities are largely ineffective for cryptoassets because they require the provision of irrelevant or inapplicable information while failing to deliver relevant information to cryptoasset investors and users.[217] Each of the major jurisdictions

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[212] *See*, *e.g.*, *EU and U.S. Regulator Sandboxes: Groundbreaking Tools for Fostering Innovation and Shaping Applicable Regulations*, JONES DAY (Apr. 2023), https://www.jonesday.com/en/insights/2023/04/eu-and-us--sandboxes-are-groundbreaking-tools.
[213] Hester Peirce, *SafeHarbor 2.0*, GITHUB (Apr. 13, 2021), https://github.com/CommissionerPeirce/SafeHarbor2.0.
[214] *Id*. at Proposed Securities Act Rule 195(k)(2)(i).
[215] *Id*.
[216] Darcy W.E. Allen et al. *Why Airdrop Cryptocurrency Tokens?*, 163 J. BUS. RES. 113945 (2023).
[217] *See* Part I.1, *supra.*

noted above has established a bespoke disclosure regime for cryptoassets or modified its existing regimes to respond to the unique technical features of cryptoassets.[218] The IOSCO Principles also recognize the necessity of cryptoasset-specific disclosures.[219]

US policymakers must enact a similar framework that ensures that the purchasers of cryptoassets from their initial creators as well as those who trade cryptoassets on platforms or other secondary markets receive comprehensible and relevant disclosures about those assets. This framework must carefully address the division of disclosure responsibilities between the creators of a cryptoasset and the trading platforms and other intermediaries that facilitate trading in the cryptoasset. This division becomes particularly critical when a cryptoasset has become sufficiently decentralized that there is no longer an identifiable creator or issuer that can be vested with the responsibility for fulfilling ongoing disclosure obligations. For instance, in the case of cryptoasset commodities or fully decentralized cryptoasset securities, market participants could look to third party providers of commercial market research, in a similar fashion to markets for natural commodity derivatives.

7. **Avoid stifling non-financial uses of cryptoassets.**

As described in the Phase I Report, cryptoassets have the potential to perform a variety of non-financial functions in the consumer economy and are not merely investment assets. Indeed the SEC's FinHUB itself acknowledged how cryptoassets with primarily consumptive uses may properly be placed outside the financial regulatory framework.[220] Failing to account for and permit these diverse functions—and treating cryptoassets solely as investment tools—could stifle innovation.[221] The jurisdictions surveyed in Part I have acknowledged this principle by carving out cryptoassets with primarily utilitarian, non-financial, uses from the regulatory regimes they have enacted for cryptoassets with significant investment or other financial uses. For instance, the EU's MiCA excludes certain cryptoassets with a limited use case from the issuance and disclosures requirements that it places on other cryptoassets.[222] Similarly, the UK excludes certain utility-type tokens with a narrow use case from the framework that governs the offering of cryptoassets with financial uses.[223] As part of the categorization of cryptoassets discussed in Recommendation 5 above, a cryptoasset regulatory framework in the US should enact an equivalent carve out.

[218] *See* Part I.2-6, *supra*.
[219] IOSCO Final Report at Recommendation 3, 5, 14, 17.
[220] *See* PIFS, *supra* n.1 at 30-31.
[221] *See* Part II, *supra*.
[222] *See* Part II.3.b.ii.2 *supra*.
[223] *See* Part II.5.a.ii, *supra*.

8. <u>Place legislative guardrails around regulatory discretion</u>.

In designing and implementing cryptoasset regulatory frameworks, other major jurisdictions have allowed their regulators reasonable discretion within legislatively defined boundaries. For example, the UK has enacted primary legislation—drafted by HM Treasury and approved by Parliament—that sets the general framework for the regulation of cryptoassets. HM Treasury, with continued Parliamentary oversight, will now put into place secondary legislation that delineates that framework in greater detail and leaves certain ongoing rulemaking discretion to regulators.[224] Japan has enacted such an approach via the establishment of a cryptoasset specific self-regulatory organization that is empowered to create rules governing the operation of cryptoasset trading platforms. And this principle is reflected throughout the existing financial regulatory structure in the US.

However, the status quo in US cryptoasset markets fails to strike this balance. Instead, the SEC applies an unchecked regulation by enforcement approach that applies the existing US securities framework in an arbitrary fashion.[225] Moreover, to date, the court decisions in this area have not themselves been consistent and the process of achieving judicial finality will take years.

Any legislation implementing a cryptoasset regulatory framework in the US should require the SEC and CFTC to establish reasonable guidance and regulations. It should also require the SEC and CFTC to be accountable to Congress for the effectiveness of their regulations in facilitating capital formation and protecting investors. More specifically, the legislation should require that any SEC rulemakings implementing a cryptoasset framework not be unnecessary or unduly burdensome and be consistent with the SEC's mission to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." The legislation should also require the Chairs of the SEC and CFTC to report annually to Congress assessing: (1) the effectiveness of their cryptoasset regulations in facilitating capital formation; and (2) whether other jurisdictions have implemented regulatory frameworks that are more successful than the US framework.

Moreover, an effective cryptoasset framework will require deep coordination and cooperation between the various agencies responsible for regulating different types of cryptoassets.[226] Any legislative mandate to the SEC, CFTC, or any other agency to establish regulations should require cross-agency cooperation. This is necessary for the establishment of a coherent and workable cryptoasset regulatory framework.

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[224] *See* Part I.5, *supra* (describing phased approach to regulation).
[225] *See, e.g.*, Karen Ubell et al., *"Regulation by Enforcement" in the Digital Asset Industry: A Lagging Response to Stale Facts* GOODWIN PROCTER LLP (May 31, 2023), https://www.goodwinlaw.com/en/insights/publications/ 2023/05/insights-otherindustries-dcb-regulation-by-enforcement.
[226] *See* Part III.3, *supra*.

9. A comparison of existing US legislative proposals.

The table on the following page reviews and compares significant features of three legislative proposals for cryptoasset regulatory frameworks and the extent to which they do or do not implement the recommendations noted above: the Digital Commodities Consumer Protection Act of 2022 (the "Digital Commodities Act"),[227] the Lummis-Gillibrand Responsible Financial Innovation Act (the "RFI Act"),[228] and the Financial Innovation and Technology for the 21st Century Act (the "FIT21 Act").[229]

The Digital Commodities Act was introduced by Senators Stabenow (D-MI), Boozman (R-AR), Booker (D-NJ), and Thune (R-SD) on August 3, 2022. Hearings were held on the bill before two Senate committees on September 15, 2022, its momentum has since stalled and it has not been voted on.

The RFI Act was originally introduced by Senators Lummis (R-WY) and Gillibrand (D-NY) in 2022 and reintroduced in its latest form on July 12, 2023. Although the Senate held multiple hearings on the RFIA in the second half of 2022, and the reintroduced version has been referred to the Committee on Finance, no votes have occurred.[230]

The FIT21 Act was introduced by Representatives Thompson (R-PA), Hill (R-AR), Johnson (R-SD), Davidson (R-OH), and Emmer (R-MN) on July 20, 2023, as an updated version of an earlier discussion draft released by Rep. Patrick McHenry (R-North Carolina), Chairman of the House Financial Services Committee on June 2, 2023. Both the House Committee on Financial Services and the House Committee on Agriculture held mark-up sessions and approved amended versions of the bill in July 2023.[231] The House voted in favor of the FIT 21 Act on May 22.[232] However it remains uncertain if a Senate vote on the FIT21 Act will occur.

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[227] Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Congress § 2 (2022), https://www.congress.gov/bill/117th-congress/senate-bill/4760/text [hereinafter "DCCPA"].
[228] Lummis-Gillibrand Responsible Financial Innovation Act, S. 2281, 118th Congress § 1 (2023), https://www.congress.gov/bill/118th-congress/senate-bill/2281/text [hereinafter "RFIA"].
[229] Financial Innovation and Technology for the 21st Century Act, H.R. 4763, 118th Congress § 1 (2023), https://www.congress.gov/bill/118th-congress/house-bill/4763/text [hereinafter "FIT21 Act"].
[230] https://www.congress.gov/bill/118th-congress/senate-bill/2281/committees.
[231] *Id.*
[232] Jesse Hamilton, Nikhilesh De, *U.S. House Approves Crypto FIT21 Bill With Wave of Democratic Support* COINDESK (May 22, 2024), https://www.coindesk.com/policy/2024/05/22/us-house-approves-crypto-fit21-bill-with-wave-of-democratic-support/.

Proposal Characteristic	**Digital Commodities Act (2022)**	**RFI Act (2023)**	**FIT21 Act (2023)**
1. Customized registration frameworks for cryptoasset trading platforms and broker-dealers?	Yes	Yes	Yes
2. Cryptoasset specific custody requirements permitting platform custody?	No; the proposal creates no custody framework for cryptoassets.	Yes	Yes
3. Permits combined cryptoasset security and non-security services with appropriate registrations?	Yes	Yes	Yes
4. Permits un-intermediated trading?	Yes	Yes	Yes
5. Clarification re: security and non-securities with off-ramp?	No	Yes	Yes
6. Cryptoasset specific disclosure rules?	Yes	Yes	Yes
7. Carves out non-financial uses?	No	No	Carve out for non-financial blockchain development activities but not for utility tokens.
8. Guardrails for regulatory discretion	Lacks critical guardrails and requirement to report to Congress.	Lacks critical guardrails and requirement to report to Congress.	Lacks critical guardrails and requirement to report to Congress.

IV. CONCLUSION

This report has illustrated the extent to which the US has fallen behind other jurisdictions in enacting an effective cryptoasset regulatory framework, the costs this has imposed on US investors, customers, businesses, and US markets more generally, and the reforms that can correct this status quo and place the US at the forefront of cryptoasset regulation.

As shown in Part I, other major jurisdictions, including each of Japan, the EU, Hong Kong, and the United Kingdom, have enacted or proposed amendments to their financial regulatory structures that adopt a coherent and integrated approach to the regulation of cryptoasset issuers and intermediaries. Australia, Canada, Singapore, and the United Arab Emirates have also taken significant steps in this regard. These frameworks have largely carried over necessary customer and investor protections from traditional financial markets while leveraging, rather than stifling, innovations in cryptoasset markets to create more efficient regulatory structures. In the US by contrast, there has been no such proposal at either the legislative or regulatory level. Service providers operate in conditions of significant legal uncertainty. Many traditional financial service providers are effectively barred from entering the cryptoasset space by unduly burdensome regulatory guidance. And regulators apply an unchecked regulation by enforcement approach by compelling cryptoasset trading platforms to operate in compliance with a securities regulatory framework that is practically impossible for them to comply with.

Part II shows how the lack of a coherent and efficient regulatory structure for cryptoassets in the US has helped drive cryptoasset trading offshore and has fostered the conditions for foreign issued cryptoassets to dominate cryptoasset trading in place of domestically issued cryptoassets and the US dollar. This in turn has exacerbated the risks to US customers and investors and limited the ability of US regulators and law enforcement to supervise cryptoasset markets. The US has also forgone cryptoasset-related jobs, tax revenue, and other economic benefits associated with cryptoasset markets and businesses. Finally, despite the presence of domestic cryptoasset trading platforms and other service providers that comply with the laws and voluntarily implement rigorous customer protections, many US investors have relied on service providers that take advantage of regulatory gaps and that do not adhere to such standards, unnecessarily exposing US investors to risks of fraud and loss.

Part III identifies eight critical principles and corresponding reforms that lawmakers and regulators in the US must implement to close the gap with other jurisdictions and address the significant issues identified in this report. These reforms include the creation of a workable framework for the registration and operation of cryptoasset trading platforms, clarifying the regulatory status of cryptoassets, and implementing workable custody requirements. Most of our recommendations will require new legislation. However, US regulators can and should act pending the passage of necessary legislation by repealing their counterproductive guidance on cryptoasset custody (SAB 121) and ceasing their counterproductive regulation by enforcement approach with regard to compliant cryptoasset trading platforms and other service providers.

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