Wild West: The Case for Cryptocurrency Regulation

By “Coach Vance” Trefethen

***Resolved: The United States Federal Government should substantially reform its banking, finance, and/or monetary policy.***

Crypto currencies are the “next big thing” in our monetary and financial system. But they operate in a “Wild West” atmosphere. Anything goes, frauds and hucksters abound, and the public is at risk. The federal government isn’t able to bring order out of chaos under existing rules. This plan follows the recommendation of financial experts to bring cryptocurrency under the purview of the Securities & Exchange Commission (SEC), the federal agency that currently regulates the stock and bond markets and related activities.

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Wild West: The Case for Cryptocurrency Regulation

that: The United States Federal Government should substantially reform its banking, finance, and/or monetary policy.

OBSERVATION 1. We offer the following DEFINITIONS.

Reform

Merriam Webster, 2019 <https://www.merriam-webster.com/dictionary/reform>

“to put or change into an improved form or condition”

Crypto Currency

Investopedia 2019. “What Is a Cryptocurrency?” 3 Nov 2019 <https://www.investopedia.com/terms/c/cryptocurrency.asp>

A cryptocurrency is a digital or [virtual currency](https://www.investopedia.com/terms/v/virtual-currency.asp) that is secured by cryptography, which makes it nearly impossible to counterfeit or double-spend. Many cryptocurrencies are decentralized networks based on [blockchain](https://www.investopedia.com/terms/b/blockchain.asp) technology—a distributed ledger enforced by a disparate network of computers.

OBSERVATION 2. INHERENCY, the structure of the Status Quo. We offer 3 key facts:

FACT 1. The rise of crypto currencies

Crypto currencies are a $42 billion market and are poised for rapid growth

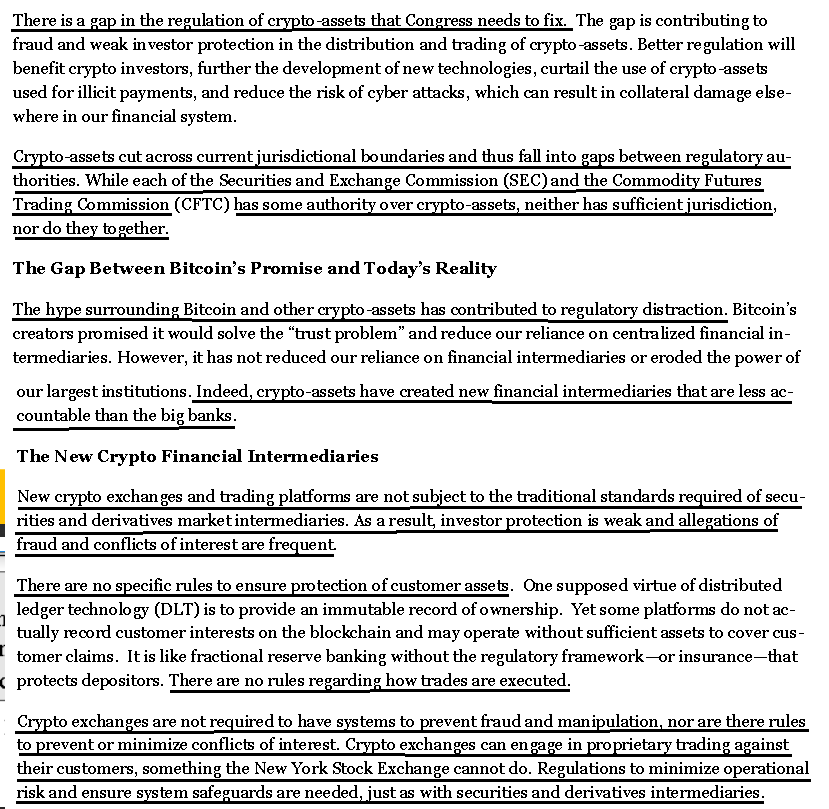
Prof. Jesus Fernandez-Villaverde and Daniel R. Sanches 2018 (Villaverde - Professor of Economics Director of Graduate Studies Department of Economics University of Pennsylvania. Sanches – Economic Advisor and Economist, Federal Reserve Bank of Philadelphia) 29 Mar 2018 “The Rise Of Cryptocurrencies” <https://www.hoover.org/research/rise-cryptocurrencies>

Today, any person with Internet access can use a bewildering array of cryptocurrencies as means of exchange. Everyone has heard about Bitcoin, whose market capitalization (the price per unit times the circulating supply) as of July 6, 2017, exceeds $42 billion, only slightly below the market capitalization of Ford Motor Company. But six other cryptocurrencies (Etherium, Ripple, Litecoin, Etherium Classic, NEM, and Dash) have market capitalizations over $1 billion, and another thirty-seven have between $100 and $999.99 million. While it is true that cryptocurrencies represent only a trivial fraction of all payments in the world economy, it is not inconceivable that such shares may exponentially increase over the next few years and even become widespread in emerging economies with dysfunctional government monies.

FACT 2. Regulatory gap

Crypto currencies have substantial regulatory gaps that Congress needs to fix

Timothy Massad 2019 (Senior Fellow, The John F. Kennedy School of Government, Harvard Univ) March 2019 It’s Time to Strengthen the Regulation of Crypto-Assets <https://www.brookings.edu/wp-content/uploads/2019/03/Economis-Studies-Timothy-Massad-Cryptocurrency-Paper.pdf>



OBSERVATION 3. The HARMS. Regulatory gaps lead to multiple harms

HARM 1. Fraud

Crypto currency fraud is easy due to lack of regulation

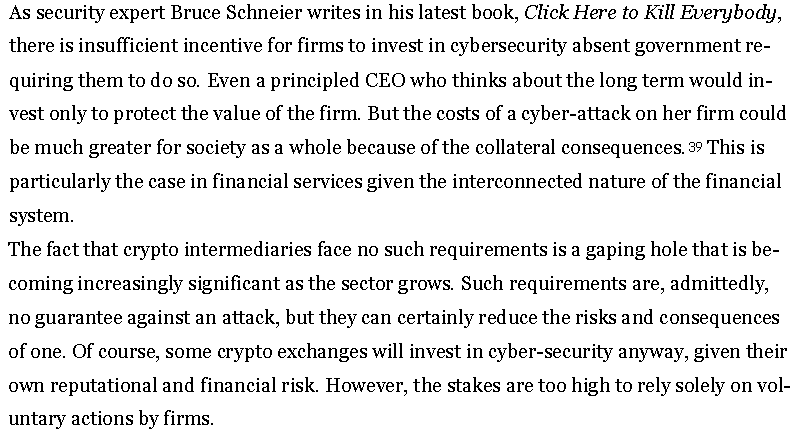
Reuters news service 2017. “[Chaos and hackers stalk investors on cryptocurrency exchanges](https://www.reuters.com/investigates/section/crypto-currency/)“ 29 Sept 2017 <https://www.reuters.com/investigates/special-report/bitcoin-exchanges-risks/>

Dan Wasyluk discovered the hard way that trading cryptocurrencies such as bitcoin happens in an online Wild West where sheriffs are largely absent. Wasyluk and his colleagues raised bitcoins for a new tech venture and lodged them in escrow at a company running a cryptocurrency exchange called Moolah. Just months later the exchange collapsed; the man behind it is now awaiting trial in Britain on fraud and money-laundering charges. He has pleaded not guilty. Wasyluk’s project lost 750 bitcoins, currently worth about $3 million, and he believes he stands little chance of recovering any money. “It really was kind of a kneecapping of the project,” said Wasyluk of the collapse three years ago. “If you are starting an exchange and you lose clients’ money, you or your company should be 100 percent accountable for that loss. And right now there is nothing like that in place.”

HARM 2. Cyber hacking

A. Link: Crypto currencies have little incentive to invest in cyber-security absent government regulation

Timothy Massad 2019 (Senior Fellow, The John F. Kennedy School of Government, Harvard Univ) March 2019 It’s Time to Strengthen the Regulation of Crypto-Assets <https://www.brookings.edu/wp-content/uploads/2019/03/Economis-Studies-Timothy-Massad-Cryptocurrency-Paper.pdf>



B. Impact: Massive losses and customers harmed

Jeremy Kirk 2016 (journalist) Bitcoin Hack Highlights Cryptocurrency Challenges 4 Aug 2016 <https://www.bankinfosecurity.com/bitcoin-hack-highlights-cryptocurrency-challenges-a-9305>

Bitfinex, one of the largest U.S. dollar bitcoin exchanges, said on Aug. 2 that it lost 119,756 bitcoins after its platform was hacked. Law enforcement has been contacted, the company said in a [statement](https://bitfinex.statuspage.io/incidents/6174rk4zpyv8). Bitcoin's market rate dropped 20 percent following Bitfinex's announcement, although it has since bounced back to about $580. The company's losses amounted to approximately $69 million, according to exchange rates on Aug. 4. Bitcoin is a virtual currency that is exchanged using peer-to-peer software. Transactions are verified by computers contributing data to a cryptographic ledger known as the [blockchain](https://bitcoin.org/en/how-it-works), which is increasingly being explored by the finance industry for broader applications. Zane Tackett, Bitfinex director of community and product development, [writes on Reddit](https://www.reddit.com/r/Bitcoin/comments/4vtuxo/bitfinex_security_breach_trading_will_be_halted/d61oelu) that the company is evaluating its options for addressing customer losses.

HARM 3. Crime

Crypto currencies enable crime

Nikita Malik 2018 (Director of the Centre on Radicalisation and Terrorism at the Henry Jackson Society) How Criminals And Terrorists Use Cryptocurrency: And How To Stop It 31 Aug 2018 FORBES <https://www.forbes.com/sites/nikitamalik/2018/08/31/how-criminals-and-terrorists-use-cryptocurrency-and-how-to-stop-it/#311741693990>

First, digital currencies are created through a process of ‘mining’ to verify each transaction on a blockchain. While information on each transaction is recorded on the blockchain, this data is not directly linked to names, physical addresses, or other identifying information. This makes digital currencies anonymous to a certain degree, and complicates efforts by law enforcement agencies to identify individual transactions and link them to [users.](https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2017-global-cryptocurrency-benchmarking-study.pdf) Second, according to a 2015 Europol [report](https://www.europol.europa.eu/activities-services/main-reports/internet-organised-crime-threat-assessment-iocta-2015), bitcoin has featured in high-profile investigations involving payments between criminals, and was used in over 40% of illicit transactions in the European Union.

OBSERVATION 4. We offer the following PLAN implemented by Congress and the President

1. Congress assigns regulatory authority over crypto currencies and related financial and derivative products and procedures to the Securities & Exchange Commission (SEC).  
2. SEC will regulate crypto currency in the same manner as it currently regulates securities and derivative markets.

3. Funding is general federal revenues  
4. Enforcement is through existing means as for violations of existing securities laws.  
5. Timeline: Plan takes effect one month after an affirmative ballot  
6. All Affirmative speeches may clarify

OBSERVATION 5. SOLVENCY. SEC Regulation solves

SEC regulation is the answer to fix the regulatory gaps

Shannon Meraw at the Brookings Institution summarizing a report by Timothy G. Massad in 2019 (Massad - Senior Fellow, The John F. Kennedy School of Government, Harvard Univ) It’s time to strengthen the regulation of crypto-assets 18 March 2019 <https://www.brookings.edu/research/its-time-to-strengthen-the-regulation-of-crypto-assets/> (brackets added)

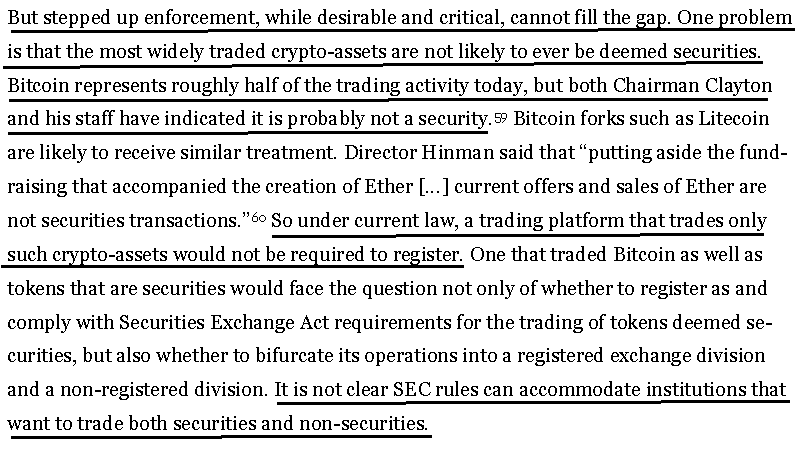
The SEC [Securities & Exchange Commission] has jurisdiction over crypto-assets deemed securities, but many crypto-assets—including the most widely traded ones such as Bitcoin—are not securities. The CFTC declared Bitcoin and other virtual currencies commodities, but that does not solve the problem. Derivatives based on crypto-assets are subject to CFTC regulation—such as Bitcoin futures and swaps– as are the platforms that trade such derivatives. But the CFTC has only very limited jurisdiction of the underlying cash market for such crypto-assets—for example, the buying and selling of Bitcoin. That is where most of the activity is today. Congress needs to fix this by creating regulatory oversight of the cash market for crypto-assets, and the trading platforms and other intermediaries that operate in that market. Either the SEC or the CFTC [Commodity Futures Trading Commission] is competent to regulate this area if given the power; it would be inefficient to create a new agency. Massad recommends making the SEC the lead agency. Massad argues we should not defer to state law in regulating crypto assets. This market strives to be international and is best served by a national regulatory framework. The variation in international regulation of crypto-assets should not cause us to hesitate in moving forward; it creates opportunity for the U.S. to exert global leadership. The 2012 law regulating crowdfunding is a good model for Congressional action. That law set principles similar to ones we have followed in the securities and derivatives markets, and left it to the SEC to figure out the details and implement regulations. Congress should do the same thing here.

2A Evidence: Cryptocurrency Regulation

MINOR REPAIR RESPONSE

Better enforcement of existing laws won’t work: Existing laws don’t cover crypto-assets, rules don’t apply

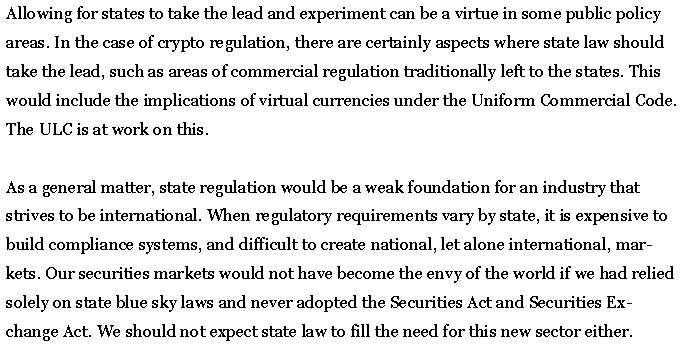
Timothy Massad 2019 (Senior Fellow, The John F. Kennedy School of Government, Harvard Univ) March 2019 It’s Time to Strengthen the Regulation of Crypto-Assets <https://www.brookings.edu/wp-content/uploads/2019/03/Economis-Studies-Timothy-Massad-Cryptocurrency-Paper.pdf>



INHERENCY

State regulation won’t solve, not a good idea

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Current regulation by Securities & Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) are inadequate

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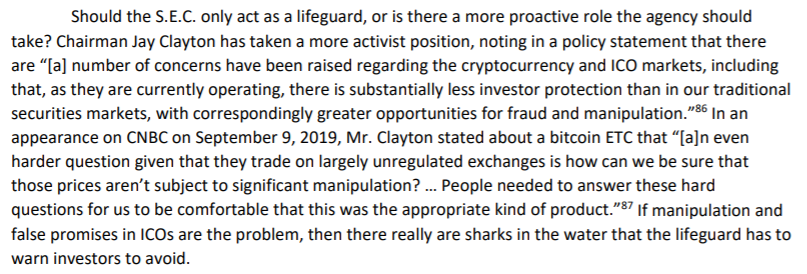
A/T “SEC is blocking new cryptocurrencies” – They’re blocking businesses that are pretending to be cryptocurrencies to get around SEC regulations

Sam Reynolds 2019 (journalist) 14 Oct 2019 “Telegram Should Have Done an STO to Avoid SEC Scrutiny” <https://wccftech.com/telegram-should-have-done-an-sto-to-avoid-sec-scrutiny/>

News broke this weekend that [Telegram](https://wccftech.com/russia-demands-apple-blocking-telegram/) -- a popular messaging app for those that are privacy-minded -- had its Initial Coin Offering canceled by the SEC. In a statement, the SEC Division of Enforcement co-director Stephanie Avakian said the action is “intended to prevent Telegram from flooding the U.S. markets with digital tokens that we allege were unlawfully sold.” “We have repeatedly stated that issuers cannot avoid the federal securities laws just by labelling their product a cryptocurrency or a digital token,” added Steven Peikin, Co-Director of the SEC’s Division of Enforcement. “Telegram seeks to obtain the benefits of a public offering without complying with the long-established disclosure responsibilities designed to protect the investing public.”

SEC Chief in Sept 2019 admits crypto currency exchanges are largely unregulated and dangerous

Prof. Peter J. Henning 2019. (law professor at Wayne State Univ.) 15 Oct 2019 Wayne State University Law School Legal Studies Research Paper Series No. 2019-63 A TAXONOMY OF CRYPTOCURRENCY ENFORCEMENT ACTIONS <https://www.ssrn.com/abstract=3483198> (brackets and ellipses in original)



Initial Coin Offerings (initiating new crypt currency) not regulated by SEC or any other government organization

Jake Fankenfield 2019 (Associate editor for Investopedia) 4 Nov 2019 “Initial Coin Offering (ICO)” <https://www.investopedia.com/terms/i/initial-coin-offering-ico.asp>

ICOs also retain at least two important structural differences from IPOs. First, ICOs are largely unregulated, meaning that government organizations like the [Securities and Exchange Commission](https://www.investopedia.com/terms/s/sec.asp) (SEC) do not oversee them. Secondly, due to their decentralization and lack of regulation, ICOs are much freer in terms of structure than IPOs.

SEC says bitcoin is not a security

Gordon Law Group 2019 (law firm specializing in crypto currency) “SEC SAYS: BITCOIN NOT A SECURITY” 22 Oct 219 <https://www.gordonlawltd.com/sec-says-bitcoin-not-security/>

**The U.S. Securities and Exchange Commission (SEC) has**[spoken](https://thetokenist.io/key-takeaways-the-sec-says-bitcoin-is-not-a-security/)**: Bitcoin is not a security. The clarification came in the form of a decision letter denying the establishment of a Bitcoin-based investment fund. Everyone invested in the cryptocurrency market should take two minutes to read about the situation since it will impact near-future industry developments.**

A/T “SEC regulating as securities” – Not all crypto currencies can be treated as securities, only those that pass the “Howey test” – leaves a “legal vacuum”

Dr. Daniel Araya 2018 (PhD; consultant and advisor with a special interest in technological innovation, public policy, and governance. He is the co-founder of AION Advisors, an international consultancy and think tank providing strategic research on smart cities) 10 Oct 2018 The future of cryptocurrency regulation <https://www.brookings.edu/blog/techtank/2018/10/10/the-future-of-cryptocurrency-regulation/>

The problem with strictly classifying all tokens as securities is that they can simultaneously function across multiple categories—as currencies, as instruments for [betting](https://venturebeat.com/2018/02/04/how-unikrn-use-blockchain-and-cryptocurrency-for-esports-betting/) (or for [voting](https://www.democracy.earth/)), and as traditional securities. Indeed, while some regulatory agencies define cryptocurrencies as monetary equivalents, others define them as [commodities](https://www.forbes.com/sites/greatspeculations/2018/03/09/cryptocurrencies-are-commodities-says-federal-judge/#3540dd15c09d), or even [taxable property](https://bitcoinist.com/irs-says-crypto-currency-warns-tax-evasion/). There is, in fact, a global legal vacuum with regard to cryptocurrencies because they [do not precisely fit](https://bitcoinmagazine.com/articles/sec-chairman-cryptocurrencies-bitcoin-are-not-securities-most-icos-are/) the traditional definition of an investment contract as defined by the [Howey test](https://caselaw.findlaw.com/us-supreme-court/328/293.html). Under the Howey test, an investment contract is “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.”

A/T “SEC can regulate crypto currency as securities” – Only if they meet the “Howey test.” If they are only used as a medium of exchange, then they don’t

Florian Uffer 2019 (J.D. Candidate at the Univ of Richmond School of Law) 11 March 2019 “Application of the Howey Test to Cryptocurrency” UNIVERSIT OF RICHMOND JOURNAL OF LAW & TECHNOLOGY <https://jolt.richmond.edu/2019/03/11/application-of-the-howey-test-to-cryptocurrency/>

The main hurdle facing regulators consists of a difficulty in properly classifying the range of cryptocurrencies that exist. This analysis, however, will only focus on cryptocurrencies used as a medium of exchange and provide a proposed answer as to whether the SEC has the ability to regulate them as securities. This analysis concludes that the SEC does not have the authority to regulate cryptocurrencies used as a medium exchange as investment contracts.  
The Howey Test  
The 1934 Securities Act’s definition of a “security” provides a catch-all provision – an “investment contract.” The Supreme Court in S.E.C. v. W. J. Howey Co.stated that “an investment contract for purposes of the Securities Act means a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.” Put differently, an investment contract exists if there is a contract, transaction, or scheme and the following elements are present: (1) a person invests money (2) in a common enterprise and (3) is led to expect profits (4) solely from the efforts of the promoter or a third party.   
The Howey Test Applied to Cryptocurrency as a Medium of Exchange  
There are two main ways to acquire Bitcoin: (i) buy it from one of the many exchanges, or (ii) acquire it as payment for the delivery of goods or services. In the first instance, it seems clear that in order to purchase Bitcoin, one has to come forth with a sum of money. Consequently, a purchaser would be investing money in order to obtain it and it would thus seem that purchasing Bitcoin would meet the first requirement of the analysis. As to the second instance, the Supreme Court in International Brotherhood of Teamsters v. Danielnoted that “[i]n every decision of this Court recognizing the presence of a ‘security’ under the Securities Acts, the person found to have been an investor chose to give up a specific consideration in return for a separable financial interest with the characteristics of a security.”But, the Court continued, “[t]his is not to say that a person’s ‘investment,’ in order to meet the definition of an investment contract, must take the form of cash only, rather than of goods and services.” Therefore, the first element of the Howey test is likely met. As to the second element, there are three ways of showing the existence of a common enterprise: horizontal commonality, broad vertical commonality, and narrow vertical commonality. Circuits are unanimous in holding that horizontal commonality satisfies the second Howey factor, but are split as to whether either type of vertical commonality is sufficient. When obtaining cryptocurrency, one does not pool his assets into an enterprise along with other investors; rather, one simply exchanges money or services for an alternative method of payment. A simple analogy can be drawn to exchanging U.S. Dollars for a foreign currency. Horizontal commonality is therefore lacking. Further, neither of the vertical commonalities are applicable to cryptocurrencies used as a medium of exchange. There is simply no promoter or third-party upon which the value of the “investment” in cryptocurrency depends. Instead, its value depends on government regulation, political and economic upheaval, and media and trader enthusiasm. Consequently, cryptocurrency as a medium of exchange most likely does not meet the second factor.  
**END QUOTE. He goes on at the end of the same article to conclude QUOTE**:  
This analysis concludes that cryptocurrency used as a medium of exchange is not an “investment” contract under the Howey standard. Therefore, the SEC would not have the authority to govern it as such.

HARMS / SIGNIFICANCE

Cyber hacking causes losses on crypto currency exchanges

Reuters news service 2017. “[Chaos and hackers stalk investors on cryptocurrency exchanges](https://www.reuters.com/investigates/section/crypto-currency/)“ 29 Sept 2017 <https://www.reuters.com/investigates/special-report/bitcoin-exchanges-risks/>

Exchanges are frequently targeted by hackers, causing additional problems for investors. Walle Wei, a Chinese trader based in Guangxi in southern China, said he was trading futures in bitcoin and a cryptocurrency called litecoin on OKCoin.com on July 10, 2015. Betting that the litecoin price, then about $4, would rise, he bought contracts for long positions using borrowed money. This meant that he only had to put down 10 percent to trade. Trading with that much leverage meant that a small move in the price could either wipe out his positions or greatly magnify his gains. Instead of rising as Wei had hoped, litecoin’s price began falling and OKCoin’s website slowed down, Wei said. He was unable to buy or sell. When he regained access to his account, his contracts had been liquidated. He said he lost 3,136 litecoins, then worth about $12,500. OKCoin announced on its blog that it had been a victim of “large scale” attacks by hackers who flooded its websites with traffic, preventing some users from accessing their accounts. On July 13, Wei suffered a second, similar event with bitcoin. He said the exchange’s website became inaccessible, his contracts were liquidated and he lost 57.9 bitcoins, then worth about $16,900.

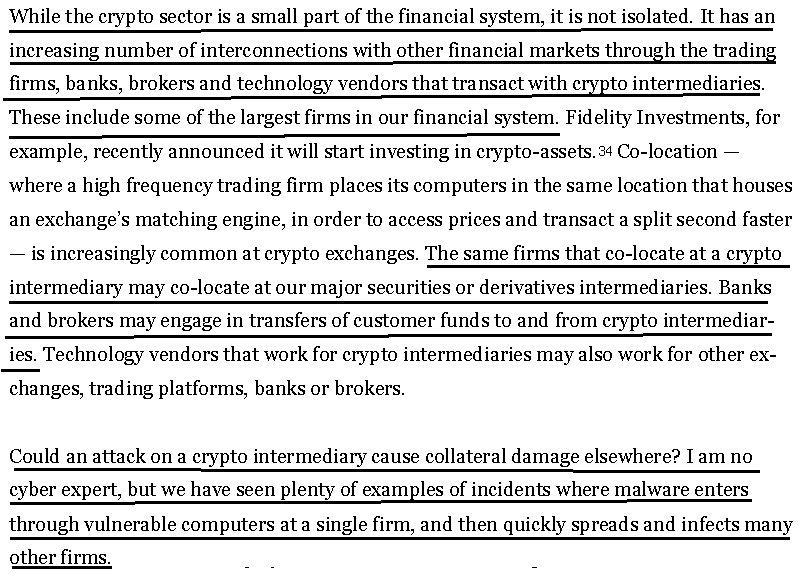
Crypto currency hacking is on the rise due to lack of regulatory oversight. It can damage the broader financial system

Timothy Massad 2019 (Senior Fellow, The John F. Kennedy School of Government, Harvard Univ) March 2019 It’s Time to Strengthen the Regulation of Crypto-Assets <https://www.brookings.edu/wp-content/uploads/2019/03/Economis-Studies-Timothy-Massad-Cryptocurrency-Paper.pdf> (brackets in original)



Crypto currency hacking could spread throughout the financial system

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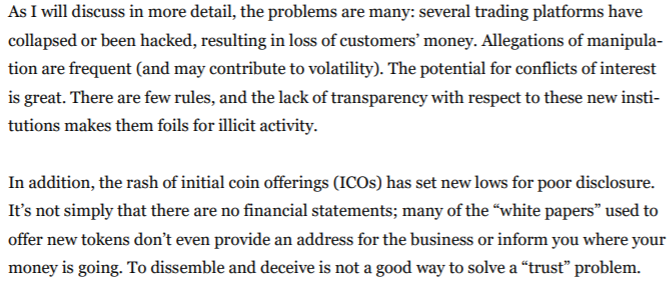
Lack of transparency invites criminal use of crypto currency

Timothy Massad 2019 (Senior Fellow, The John F. Kennedy School of Government, Harvard Univ) March 2019 It’s Time to Strengthen the Regulation of Crypto-Assets <https://www.brookings.edu/wp-content/uploads/2019/03/Economis-Studies-Timothy-Massad-Cryptocurrency-Paper.pdf>



Consumers are harmed by manipulation and deception in crypto currency markets

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Vast majority of new crypto currencies are frauds because of lack of regulatory oversight

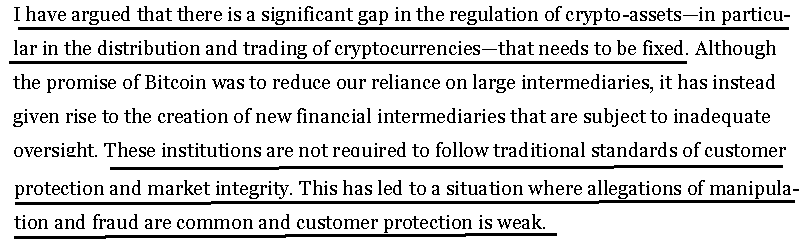
Dr. Daniel Araya 2018 (PhD; consultant and advisor with a special interest in technological innovation, public policy, and governance. He is the co-founder of AION Advisors, an international consultancy and think tank providing strategic research on smart cities) 9 Oct 2018 “The Challenges of Cryptocurrency Regulation” <https://www.theregreview.org/2018/10/09/araya-challenges-cryptocurrency-regulation/>

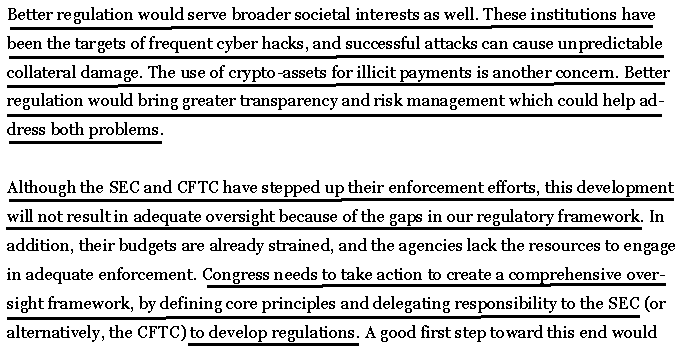
A recent [study](https://research.bloomberg.com/pub/res/d28giW28tf6G7T_Wr77aU0gDgFQ) suggests that the “vast majority” of initial coin offerings (ICOs) are in fact fraudulent schemes. But where stocks are regulated by the [U.S. Securities and Exchange Commission](https://www.sec.gov/) (SEC), and commodities by the [U.S. Commodity Futures Trading Commission](https://www.cftc.gov/) (CFTC), cryptocurrencies lack an effective regulatory body. This absence suggests the need for new institutional governance that properly understands the technical and economic issues driving cryptocurrencies.

SOLVENCY / ADVOCACY

Congress should delegate SEC responsibility for regulation of crypt currency to solve the harms

Timothy Massad 2019 (Senior Fellow, The John F. Kennedy School of Government, Harvard Univ) March 2019 It’s Time to Strengthen the Regulation of Crypto-Assets <https://www.brookings.edu/wp-content/uploads/2019/03/Economis-Studies-Timothy-Massad-Cryptocurrency-Paper.pdf>





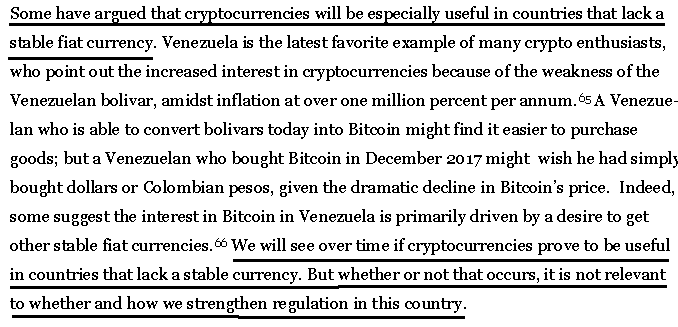
SEC regulation solves for crypto currency scams

Rakesh Sharma 2019 (master's degree from Northwestern University Medill School of Journalism; worked as a technical writer for eight years in the IT Services industry) 25 June 2019 “How SEC Regs Will Change Cryptocurrency Markets” <https://www.investopedia.com/news/how-sec-regs-will-change-cryptocurrency-markets/>

Their stratospheric growth notwithstanding, [initial coin offerings (ICOs)](https://www.investopedia.com/terms/i/initial-coin-offering-ico.asp) have become synonymous with scandals and broken promises. This is because there are no disclosure or reporting requirements for ICO listings. Even whitepapers, which provide project details, are not mandatory. Not surprisingly, then, [a recent report](https://www.bleepingcomputer.com/news/cryptocurrency/81-percent-of-recent-icos-were-scams-research-finds/)claims that 81% of all ICOs are scams. SEC regulation could clean up the space and make them viable investment options for investors by ensuring accountability and disclosure.

A/T “Crypto currencies used in foreign countries” – Doesn’t affect the decision to regulate it in this country

Timothy Massad 2019 (Senior Fellow, The John F. Kennedy School of Government, Harvard Univ) March 2019 It’s Time to Strengthen the Regulation of Crypto-Assets <https://www.brookings.edu/wp-content/uploads/2019/03/Economis-Studies-Timothy-Massad-Cryptocurrency-Paper.pdf>



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