

INSIGHTS

There Ought to Be a Law Before Enforcing Unwritten Crypto Rules

July 7, 2023

By: [Keith Blackman](#)

In the span of 24 hours, the Securities and Exchange Commission opened fire against two cryptocurrency giants. On June 5, it [filed](#) a wide-ranging, 13-count complaint against Binance — the world’s largest cryptocurrency exchange — along with its founder Changpeng Zhao.

The SEC alleged that Binance failed to register as a securities exchange, conducted unregistered securities offerings, and committed securities fraud. Just one day later, the SEC brought a similar enforcement action against Coinbase, the largest US-based crypto exchange, for failing to register its exchange and offerings.

These two securities actions are unusual because there are currently no laws or SEC rules classifying cryptocurrency as a security. In April, Coinbase filed an extraordinary writ of mandamus with the Third Circuit Court of Appeals, seeking to force the SEC to respond to Coinbase’s petition demanding the proposal of new rules identifying which digital assets (including cryptocurrency) should be defined as securities, thus bringing them within the SEC’s purview.

Coinbase’s experience isn’t unusual. Despite an almost complete lack of any regulatory framework governing digital assets, the SEC — along with its counterparts at other federal agencies — have sought to quilt a patchwork, case-by-case crypto policy via a cascade of prosecutions and civil enforcement actions against crypto traders, broker-dealers and exchanges.

Responding to Coinbase’s mandamus petition, the SEC argues in its defense that “judicial determinations made on a case-by-case basis” may precede — and even “inform” — future rulemaking, while litigants like Coinbase “are fully capable of testing their views of the securities laws” in court.

Given the government’s piecemeal regulation by enforcement approach to cryptocurrency regulation, the only way for crypto companies to understand which actions might draw the ire of law enforcement is to closely examine the facts of individual actions.

Failure to Register

Perhaps the largest unsettled question is whether cryptocurrency should be classified as a security. If so, it would fall under the jurisdiction of the SEC and be regulated like stocks or

bonds. Otherwise, if digital assets are deemed currencies or commodities, they would fall outside the ambit of the SEC.

Thus far, the SEC has been unwilling to put its position in writing — even going so far as to distance itself from its own chair’s position that all cryptocurrencies other than Bitcoin are securities.

This ambiguity in the legal classification of crypto hasn’t prevented the SEC from aggressively charging both brokers and exchanges for dealing in unregistered digital assets. Although the SEC’s actions against Binance and Coinbase are the splashiest, they are by no means unique.

In December 2020, the SEC sued Ripple Labs alleging that it breached securities laws by selling Ripple’s XRP cryptocurrency without registration. The case is ongoing, with Ripple recently disclosing it expects to spend \$200 million fighting the SEC. Similar claims have been [filed](#) against crypto asset trading platform Bittrex and its former CEO, William Shihara.

Through its enforcement actions, the SEC has also extended its jurisdiction to include [lending products](#) and “staking-as-a-service” programs, in which investors transfer, or “stake,” their assets to a blockchain validator in exchange for an advertised rate of return.

Money Laundering

In the Anti-Money Laundering Act of 2020, Congress made clear that virtual currencies fall within the scope of the Bank Secrecy Act, and the DOJ has wasted little time enforcing these provisions.

In January, the DOJ [arrested](#) Anatoly Legkodymov, a founder of China-based cryptocurrency exchange, Bitzlato Ltd., alleging “the defendant helped operate a cryptocurrency exchange that failed to implement required anti-money laundering safeguards and enabled criminals to profit from their wrongdoing, including ransomware and drug trafficking.”

Insider Trading

Last July, the DOJ brought the nation’s first cryptocurrency [insider trading prosecution](#) against Ishan Wahi, a former product manager at Coinbase Global, Inc. Prosecutors charged Wahi with misappropriating confidential information identifying the crypto assets that would be listed on Coinbase’s exchanges, and providing it to traders. Wahi pleaded guilty to two counts of conspiracy to commit wire fraud and was [sentenced](#) to two years in prison.

Touting a large and well-publicized category of crypto-related enforcement actions involves allegations against celebrities who lend their voices, faces and reputations to cryptocurrency products without disclosing that they were paid to do so. The list of celebrities charged with violations grows.

NFTs

The government’s expansion of federal law in the digital asset space includes products other than cryptocurrency — such as non-fungible tokens. In June 2022, Le Anh Tuan [was indicted](#) in connection with a scheme involving the “Baller Ape” NFT.

Tuan's scheme was shockingly straightforward: he and his conspirators allegedly created an NFT investment project called the Baller Ape Club, obtained approximately \$2.6 million from investors, then shut down the site and stole the investors' money.

Initial Coin Offerings

In a similar scheme — this time involving an initial coin offering — Michael Stollery, founder of Titanium Blockchain Infrastructure Services, allegedly falsified white papers, planted fake testimonials and fabricated business relationships to create the appearance that TBIS's ICO was legitimate. It wasn't, and [**Stollery was indicted**](#) for securities fraud for attempting to defraud investors of approximately \$21 million.

Outlook

Last year's crypto winter seemingly would have motivated federal regulators to promulgate clear-cut regulations in the crypto space. But the SEC's sudden offensive against Binance and Coinbase suggests instead that the government will continue regulating by enforcement for the foreseeable future.

Since neither Coinbase nor Binance is likely to agree to any settlement requiring it to be regulated as a securities exchange — which the SEC would demand — it will likely be years before these cases reach verdict (as Ripple's experience has demonstrated) and a judicially crafted rule is pronounced.

Until then, enforcement dockets will continue to provide the only indication of DOJ and SEC priorities, as well as their interpretation of existing federal law.

Reproduced with permission. Published July 7, 2023. Copyright 2023 Bloomberg Industry Group 800-372-1033. For further use, please visit:

<https://www.bloombergindustry.com/copyright-and-usage-guidelines-copyright/>