

NAVIGATING THE “WILD WEST” OF CRYPTOCURRENCY: CREATING A CLEAR PATH TOWARDS REGULATION

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INTRODUCTION

Since the emergence of Bitcoin and other virtual currencies, the regulation of the cryptocurrency (alternatively “crypto”) market has been a hot topic, and rightfully so. One in five Americans report having traded cryptocurrency, and studies show that crypto trading is even more prevalent in young adults.¹ Despite its popularity, regulators have warned that crypto is rife with fraud, scams, and abuses.² Per a report from the Federal Trade Commission, between January 2021 and March 2022 alone, over 46,000 individuals filed reports indicating

1. Aaron Klein, *The Future of Crypto Regulation: Highlights from the Brookings Event*, BROOKINGS (Aug. 11, 2022), <https://www.brookings.edu/2022/08/11/the-future-of-crypto-regulation-highlights-from-the-brookings-event/> [<https://perma.cc/A922-2PSQ>].

2. Chris Matthews, *SEC Chair Gensler Says Crypto ‘Rife with Fraud, Scams and Abuses,’ Threatens National Security*, MARKETWATCH (Aug. 3, 2021, 2:16 PM), <https://www.marketwatch.com/story/sec-chair-gensler-says-crypto-rife-with-fraud-scams-and-abuses-threatens-national-security-11628010216> [<https://perma.cc/B97N-GXCV>]; *Crypto Market ‘Rife with Fraud, Scams and Abuse,’ SEC Chief Says*, CBS NEWS: MONEY WATCH (Aug. 3, 2021, 4:28 PM), <https://www.cbsnews.com/news/cryptocurrency-market-fraud-scams-abuse-securities-and-exchange-commission-chairman-gary-gensler/> [<https://perma.cc/DPH2-YLGP>]; Allyson Versprille, *Crypto, NFTs Are Rife with ‘Mountains’ of Fraud, IRS Says*, BLOOMBERG (Jan. 26, 2022, 7:15 AM), <https://www.bloomberg.com/news/articles/2022-01-26/irs-seeing-mountains-and-mountains-of-fraud-with-crypto-nfts> [<https://perma.cc/EVE4-BLBT>].

losses exceeding \$1 billion due to fraudulent cryptocurrency activities.³ To complicate matters even further, there is not an entity to flag suspicious crypto transactions, and transfers cannot be reversed once the transactions are made.⁴ Regulators, such as the U.S. Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC), continue to issue conflicting guidance and file enforcement actions related to crypto; thus, it remains unclear who is responsible for the regulation and enforcement of cryptocurrency.⁵ While the two government agencies appear to be in a tug of war for regulatory power, neither agency shows signs of slowing down.⁶ In fact, the SEC's Division of Examinations announced that crypto is one of its main priorities for 2024.⁷ Continuing to expand its enforcement over crypto, the SEC filed its first ever action alleging insider trading of crypto constituting securities fraud in July of 2022.⁸ The complaint identified at least nine crypto asset securities, defined as a digital token or crypto asset that meets the definition of a security.⁹ This recent action from the SEC further muddies the water of cryptocurrency regulation. With the SEC and CFTC continuously pushing the bounds of their authority, the future of cryptocurrency remains uncertain.

This Note argues that Congress should draft legislation delineating the SEC and CFTC's roles in regulating cryptocurrency and that with or without guidance from Congress, regulators should engage the public in notice-and-comment rulemaking. Part I will explain what cryptocurrencies are and how they operate, including the technology that

3. Lesley Fair, *Reported Crypto Scam Losses Since 2021 Top \$1 Billion, Says FTC Data Spotlight*, FED. TRADE COMM'N: BUS. BLOG (June 3, 2022), <https://www.ftc.gov/business-guidance/blog/2022/06/reported-crypto-scam-losses-2021-top-1-billion-says-ftc-data-spotlight> [<https://perma.cc/7XXL-RBPK>]; Emma Fletcher, *Reports Show Scammers Cashing In on Crypto Craze*, FED. TRADE COMM'N: DATA SPOTLIGHT (June 3, 2022), <https://www.ftc.gov/news-events/data-visualizations/data-spotlight/2022/06/reports-show-scammers-cashing-crypto-craze> [<https://perma.cc/32ML-K7PG>].

4. Fair, *supra* note 3.

5. See, e.g., *Exercise Caution with Crypto Asset Securities: Investor Alert*, U.S. SEC. & EXCH. COMM'N: INV. ALERTS & BULL. (Mar. 23, 2023), <https://www.sec.gov/oiea/investor-alerts-and-bulletins/exercise-caution-crypto-asset-securities-investor-alert> [<https://perma.cc/VNK9-PUGX>]; COMMODITY FUTURES TRADING COMM'N, *THE CFTC'S ROLE IN MONITORING VIRTUAL CURRENCIES* (2020), <https://www.cftc.gov/media/4636/VirtualCurrencyMonitoringReportFY2020/download> [<https://perma.cc/LX6R-JLMF>].

6. Nathan Vrazel, *Betting It All on the Flip of a Coin: Regulating Cryptocurrency Initial Coin Offerings and Protecting Investors*, 60 S. TEX. L. REV. 527, 559-60 (2019); see Daniel M. Hawke et al., *SEC Spotlight: Enforcement and Regulatory Developments in the First Half of 2023*, ARNOLD & PORTER (Aug. 10, 2023), <https://www.arnoldporter.com/en/perspectives/advisories/2023/08/sec-spotlight-first-half-2023> [<https://perma.cc/L8T3-9ZF7>].

7. See U.S. SEC. & EXCH. COMM'N, *2024 EXAMINATION PRIORITIES 19-20* (2023), <https://www.sec.gov/files/2024-exam-priorities.pdf> [<https://perma.cc/FTD7-U4XU>].

8. Complaint at 1, SEC v. Wahi, No. 22-cv-01009 (W.D. Wash. 2022), ECF No. 1.

9. *Id.* at 8 ("A digital token or crypto asset is a crypto asset security if it meets the definition of a security, which the Securities Act defines to include 'investment contract'"); see *infra* Section II.A.

cryptocurrencies utilize and the different types of crypto in the marketplace. Part II will explain the conflicting opinions of the SEC and CFTC and their authority to regulate cryptocurrency. Part III will discuss the broad impacts of regulatory ambiguity in the crypto market. First, it will discuss the SEC's recent controversial enforcement action, *SEC v. Wahi*, and the potential impacts of the SEC expanding its authority to enforce insider trading actions to cryptocurrency. Next, it will discuss the long-term impacts of continuing regulation by enforcement. Last, it will examine the recent downfall of crypto exchange giant FTX to further highlight the need for a clear regulatory scheme. Part IV will offer three possible solutions to resolve ambiguity in cryptocurrency regulation. Namely, it will suggest that the United States could ban cryptocurrency completely, that Congress could grant exclusive authority over the crypto market to either the SEC or CFTC, or that Congress could clearly delineate what types of cryptocurrencies fall within the purview of the SEC versus that of the CFTC. This Note concludes that Congress should draft legislation granting the SEC authority to regulate promises to deliver cryptocurrencies at a future date while leaving other cryptocurrencies under the CFTC's purview. Additionally, it will advocate that with or without Congress's intervention, the SEC and CFTC should engage in notice-and-comment rulemaking to tailor existing rules and regulations or to create new rules and regulations specific to the crypto market. The cryptocurrency market is operating in a gray area, and it is essential for Congress and regulators to work together to provide a clear and consistent regulatory framework.

I. CRYPTOCURRENCY IN GENERAL

Crypto poses unique challenges to regulators. Traditionally, the SEC regulates securities while the CFTC regulates commodities and derivatives.¹⁰ The distinction between whether crypto is, or should be considered, a security or commodity is unsettled.¹¹ Before discussing the specifics, it is important to understand what crypto is, how it works, and the different types that exist.

A. *What Is Crypto and How Does It Work?*

Bitcoin, the world's first cryptocurrency created using a decentralized payment network, was introduced in 2009.¹² Prior to Bitcoin, a

10. The Investopedia Team, *Commodity Futures Trading Commission (CFTC) Overview*, INVESTOPEDIA, <https://www.investopedia.com/terms/c/cftc.asp> [https://perma.cc/9EGY-64NL] (last updated Sept. 26, 2021).

11. Klein, *supra* note 1.

12. Diego Zuluaga, *Should Cryptocurrencies Be Regulated like Securities?*, CATO INST. (June 25, 2018), <https://www.cato.org/cmfa-briefing-paper/should-cryptocurrencies-be-regu>

payment moving from one point to another required a central intermediary to collect and transfer the funds.¹³ Examples include banks transferring money or using apps such as PayPal or Venmo to send a payment to someone.¹⁴ In contrast, Bitcoin relies on profit-seeking users (or “miners”) to verify the transactions.¹⁵ In return, the miners receive a “transaction fee and newly generated bitcoins” as payment.¹⁶ Although there are variations of this system, the incentive remains the same across the board.¹⁷ The main characteristic these cryptocurrencies share is the reliance on a “scarce digital token to carry out transactions and reward miners for validating them.”¹⁸ Additionally, the use of a blockchain is consistent across cryptocurrencies.¹⁹ Blockchain operates by recording the history of all transactions made in a cryptocurrency and acts as a public record.²⁰ Each transaction is validated by a miner and makes up a chain of individual transaction blocks, hence the name “blockchain.”²¹ Although blockchain is available to all users of the cryptocurrency, its immutable characteristics make fraud more difficult.²² That is not to say it is impossible, but someone wanting to alter the blockchain would have to “break into many computers simultaneously.”²³

B. Types of Cryptocurrencies

There are numerous different types of cryptocurrencies, and the number is continuously growing.²⁴ In March 2022, there were more than 18,000 different types of cryptocurrencies worth upwards of \$2

lated-securities [<https://perma.cc/4JMX-PVM6>]; *How and When Did Bitcoin Start? The Complete Bitcoin History*, COINTELEGRAPH [hereinafter *How and When Did Bitcoin Start?*], <https://coingecko.com/bitcoin-for-beginners/the-history-of-bitcoin-when-did-bitcoin-start> [<https://perma.cc/5P79-EDKK>] (last visited Oct. 20, 2023).

13. Zuluaga, *supra* note 12, at 2; Kevin Roose, *The Latecomer’s Guide to Crypto*, N.Y. TIMES (Mar. 18, 2022), <https://www.nytimes.com/interactive/2022/03/18/technology/cryptocurrency-crypto-guide.html> [<https://perma.cc/XNS9-E8PT>].

14. Roose, *supra* note 13.

15. Zuluaga, *supra* note 12, at 2.

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*

23. Roose, *supra* note 13.

24. Carla Tardi, *Understanding the Different Types of Cryptocurrency*, SOFI LEARN (July 12, 2022), <https://www.sofi.com/learn/content/understanding-the-different-types-of-cryptocurrency/> [<https://perma.cc/5JBL-AMN3>]; Lyle Daly, *How Many Cryptocurrencies Are There?*, MOTLEY FOOL, <https://www.fool.com/investing/stock-market/market-sectors/financials/cryptocurrency-stocks/how-many-cryptocurrencies-are-there/> [<https://perma.cc/KDQ9-ZQQK>] (last updated Sept. 22, 2023, 1:17 PM).

trillion, and as of September 2023, there were more than 23,000.²⁵ Generally, cryptocurrencies can fall into one of two categories: coins or tokens.²⁶ Crypto coins are “strings of computer code that can represent an asset, concept, or project—whether tangible, virtual, or digital.”²⁷ Each crypto coin operates on an independent blockchain, meaning that each coin’s transactions are stored independently of one another.²⁸ These coins—including Bitcoins, altcoins, and stablecoins—can have various uses and valuations.²⁹ The term “altcoin” simply refers to an alternative to Bitcoin.³⁰ A majority of altcoins function as a payment method like any other traditional currency.³¹ However, altcoins can have other attributes as well, as is the case with Ethereum.³² Stablecoins are cryptocurrencies whose value is tied to some external reference, usually a fiat currency or commodity.³³ Generally, there are three types of stablecoins: fiat-collateralized, crypto-collateralized, and algorithmic.³⁴ Fiat-collateralized stablecoins maintain reserves which stabilize their value, oftentimes a currency such as the U.S. dollar or commodities such as gold, silver, and crude oil.³⁵ These reserves function as collateral and are kept by independent custodians, assuring the stablecoins’ value.³⁶ Crypto-collateralized stablecoins are instead cryptocurrencies which hold other cryptocurrencies in reserves.³⁷ In this case, the value of the cryptocurrency collateral held in reserves must exceed the value of the stablecoins issued due to the inherently high volatility of cryptocurrency.³⁸ Last, algorithmic stablecoins control supply through a computer program running a preset formula to keep the value stable.³⁹

25. Tardi, *supra* note 24; Daly, *supra* note 24.

26. Tardi, *supra* note 24 (stating that coins can include Bitcoin and altcoins and that tokens are “[p]rogrammable assets that live within the blockchain of a given platform”).

27. *Id.*

28. Vrazel, *supra* note 6, at 534; Aziz Zainuddin, *Altcoins vs. Tokens: What’s the Difference?*, MASTER CRYPTO, <https://masterthecrypto.com/differences-between-cryptocurrency-coins-and-tokens/> [<https://perma.cc/HUZ7-78BA>] (last visited Oct. 20, 2023).

29. Tardi, *supra* note 24.

30. Vrazel, *supra* note 6, at 534.

31. *Id.*

32. *See id.* at 534-35 (“The Ethereum blockchain network was created specifically for having tokens built on top of it and facilitating companies’ ICOs. At the same time, Ether (ETH), Ethereum’s coin, is used as currency and the incentive for Ethereum miners confirming the transactions on the network. ETH must be paid in the form of a transaction fee for each transfer made on the Ethereum blockchain.” (footnotes omitted)).

33. Adam Hayes, *Stablecoins: Definition, How They Work, and Types*, INVESTOPEDIA, <https://www.investopedia.com/terms/s/stablecoin.asp> [<https://perma.cc/R4VS-GXCZ>] (last updated July 6, 2023).

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

Tokens, on the other hand, operate differently. Tokens are part of and operate in conjunction with an altcoin's blockchain.⁴⁰ Given the regulatory ambiguities, there is disagreement about how many tokens there are and what they should be called.⁴¹ Some differentiate between security, equity, utility, asset-backed or commodity tokens, and reward or reputation tokens.⁴² Others only differentiate between security and utility tokens.⁴³ However, many tokens, regardless of their classification, are created and shared through a process known as an initial coin offering (ICO).⁴⁴ In this case, businesses can use an ICO to raise capital.⁴⁵ The ICO is an exchange of funds for a promise to deliver a digital token in the future.⁴⁶ Typically, the promise comes from developers who use the funds they receive to create an application where the tokens can be used.⁴⁷ This is essentially a type of crowdfunding whereby the creation and sale of the tokens fund project development.⁴⁸ An ICO shares similarities to an initial public offering (IPO) in the stock market.⁴⁹ Both serve the same purpose—to raise capital for a business endeavor.⁵⁰ These tokens, after creation and issuance, can be transferred across the blockchain network and traded on various cryptocurrency exchanges.⁵¹ As discussed above, tokens can be classified differently depending on their intended function.⁵² To understand what differentiates these tokens, this Section offers a comparison of utility and security tokens. Utility tokens allow start-ups to raise capital necessary to fund the development of their blockchain projects in

40. Vrazel, *supra* note 6, at 534.

41. *Id.* at 535.

42. *Id.* (“Security tokens represent an investment in a company with the expectation of a return. Equity tokens represent stock or equity in their issuing company. . . . Asset-backed tokens, or commodity tokens, represent physical tangible objects such as gold. Finally, there are reward tokens, or reputation tokens, that symbolize a user’s standing in a blockchain’s ecosystem.” (footnotes omitted)).

43. See Alon Harnoy, *What Are ICOs and How Do They Work?*, SMITH GAMBRELL RUSSELL, <https://www.sgrlaw.com/what-are-icos-and-how-do-they-work/> [<https://perma.cc/482X-KNLN>] (last visited Oct. 20, 2023) (“Utility tokens, called ‘user tokens’ or ‘app coins,’ represent future access to the business’s product or service. . . . Contrary to utility tokens, if a token derives its value from an external, tradable asset or it can increase in value based upon the efforts of others, it may be classified as a security token and become subject to federal securities regulations.”).

44. *Id.*; Tardi, *supra* note 24.

45. Harnoy, *supra* note 43.

46. *Id.*

47. Zuluaga, *supra* note 12, at 3.

48. Harnoy, *supra* note 43.

49. Lyle Daly, *What Is an Initial Coin Offering (ICO)?*, MOTLEY FOOL, <https://www.fool.com/investing/stock-market/market-sectors/financials/cryptocurrency-stocks/initial-coin-offering/> [<https://perma.cc/77CX-Y7HX>] (last updated June 28, 2022, 3:27 PM).

50. Vrazel, *supra* note 6, at 546; see also Brent J. Horton, *Direct Listings and the Weakening of Investor Protections*, 50 FLA. ST. U. L. REV. 279, 286-87 (2023); Usha R. Rodrigues & Michael Stegemoller, *Redeeming SPACs*, 50 FLA. ST. U. L. REV. 667, 677 (2023).

51. Harnoy, *supra* note 43.

52. Vrazel, *supra* note 6, at 535; Harnoy, *supra* note 43.

exchange for offering users access to the service at some point in the future.⁵³ Take, for example, Filecoin, a utility token which raised \$257 million by selling tokens which ultimately provided users with access to its decentralized cloud storage program.⁵⁴ Compare that example to Overstock.com (Overstock).⁵⁵ One of Overstock's portfolio companies, tZERO, held an ICO to fund development of a trading platform for tZERO tokens.⁵⁶ In exchange, the tZERO token holders were promised quarterly dividends derived from the platform's profits.⁵⁷ The various uses and functions of these tokens can create difficulty for regulators attempting to determine whether they constitute a security or a commodity.

II. THE SEC AND CFTC'S ENDLESS TUG OF WAR

Gary Gensler, the current Chairman of the SEC, has often argued that the regulation of cryptocurrency falls within the SEC's jurisdiction.⁵⁸ Gensler has even gone so far as to say that cryptocurrencies not only resemble securities, but they are securities.⁵⁹ In furtherance of this position, the SEC created an entire unit within the Division of Enforcement in 2017, the Crypto Assets and Cyber Unit, focused on increasing the oversight of crypto markets.⁶⁰ As of 2022, the SEC had brought more than eighty enforcement actions related to crypto offerings and exchanges.⁶¹ Those actions have resulted in relief exceeding \$2 billion.⁶² That number has increased significantly, totaling 127 enforcement actions as of January 2023.⁶³ But while SEC Chair Gensler has claimed that "[crypto] products are subject to the securities laws

53. Vrazel, *supra* note 6, at 535; Harnoy, *supra* note 43.

54. Harnoy, *supra* note 43.

55. *Id.*; see Press Release, Overstock, Overstock Completes Planned Investment in tZERO (Aug. 26, 2022), <https://www.globenewswire.com/en/news-release/2022/08/26/2505333/33533/en/Overstock-Completes-Planned-Investment-in-tZERO.html> [<https://perma.cc/C5RU-CVAG>].

56. Harnoy, *supra* note 43.

57. *Id.*

58. Matt Levine, *Gary Gensler Wants to Regulate Crypto*, BLOOMBERG (Sept. 8, 2022, 2:33 PM), <https://www.bloomberg.com/opinion/articles/2022-09-08/gary-gensler-wants-to-regulate-crypto> [<https://perma.cc/H6JQ-WKGG>].

59. See Nikhilesh De, *SEC's Gensler Holds Firm That Existing Laws Make Sense for Crypto*, COINDESK (Sept. 13, 2022, 3:00 PM), <https://www.coindesk.com/policy/2022/09/13/secs-gensler-holds-firm-that-existing-laws-make-sense-for-crypto/> [<https://perma.cc/8VCG-RNUV>].

60. Press Release, U.S. Sec. & Exch. Comm'n, SEC Nearly Doubles Size of Enforcement's Crypto Assets and Cyber Unit (May 3, 2022), <https://www.sec.gov/news/press-release/2022-78> [<https://perma.cc/VBN3-RKM2>].

61. *Id.*

62. *Id.*

63. Press Release, Cornerstone Rsch., SEC Tightens Cryptocurrency Enforcement (Jan. 18, 2023), <https://www.cornerstone.com/insights/press-releases/sec-tightens-cryptocurrency-enforcement/> [<https://perma.cc/4PKR-M8T6>].

and must work within our securities regime,⁶⁴ the CFTC has also taken a front-seat approach to oversight in the market.⁶⁵

The CFTC has played an active role in enforcing CFTC regulations on crypto, specifically on Bitcoin exchanges and Bitcoin-based products.⁶⁶ Through an enforcement order in September 2015, the CFTC made its position clear that Bitcoin and other similar virtual currencies are a type of commodity.⁶⁷ The CFTC has maintained this stance. In February 2022, CFTC Commissioner Rostin Behnam stated before the U.S. Senate that the CFTC's "flexible approach has allowed the CFTC, with authority from Congress, to evolve along with the derivatives markets from their historical roots And [the CFTC] now stand[s] ready to do the same within the digital asset commodity market."⁶⁸ So, whose job is it to regulate crypto? This ultimately boils down to whether cryptocurrency is a security or commodity.

A. *The SEC's Authority to Regulate Securities*

According to *Black's Law Dictionary*, a security is "[a]n instrument that evidences the holder's ownership rights in a firm (e.g., a stock), the holder's creditor relationship with a firm or government (e.g., a bond), or the holder's other rights (e.g., an option)."⁶⁹ The Securities Act of 1933 and the Securities Exchange Act of 1934 authorize the SEC to regulate securities and to pursue enforcement actions for violations of the federal securities laws, which include fraud and insider trading.⁷⁰ Both include a definition of a security, and the Supreme Court

64. Gary Gensler, Chair, U.S. Sec. & Exch. Comm'n, Remarks Before the Aspen Security Forum (Aug. 3, 2021), <https://www.sec.gov/news/speech/gensler-aspen-security-forum-2021-08-03> [<https://perma.cc/4PKR-M8T6>].

65. See COMMODITY FUTURES TRADING COMM'N, *supra* note 5, at 1.

66. Scott D. Hughes, *Cryptocurrency Regulations and Enforcement in the U.S.*, 45 W. ST. U. L. REV. 1, 11 (2017).

67. *Id.* at 8; see *CFTC Orders Bitcoin Options Trading Platform Operator and Its CEO to Cease Illegally Offering Bitcoin Options and to Cease Operating a Facility for Trading or Processing of Swaps Without Registering*, COMMODITY FUTURES TRADING COMM'N, <https://www.cftc.gov/PressRoom/PressReleases/7231-15> [<https://perma.cc/E66B-7KUJ>] (last visited Oct. 20, 2023).

68. Rostin Behnam, Chairman, Commodity Futures Trading Comm'n, Testimony Before the U.S. Senate Committee on Agriculture, Nutrition, and Forestry: Examining Digital Assets: Risks, Regulation, and Innovation (Feb. 9, 2022), <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam20> [<https://perma.cc/7Q64-CM2G>].

69. *Security*, BLACK'S LAW DICTIONARY (11th ed. 2019).

70. Complaint, *supra* note 8, at 5; see Securities Act of 1933, 15 U.S.C. § 77; Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10) (defining a security as "any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to

has determined that the two statutory definitions are to be construed the same.⁷¹ Congress chose this definition to ensure it would “encompass virtually any instrument that might be sold as an investment.”⁷² Both stocks and investment contracts, included in the statutory definition, share significant resemblances to cryptocurrency tokens.⁷³ There is no federal statutory definition of “stock,” but *Black’s Law Dictionary* defines stock as “[a] proportional part of a corporation’s capital represented by the number of equal units (or shares) owned, and granting the holder the right to participate in the company’s general management and to share in its net profits or earnings.”⁷⁴ The term “investment contract” also lacks a statutory definition⁷⁵ and has been scrutinized by scholars.⁷⁶

The Supreme Court attempted to resolve that ambiguity in 1946 through the creation of the *Howey* test.⁷⁷ The test is used to determine whether a scheme is considered an “investment contract” and thus meets the statutory definition of a security.⁷⁸ The *Howey* test established four elements that must be met for an instrument to be considered an investment contract.⁷⁹ First, the instrument must involve an investment of money.⁸⁰ However, the investment does not need to be in the form of cash.⁸¹ Second, the investment must be “in a common enterprise.”⁸² Third, the investment must include an expectation of profit.⁸³ The term “profits” does not refer to profits of the overall

foreign currency, or in general, any instrument commonly known as a ‘security’; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited”).

71. Miriam R. Albert, *The Howey Test Turns 64: Are the Courts Grading This Test on a Curve?*, 2 WM. & MARY BUS. L. REV. 1, 6 (2011).

72. Vrazel, *supra* note 6, at 537 (quoting SEC v. Edwards, 540 U.S. 392, 393 (2004)).

73. *Id.*

74. *Stock*, BLACK’S LAW DICTIONARY (11th ed. 2019).

75. Vrazel, *supra* note 6, at 537. See generally Jaiden Pokoski, Note, *Navigating the Complexities of Cryptocurrency Taxation*, 51 FLA. ST. U. L. REV. (forthcoming 2024).

76. André Beganski, *Law Professors Scrutinize SEC Notion of ‘Investment Contract’ in Coinbase Lawsuit*, DECRYPT (Aug. 13, 2023), <https://decrypt.co/152343/sec-investment-contract-howey-test-amicus-brief> [https://perma.cc/N9C5-593T].

77. See SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

78. Daniel Nathan & Brian Bloomer, “*But if You Fall, You Fall Alone*”—*The SEC Goes After Ripple*, ORRICK, <https://blogs.orrick.com/blockchain/author/dnathan/> [https://perma.cc/76XF-WBY8] (last visited Oct. 20, 2023).

79. See *Howey*, 328 U.S. at 301.

80. *Id.*

81. Vrazel, *supra* note 6, at 537 (citing Int’l Bhd. of Teamsters, Chauffeurs, Warehousemen & Helpers of Am. v. Daniel, 439 U.S. 551, 560 n.12 (1979)).

82. *Howey*, 328 U.S. at 301.

83. SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946); John O. McGinnis, *Two Paradoxes of Crypto*, 26 CHAP. L. REV. 445, 454 (2023).

scheme but instead to what the investors seek to gain.⁸⁴ Fourth, the profits from the investment must come solely from the efforts of others.⁸⁵ The profits can come in a variety of forms, including “dividends, other periodic payments, or the increased value of the investment.”⁸⁶ The *Howey* test has been broadly applied to include instruments that may not appear to be securities on their face.⁸⁷ For example, “fractionalized interests in pools of home mortgage or auto loans, interests in earthworm farms and chinchilla ranches, and various forms of pyramid schemes” have been classified as investment contracts under the *Howey* test and thus deemed to be securities.⁸⁸

The Supreme Court has held that to determine whether security regulations are appropriate, “form should be disregarded for substance and the emphasis should be on economic reality.”⁸⁹ Additionally, the Court has emphasized that the instruments in *Howey* had “equivalent values to most persons and could have been traded publicly,” essentially stating that these are required characteristics of securities.⁹⁰ In sum, stocks and investment contracts must be fungible to possess these characteristics and meet the definition of a security.⁹¹ Cryptocurrency tokens are fungible,⁹² as are cryptocurrency coins used for money.⁹³ Although tokens are fungible, they can represent a specific asset or security.⁹⁴ However, most cryptocurrency *coins* do not satisfy the *Howey* test because coins that serve no purpose other than to be used as a medium of exchange “do not provide the holder with any rights to ownership, voting, or returns on investment.”⁹⁵

B. *The SEC in Action*

The SEC brought twenty enforcement actions related to cryptocurrency in the fiscal year for 2021.⁹⁶ Seventy percent of those actions

84. Vrazel, *supra* note 6, at 537 (quoting SEC v. Edwards, 540 U.S. 389, 394 (2004)).

85. *Howey*, 328 U.S. at 301.

86. Vrazel, *supra* note 6, at 537 (quoting *Edwards*, 540 U.S. at 394).

87. Albert, *supra* note 71, at 7.

88. *Id.*

89. Vrazel, *supra* note 6, at 550 (quoting *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967)).

90. See *Marine Bank v. Weaver*, 455 U.S. 551, 560 (1982).

91. Vrazel, *supra* note 6, at 537; see also Jake Frankenfield, *All About Fungibility: What It Means, Why It Matters*, INVESTOPEDIA, <https://www.investopedia.com/terms/f/fungibility.asp> [<https://perma.cc/8XYS-JMGL>] (last updated May 7, 2022) (“Fungibility is the ability of a good or asset to be interchanged with other individual goods or assets of the same type.”).

92. See Zainuddin, *supra* note 28.

93. Vrazel, *supra* note 6, at 538; see Zainuddin, *supra* note 28.

94. Vrazel, *supra* note 6, at 538.

95. *Id.*

96. SIMONA MOLA, SEC CRYPTOCURRENCY ENFORCEMENT 1 (2021), <https://www.cornerstone.com/wp-content/uploads/2022/01/SEC-Cryptocurrency-Enforcement-2021-Update.pdf> [<https://perma.cc/ZK5M-TCQ9>].

were related to ICOs.⁹⁷ The SEC continues to pursue ICO-related enforcement actions, encompassing approximately forty-seven percent of enforcement actions in 2022.⁹⁸ Its Crypto Asset and Cyber Unit in the Division of Enforcement is responsible for investigating alleged securities law violations related to (1) crypto asset offerings, (2) crypto asset exchanges, (3) crypto asset lending and staking products, (4) decentralized platforms, (5) non-fungible tokens, and (6) stablecoins.⁹⁹ In May 2022, the SEC announced that the Crypto Asset and Cyber Unit was expanding to account for twenty additional positions.¹⁰⁰ While nearly filling these positions, the SEC has hired additional staff for the unit.¹⁰¹ With a growing enforcement unit focused on cryptocurrency, the SEC will likely continue to bring more enforcement actions in this industry each year.

In December 2020, the SEC filed an enforcement action against Ripple Labs, Inc. (Ripple), alleging that the sale of Ripple’s digital token, XRP, was an unregistered security.¹⁰² The SEC stated that XRP met the *Howey* test because XRP was bought as a speculative investment, Ripple was a common enterprise, and investors reasonably expected to profit.¹⁰³ The SEC and Ripple filed competing motions for summary judgment in the suit.¹⁰⁴ Ripple’s motion pushed back against the SEC, arguing that distribution of XRP is not an investment contract according to the *Howey* test.¹⁰⁵ First, Ripple asserted that many of the transactions listed in the SEC’s complaint contain “no actual contract between a promoter and an investor.”¹⁰⁶ Second, Ripple argued that when contracts did exist, they did not contain any “post-sale obligations for Ripple or rights for the purchaser of XRP to share in profits from [Ripple’s] efforts.”¹⁰⁷ Last, Ripple argued that a common enterprise does not exist because the XRP ecosystem, “comprised by

97. *Id.*

98. Press Release, Cornerstone Rsch., *supra* note 63.

99. Press Release, U.S. Sec. & Exch. Comm’n, *supra* note 60.

100. *Id.*

101. Sandali Handagama, *SEC Is Adding Attorneys to Crypto Enforcement Unit*, COINDESK, <https://www.coindesk.com/policy/2023/04/11/us-sec-adding-attorneys-to-crypto-enforcement-unit-signals-continued-crackdown/> [<https://perma.cc/F78F-GF7A>] (Apr. 11, 2023, 1:37 PM).

102. Complaint at 1, SEC v. Ripple Labs, Inc., No. 20-cv-10832 (S.D.N.Y. 2021), ECF No. 1; Stephen Humenik et al., *CFTC and SEC Perspectives on Cryptocurrency and Digital Assets—Volume I: A Jurisdictional Overview*, JDSUPRA (May 6, 2022), <https://www.jdsupra.com/legalnews/cftc-and-sec-perspectives-on-2330927/> [<https://perma.cc/CA6V-MWVQ>].

103. Complaint, *supra* note 102, at 35, 45, 49.

104. Katherine J. Stoller & John A. Nathanson, *SEC’s Enforcement Actions and Public Pronouncements Reinforce Approach on Digital Assets*, SHEARMAN & STERLING (Sept. 27, 2022), <https://www.shearman.com/en/perspectives/2022/09/sec-enforcement-actions-and-public-pronouncements-reinforce-approach-on-digital-assets> [<https://perma.cc/LF4F-R5QY>].

105. *Id.*

106. *Id.*

107. *Id.*

multiple third parties who interact with the XRP Ledger or own XRP currency, cannot be characterized as a ‘common enterprise’” under the *Howey* test.¹⁰⁸ Ripple’s motion also warned of potential implications, claiming that the SEC’s application of the rules represents an “open-ended assertion of jurisdiction over any transfer of an asset (for consideration or not) that the SEC thinks may benefit from the registration and disclosure requirements of securities law.”¹⁰⁹

In February of 2022, the SEC charged BlockFi Lending L.L.C. (BlockFi) for unregistered offers and sales of BlockFi Interest Accounts (BIAs) as investment opportunities.¹¹⁰ The SEC asserted that the BIAs met all requirements under the *Howey* test.¹¹¹ According to the order, BlockFi promised “BIA investors a variable interest rate, determined by BlockFi on a periodic basis, in exchange for crypto assets loaned by the investors,” and investors reasonably expected to obtain “future profit from BlockFi’s efforts in managing the BIAs based on BlockFi’s statements about how it would generate the yield to pay BIA investors interest.”¹¹² Additionally, the SEC argued that investors reasonably expected “BlockFi would use the invested crypto assets in BlockFi’s lending and principal investing activity, and that investors would share profits in the form of interest payments.”¹¹³ BlockFi ultimately agreed to pay \$100 million in aggregate penalties; to pursue registration of the BIAs; to stop unregistered offers and sales; and to take efforts to comply with the Investment Company Act of 1940.¹¹⁴

C. *The CFTC’s Authority to Regulate Commodities*

The Commodity Exchange Act (CEA) establishes the CFTC’s authority to regulate commodities.¹¹⁵ *Black’s Law Dictionary* defines a

108. *Id.*

109. *Id.*

110. BlockFi Lending L.L.C., Securities Act Release No. 11029, Investment Company Act Release No. 34503, 2022 WL 462445, at *2 (Feb. 14, 2022); Wendy Cohen et al., *United States: Fintech 2022*, MONDAQ (Mar. 31, 2022), <https://www.mondaq.com/unitedstates/fintech/1178102/fintech-2022> [<https://perma.cc/QM3X-UKMD>].

111. BlockFi Lending L.L.C., *supra* note 110, at *2.

112. *Id.*

113. *Id.*

114. Press Release, U.S. Sec. & Exch. Comm’n, BlockFi Agrees to Pay \$100 Million in Penalties and Pursue Registration of Its Crypto Lending Product (Feb. 14, 2022), <https://www.sec.gov/news/press-release/2022-26> [<https://perma.cc/6TYU-34HN>].

115. Commodity Exchange Act, 7 U.S.C. § 1a (defining a commodity as “wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, *Solanum tuberosum* (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by the first section of Public Law 85-839 (7 U.S.C. 13-1)) and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in”).

“commodity” as “[a]n article of trade or commerce,” including “only tangible goods, such as products or merchandise, as distinguished from services.”¹¹⁶ The definition of a commodity is exceedingly broad. If a commodity is involved, the CFTC’s jurisdiction applies only if a “commodity interest” exists based on the transaction.¹¹⁷ Transactions with a “commodity interest” are defined types of instruments subject to the CFTC’s regulation pursuant to 17 C.F.R. § 1.3.¹¹⁸ Although the CFTC has not formally defined virtual currency or digital assets, the CFTC included a broad definition of the term “virtual currency” within its March 2020 *Final Interpretive Guidance for Retail Commodity Transactions Involving Certain Digital Assets*.¹¹⁹ In this interpretation, virtual currency was defined as:

[A] digital asset that encompasses any digital representation of value or unit of account that is or can be used as a form of currency (*i.e.*, transferred from one party to another as a medium of exchange); may be manifested through units, tokens, or coins, among other things; and may be distributed by way of digital “smart contracts,” among other structures.¹²⁰

D. The CFTC in Action

Over twenty percent of the CFTC’s enforcement actions involved conduct related to digital assets in the 2022 fiscal year alone.¹²¹ These included “charg[ing] manipulation of the Digitex Futures native token; charg[ing] a decentralized autonomous organization (DAO); [and] address[ing] failures to register or seek designation as a designated contract market (DCM), swap execution facility (SEF) or futures commission merchant (FCM).”¹²² Additionally, the CFTC settled a case against two defendants “charged in connection with a fraudulent forex and digital asset scheme.”¹²³ The settlement order required a payout of \$1.2 million in restitution and a \$600,000 civil monetary penalty.¹²⁴

116. *Commodity*, BLACK’S LAW DICTIONARY (11th ed. 2019).

117. Matthew Kluchenek, *Bitcoin and Virtual Currencies: Welcome to Your Regulator*, 7 HARV. BUS. L. REV. ONLINE 1, 2 (2016).

118. *Id.* at 3 (stating that the types of instruments subject to the CFTC’s regulation are “(i) futures contracts, (ii) options on futures contracts, (iii) swaps, (iv) leveraged retail foreign exchange contracts, (v) leveraged retail commodity transactions, and (vi) certain other leveraged products”); see 17 C.F.R. § 1.3 (2023).

119. COMMODITY FUTURES TRADING COMM’N, *supra* note 5, at 2.

120. *Id.*

121. Press Release, Commodity Futures Trading Comm’n, Division of Enforcement Performance Highlights (Oct. 20, 2022), <https://www.cftc.gov/PressRoom/PressReleases/8613-22> [<https://perma.cc/ZZ62-PMWZ>].

122. *Id.*

123. *Id.*

124. *Id.*

The amount of digital asset enforcement actions the CFTC has brought in a single year more than doubled since the 2020 fiscal year.¹²⁵

In October 2020, the CFTC charged five companies with illegally operating the BitMEX “cryptocurrency derivatives trading platform and with anti-money laundering (AML) violations due to providing U.S. persons with crypto derivatives.”¹²⁶ The order found BitMEX violated the CEA because while BitMEX operated a facility to trade or process swaps and operated as a futures commission merchant, it failed to be approved or registered with the CFTC.¹²⁷ Additionally, BitMEX violated CFTC regulations related to AML by “failing to implement a Customer Information Program (CIP) and Know-Your-Customer (KYC) procedures that would enable the identification of U.S. persons using the platform, and by failing to implement an adequate” AML program.¹²⁸

On October 15, 2021, the CFTC settled charges with Tether and Bitfinex.¹²⁹ Tether was charged with violating the CEA for making material misrepresentations and omissions about its U.S. dollar-denominated stablecoin, Tether.¹³⁰ Tether maintained to customers that they had sufficient reserves to back their stablecoins with the “equivalent amount of corresponding fiat currency”; however, a majority of the time, the reserves were not “fully-backed.”¹³¹ Additionally, Tether falsely stated that it would complete audits to demonstrate fully-backed reserves at all times, but the reserves were never audited.¹³² Tether was thus required to pay a \$41 million penalty and to cease and desist from further CFTC violations.¹³³ The Bitfinex order found that Bitfinex operated as a futures commission merchant without CFTC registration by “accepting orders for, acting as a counterparty to, and

125. COMMODITY FUTURES TRADING COMM’N, FY2020: DIVISION OF ENFORCEMENT ANNUAL REPORT 1, 7 (2020) (stating that the CFTC brought “seven cases involving digital assets, including a case in which defendants allegedly targeted churchgoers and misappropriated \$28 million dollars in connection with purported Bitcoin investments, and a matter where a foreign trading platform was offering illegal leveraged transactions in Ether, Litecoin, and Bitcoin”).

126. Humenik et al., *supra* note 102; Press Release, Commodity Futures Trading Comm’n, Federal Court Orders BitMEX to Pay \$100 Million for Illegally Operating a Cryptocurrency Trading Platform and Anti-Money Laundering Violations (Aug. 10, 2021), <https://www.cftc.gov/PressRoom/PressReleases/8412-21> [<https://perma.cc/UT4F-FV2X>].

127. Press Release, Commodity Futures Trading Comm’n, *supra* note 126.

128. *Id.*

129. Press Release, Commodity Futures Trading Comm’n, CFTC Orders Tether and Bitfinex to Pay Fines Totaling \$42.5 Million (Oct. 15, 2021), <https://www.cftc.gov/PressRoom/PressReleases/8450-21> [<https://perma.cc/4MVC-2HLD>].

130. *Id.*

131. *Id.*; Carol R. Goforth, *Regulation by Enforcement: Problems with the SEC’s Approach to Cryptoasset Regulation*, 82 MD. L. REV. 107, 140 (2022).

132. Press Release, Commodity Futures Trading Comm’n, *supra* note 129.

133. *Id.*

accepting funds or property, including bitcoin and USDt tokens, in connection with those same retail commodity transactions.”¹³⁴ Bitfinex was required to pay a \$1.5 million penalty and the order prohibited Bitfinex from further violations of the CEA.¹³⁵

III. THE BROAD IMPACTS OF REGULATORY AMBIGUITY IN THE CRYPTO MARKET

The number of players and the ambiguity of cryptocurrency regulation pose many problems to the market. The SEC and the CFTC have yet to agree which regulator has authority over cryptocurrencies.¹³⁶ Without intervention from Congress to determine whether crypto is a security or a commodity, or whether the SEC or the CFTC should have jurisdiction, the crypto market will continue to be the “wild west.”¹³⁷ Meanwhile, the CFTC and SEC continue to bring enforcement actions that have broad impacts on the crypto and digital asset markets, challenging the bounds of the current regulatory framework. Without a cohesive regulatory framework, crypto exchanges can engage in fraudulent schemes with little oversight, as most recently seen in the scandal engulfing FTX.

A. *Potential Implications of SEC v. Wahi*

In the SEC’s first enforcement action alleging insider trading of crypto, the complaint identified nine “crypto asset securities.”¹³⁸ Insider trading is the buying or selling of a security “while in possession of material, nonpublic information about the security.”¹³⁹ The SEC uses the term “crypto asset security” in the complaint to refer to an “asset that is issued and/or transferred using distributed ledger or blockchain technology—including, but not limited to, so-called ‘digital assets,’ ‘virtual currencies,’ ‘coins,’ and ‘tokens’—and that meets the definition of ‘security’ under the federal securities laws.”¹⁴⁰ Coinbase publicly responded to the complaint and stated that the company does not list any securities on their platform.¹⁴¹ Coinbase even filed their own petition for rulemaking by the SEC for digital assets under federal

134. *Id.*

135. *Id.*

136. Vrazel, *supra* note 6, at 559.

137. Sylvan Lane, *Gensler Compares Cryptocurrency Market, Regulations to ‘Wild West,’* HILL (Sept. 14, 2021, 6:42 PM), <https://thehill.com/policy/finance/572278-gensler-compares-cryptocurrency-market-regulations-to-wild-west/> [<https://perma.cc/QJ48-K7DD>].

138. Complaint, *supra* note 8, at 3.

139. Emily Crane, *Regulation Without Deflation: Cryptocurrency and Its Insider Trading Conundrum*, 51 J. MARSHALL L. REV. 797, 804 (2019).

140. Complaint, *supra* note 8, at 2.

141. Keri E. Riemer et al., *SEC v. Wahi: An Enforcement Action Impacting the Broader Crypto/Digital Assets and Investment Management Industries*, NAT’L L. REV. (Aug. 23, 2022), <https://www.natlawreview.com/article/sec-v-wahi-enforcement-action-impacting-broader-cryptodigital-assets-and-investment> [<https://perma.cc/4FWJ-HV2Y>].

securities laws and regulations, including identifying which digital assets are securities.¹⁴² The SEC's complaint provides examples of what the SEC will consider when determining whether a crypto asset is a crypto asset security, including: "(1) public statements about the potential for crypto asset purchasers to realize profits; (2) involvement of management teams in the ongoing success of the crypto asset and related network; and (3) efforts to facilitate and promote listing of crypto assets on secondary market trading platforms."¹⁴³ Ishan and Nikhil Wahi ultimately agreed to settle charges in a parallel criminal case, and the SEC announced it would not seek civil penalties in light of their prison sentences.¹⁴⁴ Although the Wahis agreed to be permanently enjoined from violating Section 10(b) of the Securities Exchange Act,¹⁴⁵ the settlement circumvented the court's opportunity to determine whether the SEC's jurisdiction extends to crypto.

This suggests that other crypto assets on Coinbase, and other crypto exchanges, could be considered securities.¹⁴⁶ Coinbase is one of the largest trading platforms, offering more than 150 cryptocurrencies, including the most popular: Bitcoin, Tether, and Ethereum.¹⁴⁷ Companies may have to reconsider whether their particular assets are subject to federal securities laws.¹⁴⁸ By bringing an insider trading action against Coinbase, the SEC is suggesting that any exchange trading crypto asset securities is subject to insider trading rules, which the SEC just recently voted to amend.¹⁴⁹ This would require executives of these exchanges to report trades at least ninety days beforehand.¹⁵⁰ In sum, these reconsiderations could have broad effects throughout the industry, such as companies being required to revisit disclosures or to

142. *Id.*; Michael J. Blankenship & Jacob Botros, *SEC Responds to Coinbase Petition for Regulation of Digital Assets*, WINSTON & STRAWN LLP (May 25, 2023), <https://www.winston.com/en/blogs-and-podcasts/non-fungible-insights-blockchain-decrypted/sec-responds-to-coinbase-petition-for-regulation-of-digital-assets> [<https://perma.cc/EBY5-PXSD>] (noting that the SEC responded by stating that "its regulatory regime is not egregiously delayed and that the SEC is not withholding any decisions already made").

143. John J. Carney et al., *SEC and DOJ Bring Parallel Crypto Insider Trading Cases; SEC Alleges Nine Tokens Are Securities*, BAKERHOSTETLER (July 22, 2022), <https://www.bakerlaw.com/insights/sec-and-doj-bring-parallel-crypto-insider-trading-cases-sec-alleges-nine-tokens-are-securities/> [<https://perma.cc/C885-G6AQ>].

144. Press Release, U.S. Sec. & Exch. Comm'n, Former Coinbase Manager and His Brother Agree to Settle Insider Trading Charges Relating to Crypto Asset Securities (May 30, 2023), <https://www.sec.gov/news/press-release/2023-98> [<https://perma.cc/NRX9-5LS3>]. See generally 17 C.F.R. § 240.10b-5 (2023).

145. Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 144.

146. *See id.*

147. *About Coinbase Exchange*, COINMARKETCAP, <https://coinmarketcap.com/exchanges/coinbase-exchange/> [<https://perma.cc/Y27C-495J>] (last visited Oct. 20, 2023).

148. Riemer et al., *supra* note 141.

149. Andrew Ramonas, *SEC Toughens Insider Trading Rules for Execs, Limits Protections*, BLOOMBERG L. (Dec. 14, 2022, 11:51 AM), <https://news.bloomberglaw.com/securities-law/sec-toughens-insider-trading-rules-for-execs-limits-protections> [<https://perma.cc/X4B8-KWC5>].

150. *Id.*

amend or adopt specific policies and procedures in line with the SEC’s assertions.¹⁵¹ Additionally, if the SEC continues to take a sweepingly broad view on what constitutes a security, it is likely that crypto assets could be deemed an “investment security” subject to the Investment Company Act of 1940.¹⁵² This could require pooled investment vehicles that invest in one or more “crypto asset securities” to register as an “investment company” under the Act.¹⁵³ Under this theory, the SEC could charge an unregistered fund with “violating Section (7)(a) of the 1940 Act by engaging in interstate commerce while failing to register as an investment company.”¹⁵⁴ This possibility is not far-fetched. In fact, this is consistent with the SEC’s BlockFi approach.¹⁵⁵ If the SEC’s sweepingly broad definition deems more crypto assets to be considered securities, it is likely that more companies would be considered “investment companies” under the Act. This exposes crypto to yet another regulation. Because of this uncertainty, some have urged start-up cryptocurrencies to preemptively comply with the Investment Company Act.¹⁵⁶ Most start-up companies may be inclined to limit investors within a particular fund to less than 100 “beneficial owners” to satisfy the registration exemption under Section 3(c)(1).¹⁵⁷ This is based on mere assertions made by the SEC in a complaint rather than clear regulation produced through a transparent rulemaking process outlined in the Administrative Procedure Act.¹⁵⁸

B. Regulation by Enforcement

CFTC Commissioner Caroline Pham has warned that “*SEC v. Wahi* is a striking example of ‘regulation by enforcement.’”¹⁵⁹ Regulation by enforcement is retroactive and resource intensive. Instead of providing crypto participants with clear rules and regulations they must abide by, crypto exchanges are facing enforcement actions after the fact and relying on ambiguous parameters to evaluate whether they are adhering to necessary federal laws. The SEC is bringing enforcement actions

151. Riemer et al., *supra* note 141.

152. *Id.* (“The term ‘investment securities’ is defined by the 1940 Act to mean all securities except (A) government securities, (B) securities issued by employees’ securities companies, and (C) securities issued by majority-owned subsidiaries of the owner that (i) are not investment companies, and (ii) are not relying on either the Section 3(c)(1) exception or Section 3(c)(7) exception from the definition of ‘investment company.’”).

153. *Id.*

154. *Id.*

155. *See supra* Section II.B.

156. *SEC and CFTC Regulation for Startup Cryptocurrency Hedge Funds*, CAP. FUND L. GRP. (May 4, 2023), <https://www.capitalfundlaw.com/blog/sec-and-cftc-regulation-and-registration-for-startup-cryptocurrency-hedge-funds> [<https://perma.cc/7EAE-RM2M>].

157. *Id.*; *see also* 17 C.F.R. § 240.13d-3 (2023) (defining “beneficial owner”).

158. Riemer et al., *supra* note 141.

159. Caroline D. Pham, Comm’r, Commodity Futures Trading Comm’n, Statement of Commissioner Caroline D. Pham on *SEC v. Wahi* (July 21, 2022), <https://www.cftc.gov/Press-Room/SpeechesTestimony/phamstatement072122> [<https://perma.cc/734L-AAH6>].

by relying on “broadly worded statutory phrases to develop the law case-by-case.”¹⁶⁰ These settled cases do not offer much clarity and result in a patchwork of articulations.¹⁶¹ For example, in the case of *SEC v. Wahi*, without a court opinion analyzing whether the crypto assets were in fact subject to federal securities laws, crypto participants must speculate given the nature of the settled charges. With the increasing popularity of crypto, the SEC will be unable to keep up with this current model. Many people, including SEC Commissioners, have recognized this.¹⁶² SEC Commissioner Mark Uyeda has argued that “regulation through enforcement does not yield the outcomes achievable through a process that involves public comment.”¹⁶³ Additionally, SEC Commissioner Hester Peirce has stated that although one-off enforcement actions should be used to address fraud in the crypto space, they “are not the right way to build a regulatory framework.”¹⁶⁴ Peirce has suggested that more appropriate solutions would be crafting tailored exemptions and notice-and-comment rulemaking.¹⁶⁵ Peirce mentioned the following reasons in explaining why it is important to reach a prudent and properly calibrated regulatory outcome.¹⁶⁶ First, allowing those with crypto to keep their crypto assets while still earning a return is valuable.¹⁶⁷ Second, she stated that inviting people to come in and talk with the Commission “only to drag them through a difficult, lengthy, unproductive, and labyrinthine regulatory process casts the Commission in a bad light” and “makes [the Commission] a less effective regulator.”¹⁶⁸ Third, she reasoned that a company that tries to do the right thing by working with the SEC “should be met across the table by a regulator that tries to get to a sensible result in a reasonable

160. Ryan Deffenbaugh & Ben Brody, *The Three Words Driving the Crypto Policy Debate*, PROTOCOL (Aug. 5, 2022), <https://www.protocol.com/policy/what-is-regulation-by-enforcement> [<https://perma.cc/5QP8-KGZZ>].

161. Leo Schwartz, *‘Our Rules Have to Evolve’: The Crypto Industry Is Trapped in Regulatory Purgatory*, FORTUNE CRYPTO (Sept. 19, 2022, 7:00 AM), <https://fortune.com/crypto/2022/09/19/crypto-industry-trapped-regulatory-purgatory/> [<https://perma.cc/KYM2-B2Y8>].

162. Kenneth Corbin, *‘Regulation by Enforcement’ Won’t Work for Crypto, Argues SEC Commissioner*, BARRON’S (Sept. 9, 2022, 2:19 PM), <https://www.barrons.com/advisor/articles/sec-regulation-enforcement-crypto-commissioner-51662747452> [<https://perma.cc/8ZYW-6FE4>]; Hester M. Peirce, Comm’r, U.S. Sec. & Exch. Comm’n, *On the Spot: Remarks at Regulatory Transparency Project Conference on Regulating the New Crypto Ecosystem: Necessary Regulation or Crippling Future Innovation?* (June 14, 2022), <https://www.sec.gov/news/speech/peirce-remarks-regulatory-transparency-project-conference> [<https://perma.cc/Z2BD-JGZ7>].

163. Corbin, *supra* note 162.

164. Peirce, *supra* note 162.

165. *Id.*

166. Statement, Hester M. Peirce, Comm’r, U.S. Sec. & Exch. Comm’n, *Statement on Settlement with BlockFi Lending LLC* (Feb. 14, 2022), <https://www.sec.gov/news/statement/peirce-blockfi-20220214> [<https://perma.cc/8MZ6-6F3T>].

167. *Id.*

168. *Id.*

timeframe.¹⁶⁹ Peirce has gone so far as to release a proposed safe harbor for tokens, developed through feedback from crypto participants,¹⁷⁰ but the SEC has failed to adopt such a measure or take steps towards the same. Just as Commissioner Peirce has previously concluded, the SEC must do better at accommodating innovation through the use of the exemptive authority Congress provided them.¹⁷¹

C. *The FTX Scandal—Why Cryptocurrency Regulation Is Crucial*

The recent FTX scandal is a perfect example of why clear regulation is needed for crypto. Sam Bankman-Fried cofounded the hedge fund Alameda Research in 2017 before starting his own crypto exchange, FTX, in 2019.¹⁷² FTX grew rapidly due to promising higher than average returns and Bankman-Fried's aggressive marketing strategies, which included airing a Super Bowl ad campaign, purchasing naming rights to the Miami Heat's arena, and engaging well-known celebrities such as Kevin O'Leary.¹⁷³ By January of 2022, FTX had raised \$2 billion in funding and the company was valued at \$32 billion.¹⁷⁴ That quickly changed when Coinbase published an article stating that Alameda Research's main asset was FTT, a token created by FTX.¹⁷⁵ This led to concern that the hedge fund's main assets were tied to a risky and volatile token.¹⁷⁶ The Coinbase article sent a ripple throughout the country. Binance, a rival of FTX, subsequently announced its plan to sell around \$530 million worth of FTT; consequently, investors took their money out of FTX, dropping the price of FTT tokens.¹⁷⁷ FTX had to pause withdrawals once they reached \$6 billion because they did not have the funds to fulfill them.¹⁷⁸ Shortly after, Binance reached a non-binding agreement to purchase FTX to improve liquidity concerns, but

169. *Id.*

170. See Statement, Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, Token Safe Harbor Proposal 2.0 (Apr. 13, 2021), <https://www.sec.gov/news/public-statement/peirce-statement-token-safe-harbor-proposal-2.0> [<https://perma.cc/BB3A-KXNN>].

171. Statement, Peirce, *supra* note 166.

172. *What Happened to Crypto Giant FTX? A Detailed Summary of What We Actually Know So Far*, FORBES (Dec. 13, 2022, 12:48 PM) [hereinafter *What Happened to Crypto Giant FTX?*], <https://www.forbes.com/sites/qai/2022/12/13/what-happened-to-crypto-giant-ftx-a-detailed-summary-of-what-we-actually-know-here/?sh=78d6513d60fa> [<https://perma.cc/42WE-2MH2>].

173. *Id.*

174. *Id.*

175. Ian Allison, *Divisions in Sam Bankman-Fried's Crypto Empire Blur on His Trading Titan Alameda's Balance Sheet*, COINDESK (Nov. 2, 2022, 10:44 AM), <https://www.coindesk.com/business/2022/11/02/divisions-in-sam-bankman-frieds-crypto-empire-blur-on-his-trading-titan-alamedas-balance-sheet/> [<https://perma.cc/FJC5-PNAZ>].

176. *What Happened to Crypto Giant FTX?*, *supra* note 172.

177. *Id.*

178. *Id.*

that did not last long.¹⁷⁹ The deal crumbled, and Binance announced that they could not pursue the acquisition “due to the news of mishandling customer funds and an alleged U.S. agency investigation.”¹⁸⁰ Bankman-Fried stepped down as CEO, and FTX was forced to file for bankruptcy.¹⁸¹ In a matter of days, FTX went from a \$32 billion valuation to bankrupt.¹⁸² Since then, Bankman-Fried was convicted on seven criminal counts, including wire fraud, conspiracy to commit money laundering, securities fraud, and commodities fraud.¹⁸³ As of fall 2023, Bankman-Fried still faces civil charges from both the SEC and the CFTC.¹⁸⁴ The scandal has been described as one of the biggest financial frauds in American history.¹⁸⁵

The evidence suggests that some of FTX’s customer funds were sent to the linked trading firm, Alameda Research, and then gambled away.¹⁸⁶ While the total losses are still unknown, approximately one million customers could be impacted.¹⁸⁷ Unfortunately, the downfall of FTX does not stop there, and we are likely to continue to see the effects of FTX as additional investigations and lawsuits unfold. This extends to other cryptocurrencies and exchanges that were exposed to FTX and FTT and the technology sector as a whole.¹⁸⁸ BlockFi was also forced to file for bankruptcy due to its significant exposure to FTX.¹⁸⁹ Owing approximately \$3.4 billion to creditors after the downfall of FTX,

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.*

183. Marley Jay et al., *Sam Bankman-Fried Found Guilty on All Counts at Fraud Trial Over Crypto Exchange FTX*, NBC NEWS (Nov. 2, 2023, 7:49 PM), <https://www.nbcnews.com/business/business-news/sam-bankman-fried-verdict-ftx-trial-rcna123158#> [<https://perma.cc/L759-PT54>].

184. Renato Mariotti, *What Sam Bankman-Fried’s Swift Indictment Says About DOJ’s Case*, BLOOMBERG L. (Dec. 15, 2022, 11:38 AM), <https://news.bloomberglaw.com/us-law-week/what-sam-bankman-frieds-swift-indictment-says-about-doj-s-case> [<https://perma.cc/75CJ-LKJ6>].

185. *Id.*

186. David Z. Morris, *FTX’s Collapse Was a Crime, Not an Accident*, COINDESK (Nov. 30, 2022, 2:15 PM), <https://www.coindesk.com/layer2/2022/11/30/ftxs-collapse-was-a-crime-not-an-accident/> [<https://perma.cc/T3LY-R5NY>].

187. *Id.*

188. *The Rise and Fall of FTX: What Does It Mean for Crypto Investors?*, BKS PARTNERS (Nov. 18, 2022), <https://bks-partners.com/the-rise-and-fall-of-ftx-what-does-it-mean-for-crypto-investors/> [<https://perma.cc/TJ5F-YGB3>].

189. *What Happened to Crypto Giant FTX?*, *supra* note 172.

Genesis, a cryptocurrency lender, additionally filed for bankruptcy in January 2023.¹⁹⁰ The FTX scandal is a prime example of why crypto regulation is needed to foster market growth and technological innovation while also protecting consumers.¹⁹¹

IV. POTENTIAL SOLUTIONS TO REGULATING CRYPTOCURRENCY IN THE UNITED STATES

The current regulatory framework, or lack thereof, for cryptocurrencies must change to protect investors and provide crypto market participants with more clarity as to which rules and regulations they must abide by. Regulators have several options for resolving ambiguity in the crypto market. First, the federal government could outlaw cryptocurrencies altogether, eliminating risks to investors completely. Second, regulators could determine that cryptocurrencies fall exclusively within the SEC's or CFTC's jurisdiction. Third, Congress could pass new laws specifically related to cryptocurrency regulation clarifying when cryptocurrency is a security, subject to SEC rules and regulations, and when it is a commodity, subject to CFTC rules and regulations.

As of November 2021, nine countries had a full ban on cryptocurrencies, with forty-two having an implicit ban.¹⁹² In countries with an implicit ban, the government either does not "allow financial institutions to take on crypto companies or holders as clients" or they prohibit their operation completely.¹⁹³ Even with these bans in place, it is not clear if these countries are successful in enforcing their bans.¹⁹⁴ Although many regulators criticize the crypto industry for being rife with fraud, the United States has not taken steps towards outlawing crypto, likely because it has proven to be lucrative for investors and businesses.¹⁹⁵ However, in November of 2022, New York banned certain

190. Amanda Hetler, *FTX Scam Explained: Everything You Need to Know*, TECHTARGET (Oct. 2, 2023), <https://www.techtargget.com/whatis/feature/FTX-scam-explained-Everything-you-need-to-know> [<https://perma.cc/6E5X-H2F2>].

191. Lexia Avvocati, *The FTX Scandal Explained: What Happened?*, CRYPTONOMIST (Nov. 26, 2022), <https://en.cryptonist.ch/2022/11/26/the-ftx-scandal-what-happened/> [<https://perma.cc/9VAT-G3QC>].

192. Luc Olinga, *Russia Wants to Ban Crypto. Here Are Countries Where Crypto Is Illegal*, STREET (Jan. 21, 2022, 12:41 PM), <https://www.thestreet.com/investing/russia-wants-to-ban-crypto-these-countries-outlaw-crypto> [<https://perma.cc/5J5V-GKPL>] (citing THE L. LIBR. OF CONG., REGULATION OF CRYPTOCURRENCY AROUND THE WORLD: NOVEMBER 2021 UPDATE (2021), <https://tile.loc.gov/storage-services/service/l1/l1glrd/2021687419/2021687419.pdf> [<https://perma.cc/9EYZ-XBMH>]).

193. *Id.*

194. *Id.* (listing Algeria and China as countries where cryptocurrency is explicitly banned but transactions are still taking place).

195. *See generally supra* note 2 and accompanying text; Vrazel, *supra* note 6, at 530.

types of crypto mining.¹⁹⁶ The ban is aimed at “cryptocurrency mining companies in the state that consume large amounts of energy by utilizing ‘proof-of-work’ authentication—the process that uses sometimes millions of high-powered computers to track and secure transactions in bitcoin and other virtual currencies.”¹⁹⁷ No other states have taken steps to outlaw crypto, although some require certain licenses or disclosures.¹⁹⁸ If used within legal boundaries, cryptocurrencies can be very beneficial.¹⁹⁹ It is necessary to form a well-structured legal framework to regulate cryptocurrencies rather than banning it altogether.²⁰⁰

Alternatively, Congress could decide to apply blanket authority of either the SEC or CFTC to regulate the entirety of the cryptocurrency market. This would certainly resolve ambiguity because cryptocurrency users and exchanges would definitively know which laws apply to their transactions without having to speculate.²⁰¹ Instead of trying to navigate inconsistent applications of regulations, issuers and traders would have a clear picture of how to operate within the bounds of the law.²⁰² However, cryptocurrencies share many similarities with both securities and commodity markets.²⁰³ Regulating them uniformly as one or the other would deny their unique nature.²⁰⁴ Applying a case-by-case approach to each cryptocurrency would lead to more accurate results in classifications, but this would look similar to regulation by enforcement.²⁰⁵ Additionally, because classifying a security is dependent on the *Howey* test, it could yield different conclusions based on who applies the test.²⁰⁶ Regulating cryptocurrency trading exclusively under either security or commodity classification is not an ideal permanent solution.²⁰⁷ Therefore, a middle ground approach to cryptocurrency regulation would better serve financial markets and protect investors, and Congress should pass legislation resolving this conflict.²⁰⁸

196. Cheyenne DeVon, *New York Is the First State to Ban Certain Types of Crypto Mining—Here’s What to Know*, CNBC (Nov. 25, 2022, 12:26 PM), <https://www.cnbc.com/2022/11/25/new-york-is-the-first-state-to-ban-certain-types-of-crypto-mining.html> [<https://perma.cc/K3KN-W9HZ>].

197. *Id.*

198. Tom Blackstone & Gabe Turner, *2023 Guide: Everything You Should Know to Invest in Crypto Safely*, SECURITY.ORG, <https://www.security.org/crypto/legality/> [<https://perma.cc/B55D-EPTB>] (Aug. 25, 2023).

199. Urvashi Asudani, *Status of Cryptocurrency in India: A Broader Perspective*, 4 INT’L J.L. MGMT. & HUMANS. 5571, 5576 (2021). See generally Lital Helman & Ofer Tur-Sinai, *Bracing Scarcity: Can NFTs Save Digital Art?*, 51 FLA. ST. U. L. REV. 183 (2023).

200. *Id.*

201. See Vrazel, *supra* note 6, at 560.

202. *Id.*

203. *Id.* at 561.

204. *Id.*

205. *Id.*; see also *supra* Section III.B.

206. Vrazel, *supra* note 6, at 561.

207. *Id.* at 545.

208. *Id.* at 561.

On September 16, 2022, the White House issued guidelines that encouraged the SEC and CFTC to “aggressively pursue investigations and enforcement actions” and to “issue guidance and address current and emergent risks in the digital asset ecosystem.”²⁰⁹ However, the guidance did not distinguish responsibilities between the two regulators.²¹⁰ Similarly, the U.S. Department of the Treasury issued a report in September 2022 that urged U.S. regulatory and law enforcement agencies to “vigilantly monitor the crypto-asset sector” and “continue using their existing authorities to issue supervisory guidance and rules.”²¹¹ Additionally, Congress has attempted to draft legislation, the Digital Commodities Consumer Protection Act, that would resolve some ambiguity.²¹² The Act amends the definition of “commodity” in the CEA to include “digital commodity.”²¹³ The Act defines “digital commodity” to include Bitcoin and Ethereum (also known as Ether) while excluding certain financial instruments, including securities.²¹⁴ Furthermore, the Act grants the CFTC “exclusive jurisdiction over, any account, agreement, contract, or transaction involving a digital commodity trade.”²¹⁵ Although this is a step in the right direction, the bill does not sufficiently outline the role regulators will take on digital assets.²¹⁶ Sheila Warren, CEO of the Crypto Council for Innovation, stated that the Act needed to better define a “digital commodity” and security, and the matter should not be left to regulatory agencies or courts.²¹⁷ The Act only provides that Bitcoin and Ether are digital commodities, and it does not go further to draw the line of classification.²¹⁸ Warren emphasized that leaving it to the agencies and courts to determine whether a digital asset, other than Bitcoin and Ether, is a security or not “has not worked well, with significant implications for con-

209. Schwartz, *supra* note 161 (citing Statement, The White House, Fact Sheet: White House Releases First-Ever Comprehensive Framework for Responsible Development of Digital Assets (Sept. 16, 2022), <https://www.whitehouse.gov/briefing-room/statements-releases/2022/09/16/fact-sheet-white-house-releases-first-ever-comprehensive-framework-for-responsible-development-of-digital-assets/> [<https://perma.cc/LRP7-GN5Z>]).

210. *Id.*

211. *Id.* (citing U.S. DEPT OF THE TREASURY, CRYPTO-ASSETS: IMPLICATIONS FOR CONSUMERS, INVESTORS, AND BUSINESSES 2 (2022), https://home.treasury.gov/system/files/136/CryptoAsset_EO5.pdf [<https://perma.cc/BE23-LRUP>]).

212. See Digital Commodities Consumer Protection Act of 2022, S. 4760, 117th Cong. (2022).

213. *Id.* § 2(a)(18)(A).

214. *Id.* § 2(a)(18)(B).

215. *Id.* § 3(e)(2)(F).

216. Turner Wright, *Crypto Bill a Pivotal Step’ but Needs Clarification on ‘Digital Commodity’—Sheila Warren*, COINTELEGRAPH (Sept. 15, 2022), <https://cointelegraph.com/news/crypto-bill-needs-clarification-on-digital-commodity-sheila-warren> [<https://perma.cc/ZLF5-HXGA>].

217. *Id.*

218. *Id.*

sumers, and is why the industry has made numerous calls for proactive regulation, rather than regulation by enforcement.²¹⁹ In order to resolve this ambiguity, Congress should distinguish between fully functional and operational cryptocurrencies and those which are promises to deliver cryptocurrencies in the future.²²⁰

Regulators have agreed that Bitcoin is not a security because it does not meet the *Howey* test.²²¹ Bitcoin was started by an unknown person(s) using a pseudonym and was created as a monetary system built on trust, freedom, and privacy.²²² Ether was deemed not to be a security during the Trump administration when the SEC noted that “while Ether may have started out qualifying as a security—the Ethereum Foundation used it to raise money—it had grown into something sufficiently decentralized that it probably no longer was one.”²²³ However, Ether then moved to a system using “staked” coins when recording transactions.²²⁴ This type of blockchain network is known as “proof of stake,” and owners can earn interest by staking their holdings.²²⁵ In response, SEC Chairman Gensler said that because staked coins can earn interest, they could be investment contracts and regulators might start treating it as a security.²²⁶ However, the CFTC stands firm and argues that Ether qualifies as a commodity despite Gensler’s comments.²²⁷ Even if buying Bitcoin or Ether is an investment of money and may involve an expectation of profits if the buyer intends to hold the cryptocurrency rather than use it on goods or services, it is still difficult to argue that a “cryptocurrency network is a common enterprise when the roles and intentions of its users are so varied.”²²⁸ In addition, the profits from holding and using cryptocurrencies do not accumulate from the efforts of others as required by the *Howey* test

219. *Id.*

220. Zuluaga, *supra* note 12, at 4.

221. Lydia Beyoud & Allyson Versprille, *Why the Crypto World Flinches When the SEC Calls Coins Securities*, BLOOMBERG, <https://www.bloomberg.com/news/articles/2022-07-29/why-crypto-flinches-when-sec-calls-coins-securities-quicktake#xj4y7vzkq> [<https://perma.cc/ZY7Y-LWQ5>] (June 12, 2023, 1:21 PM).

222. *See How and When Did Bitcoin Start?*, *supra* note 12.

223. Beyoud & Versprille, *supra* note 221.

224. *Id.*

225. Nicholas Rossolillo, *Types of Cryptocurrency*, MOTLEY FOOL, <https://www.fool.com/investing/stock-market/market-sectors/financials/cryptocurrency-stocks/types-of-cryptocurrencies/> [<https://perma.cc/2MSZ-RLF6>] (Oct. 27, 2023, 2:09 PM).

226. Danny Nelson, *SEC’s Gensler Signals Extra Scrutiny for Proof-of-Stake Cryptocurrencies Report*, COINDESK, <https://www.coindesk.com/policy/2022/09/15/secs-gensler-signals-extra-scrutiny-for-proof-of-stake-cryptocurrencies-report/> [<https://perma.cc/HG2E-ZJP3>] (May 11, 2023, 2:37 PM); Beyoud & Versprille, *supra* note 221.

227. Mandy Williams, *CFTC Chair Reiterates: Bitcoin and Ether Are Commodities*, CRYPTO POTATO, <https://cryptopotato.com/cftc-chair-reiterates-bitcoin-and-ether-are-commodities/> [<https://perma.cc/6859-ZRL2>] (last updated Oct. 25, 2022, 1:58 PM).

228. Zuluaga, *supra* note 12, at 3.

but instead from using the cryptocurrencies on the blockchain network.²²⁹ Thus, existing cryptocurrencies are unlikely to meet the *Howey* test; applying federal securities laws to them would be inappropriate and negatively affect the future of blockchain.²³⁰ It is for these reasons that most cryptocurrencies should be regulated by the CFTC. However, the SEC should regulate some ICOs, which are promises to deliver. Former SEC Chairman Jay Clayton has recognized that the promise to deliver a digital token in the future is different and should not be treated the same as the token itself.²³¹ Clayton once said that "every ICO I have seen is a security," and the SEC's current Chairman, Gensler, has agreed.²³² However, not all ICOs pass the *Howey* test.²³³ To clearly differentiate this, regulators should delineate between two types of contracts: (1) those that are marketed as investments and allow trading on secondary markets before the launch of the associated applications, and (2) contracts marketed as future promises of a commodity, which are not tradable before the associated application is created.²³⁴ The latter resemble forward contracts and should not be considered securities because "they would involve the physical delivery of the cryptocurrency to the contract buyer when the application became functional."²³⁵ These should be left to the CFTC. However, contracts that meet the first set of criteria would pass the *Howey* test and qualify as securities. In this case, the ICO would be substantially similar to an IPO and should be subject to federal securities laws. ICOs and IPOs "seek to raise capital for a business enterprise through the creation and sale of financial instruments to investors."²³⁶ Despite some procedural differences between ICOs and IPOs, the SEC could make "the IPO registration requirements of securities applicable to all ICOs."²³⁷ The processes are similar enough that applying U.S. securities laws to ICOs would provide a barrier for fraudulent practices.²³⁸

Even with this legislative guidance from Congress, the SEC and CFTC will need to engage in notice-and-comment rulemaking to tailor existing rules and regulations to fit the crypto market or to create new rules and regulations. Clarifying the types of digital assets that should

229. *Id.*

230. *Id.*

231. *Id.* at 2.

232. Gensler, *supra* note 64.

233. See Hester M. Peirce, Comm'r, U.S. Sec. & Exch. Comm'n, *How We Howey* (May 9, 2019), <https://www.sec.gov/news/speech/peirce-how-we-howey-050919> [<https://perma.cc/KSE5-39N8>].

234. Zuluaga, *supra* note 12, at 4.

235. *Id.* See generally Rajeev Dhir, *Forward Contract: How to Use It, Risks, and Example*, INVESTOPEDIA, <https://www.investopedia.com/terms/f/forwardcontract.asp> [<https://perma.cc/35HK-VKNU>] (last updated July 10, 2022).

236. Vrazel, *supra* note 6, at 551.

237. *Id.* at 564.

238. *Id.* at 562.

be under the SEC's purview and those that should be under the CFTC's purview is merely the first step towards resolving regulatory ambiguity in the crypto market. Once that line is drawn, the regulators must act. Simply applying old rules to this new emerging market could have inadvertent effects such as more expensive and less accessible financial services.²³⁹ Colorado Senator John Hickenlooper voiced these same concerns in a letter to SEC Chairman Gensler in October 2022.²⁴⁰ While recognizing that many of these questions are complicated, Hickenlooper stated that adding a notice-and-comment period "will yield critical public input," and because some digital assets are securities and some may be commodities, "a formal regulatory process will improve policy development."²⁴¹ As CFTC Commissioner Pham has stated, "[r]egulatory clarity comes from being out in the open, not in the dark."²⁴² The CFTC and SEC can create a formal regulatory process for cryptocurrency with legislative guidance and engage the public in notice-and-comment rulemaking.

CONCLUSION

Answering the question of whether cryptocurrency is a commodity or a security will offer guidance for cryptocurrency issuers and holders, determine which investors can participate, and what, if any, disclosure and registration requirements are applicable.²⁴³ These are not questions that should be answered, but questions that *must* be answered. If the SEC and CFTC continue to avoid notice-and-comment rulemaking, the crypto market will continue to operate in regulatory purgatory. The current state of cryptocurrency regulation poses many hurdles and roadblocks for issuers and investors, and consumers reap zero protections. Congress should draft legislation granting the SEC authority to regulate promises to deliver cryptocurrencies, where the contracts marketed as investments are tradable on secondary markets before the associated applications are functional, while leaving other cryptocurrencies under the CFTC's purview. With or without Congress's intervention, the SEC and CFTC should engage in notice-and-comment rulemaking to tailor existing rules and regulations or to create new rules and regulations that align with the crypto market. The best way to create a formal regulatory framework is to engage crypto issuers and investors themselves. Cryptocurrency is here to stay, and the government should embrace economic innovation and work with regulators to better adapt to changes in the financial market.

239. Sarah Jarvis, *Senate Dem Tells SEC Chair Crypto Rulemaking 'Needed Now,'* LAW360 (Oct. 12, 2022, 4:01 PM), <https://www.law360.com/articles/1539576/senate-dem-tells-sec-chair-crypto-rulemaking-needed-now> [<https://perma.cc/X6B2-7YVK>].

240. *Id.*

241. *Id.*

242. Pham, *supra* note 159.

243. Zuluaga, *supra* note 12, at 1.