

SEC, FinCEN, and CFTC Actions Continue to Paint a Fragmented Regulatory Landscape for Digital Tokens

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The past few days have seen several interesting developments in the law and regulation of digital tokens. Each action reflects an intense focus by U.S. regulators to clarify the treatment of digital tokens, from those issued by startups in initial coin offerings (ICOs) to the more “traditional” cryptocurrencies such as bitcoin and litecoin, as well as the regulatory status under U.S. law of persons engaging in certain activities involving digital tokens. These actions are merely the latest—and most certainly not the last—efforts by regulators and courts to address the many policy, legal, and regulatory issues raised by digital tokens. The picture emerging from these efforts is one of a fragmented, overlapping, and complex regulatory landscape for digital tokens.

SEC Flags Regulation of Digital Token Intermediaries. The SEC Divisions of Enforcement and Trading and Markets released a joint statement yesterday that cautions investors who transact on unregulated digital token exchanges and included expanded warnings about the potential registration obligations of digital asset intermediaries—including exchanges, wallet providers and others.

This iteration of the SEC’s warnings concerning digital assets focuses on digital token transactions conducted through, and the activities of, online trading platforms and other intermediaries. The statement describes the risks to investors trading on platforms that are not registered with the SEC and, thus, are not subject to SEC oversight of their listing standards, order execution protocols, customer access standards, or market data integrity.

The statement also provides explicit warnings to intermediaries about the extensive securities regulatory framework that applies to exchange, storage and other activities involving digital tokens that are securities—moving beyond the securities registration requirements that have been the primary focus of the SEC’s ICO enforcement activity until now. The Divisions warn that trading platforms may be subject to registration as national securities exchanges (or as alternative trading systems, if the platform qualifies for that exemption), while wallet providers and other service providers may be subject to registration and regulation as broker-dealers, transfer agents, or clearing agencies. Each of these registration and regulatory categories entails extensive compliance obligations and may be implicated where the tokens involved are deemed securities, depending on the particular services being provided.

The statement reiterates the SEC’s view that digital token market participants should consult legal counsel to determine the applicability of these requirements to their activities and suggests that the SEC staff may be willing to discuss these regulatory considerations with market participants who are seeking to navigate the SEC’s regulations.

FinCEN on ICO Participants as MSBs. The Financial Crimes Enforcement Network (**FinCEN**), a bureau of the U.S. Department of the Treasury, has, since [at least 2013](#), expressly applied its money services business (**MSB**) licensing regime to activities involving the exchange, transmission, and administration of virtual currencies. A letter from FinCEN staff that was made public on March 6, 2018 has garnered much attention for its focus on the application of the MSB licensing regime to participants in ICOs. The letter was addressed to Senator Ron Wyden, the ranking member of the Senate Committee on Finance, in response to his December 14, 2017 letter to FinCEN requesting information on the oversight and enforcement capabilities of FinCEN over virtual currency financial activities. FinCEN has not itself yet publicly released the letter, and it is not clear whether it is intended to convey public guidance.

The letter has raised questions about which types of ICO tokens and activities would be viewed by FinCEN as triggering MSB licensing requirements. For example, the letter itself does not undertake to distinguish among the many types of digital tokens—which range from those that are explicitly designed to represent securities (**security tokens**), to those structured to provide holders with access to or use of a network or product (**utility tokens**), to those that are designed to, or do, function as a medium of exchange or store of value or have other currency-like functions (**cryptocurrencies**).

A closer read, however, leads us to believe that the letter is not intended as a new pronouncement on the reach of the MSB licensing regime, but rather a reiteration of [FinCEN's 2013 guidance](#), in the context of ICOs. The 2013 guidance states that a person involved in administering, exchanging, or transmitting a virtual currency, including a “convertible virtual currency,” may be subject to MSB licensing on the basis that those virtual currencies function as currency, even if not backed by a government. The guidance describes a virtual currency as “a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency,” and a convertible virtual currency as “virtual currency either has an equivalent value in real currency, or acts as a substitute for real currency.”

While the letter discusses FinCEN's approach to ICOs, when describing FinCEN's MSB registration regime, the letter focuses on examples involving currency, virtual currency and convertible virtual currency. For example, the letter states that “a developer that sells convertible virtual currency, including in the form of ICO coins or tokens, in exchange for another type of value that substitutes for currency” as well as “an exchange sells ICO coins or tokens, or exchanges them for other virtual currency, fiat currency, or other value that substitutes for currency,” would each be required to register as an MSB. The proposition that ICO issuers and intermediaries involved in digital token activities would need to evaluate whether they are administering, exchange or transmitting virtual currencies or convertible virtual currencies is not new; this concept instead seems firmly grounded in the 2013 guidance.

There are, however, puzzling aspects of and core questions raised by the letter. For example, the letter cites to the SEC's regulation of broker-dealers and the CFTC's regulation of “merchants and brokers in commodities” in noting that certain ICO offerings may be subject to regulation by the SEC or CFTC. It is not clear why the types of activities described in the letter—particularly where they involve the sale of virtual currencies and convertible virtual currencies by the developer—would themselves trigger SEC broker-dealer regulation or CFTC regulation over futures or swap brokerage activities, which apply to intermediaries, rather than developers. In addition, FinCEN seems to assume that ICO developers would be “administrators” for purposes of the MSB licensing regime. However, as has been recognized by [commenters](#), there may be circumstances in which an ICO developer is more appropriately viewed as not engaged “as a business in issuing (putting into circulation) a virtual currency, and who has the authority to redeem (to withdraw from circulation) such virtual currency.” At the very least, the letter recognizes that multiple regulatory regimes may apply to ICOs.

[Virtual Currencies as Commodities](#). The CFTC has through guidance and enforcement actions consistently asserted that digital tokens (virtual currencies in CFTC parlance) are commodities and, therefore, subject to CFTC anti-fraud and anti-manipulation regulation.¹ Renowned jurist Judge Jack Weinstein of the U.S. District Court for the Eastern District of New York agrees.

The case, *CFTC vs. Patrick K. McDonnell and CabbageTech, Corp. d/b/a Coin Drop Markets*, concerned allegations of fraud involving bitcoin and litecoin brought by the CFTC against a *pro se* defendant. The Court's order is interesting for a few reasons. First, it is the first pronouncement by a court that virtual currencies—including those on which no futures contract is currently offered—are commodities. The order also concisely describes the overlapping jurisdiction of several federal regulators, including the CFTC, SEC, Treasury Department, DOJ, and IRS, over virtual currency activities. The court notes, however, that regulators view their jurisdiction as incomplete but that “Congress has yet to authorize a system to regulate virtual currency.” This sentiment perhaps foreshadows efforts that may come from Congress to consider a more comprehensive regulatory regime for digital tokens and participants in digital token markets.

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¹ Security tokens, even though technically commodities, would instead be subject to the exclusive jurisdiction of the SEC.