

Fact Sheet: Crypto Regulation

April 27, 2023

Introduction

The threat of harm to investors and markets is huge. The cryptocurrency market has exploded and imploded dramatically over just the past few years, costing investors trillions of dollars in losses. Many of those victims are individual retail investors swept up in the hype. Making sure that these financial products are properly regulated is critical.

Securities regulation is the first line of defense. As SEC Chairman Gensler has repeatedly said, the “vast majority” of cryptocurrency offerings are securities. Yet few of the issuers and promoters are complying with the securities laws like every other law-abiding financial firm in the U.S. The solution is first and foremost to aggressively enforce all of the available laws and regulations that apply to securities even if they are in the crypto space, including the registration requirements and the antifraud provisions set forth in the securities laws. And the SEC should be adequately funded to do the job. This is essential for protecting investors and the overall stability and integrity of our securities markets. In fact, the US global leadership in the capital markets depends on this strong regulatory framework and those investor protections. Claims that compliance with the securities laws is too difficult or even impossible, now heard from some in the cryptocurrency industry, are simply unfounded. Moreover, yielding to those claims would create an unlevel playing field and unfairly advantage crypto over all other law-abiding firms.

The CFTC also has a role to play in crypto derivatives regulation, as well as basic antifraud authority over commodities. The CFTC has full regulatory authority over crypto-based derivatives, including futures, options, and swaps. To the extent a cryptocurrency is considered a “commodity” under the Commodity Exchange Act, the CFTC also has authority to police that market for fraud and manipulation.


Any regulatory gaps are narrow and do not justify an overhaul of the regulatory framework. To the extent there are any gaps in the regulatory and enforcement tools applicable to cryptocurrencies, they are narrow, and they do not warrant an overhaul of the current system of financial regulation or special carve-outs from the current framework. Above all, it would be a mistake to deprive the SEC of securities jurisdiction over cryptocurrency offerings or weaken its authority, or to transfer that authority to an agency such as the CFTC. Other policy solutions to the challenge of cryptocurrency regulation that have surfaced are also unwise and unwarranted because they would dangerously legitimize a risky and largely lawless sector without providing genuine safeguards that would protect investors and markets.

Crypto Poses a Huge Threat to Investors While Failing to Deliver on Promised Benefits

The most significant aspect of the cryptocurrency market is the prevalence of fraud and manipulation. In a 2021 white paper, Deloitte estimated that up to 90% of the trading volume in cryptocurrency could be subject to manipulation.¹ The schemes used to manipulate cryptocurrency markets run the gamut, from pump-and-dump schemes, spoofing, and layering to wash sales.² Fraud and outright theft are also prevalent in the cryptocurrency

¹ Deloitte, Market Manipulation in Digital Assets (Mar. 2021), <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Financial-Services/gx-design-market-manipulation-in-digital-assets-whitepaper-v2-1.pdf>.

² Deloitte, Market Manipulation in Digital Assets (Mar. 2021), <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Financial-Services/gx-design-market->



markets, with Chairman Gary Gensler of the Securities and Exchange Commission referring to it as the “Wild West.”³ Crime and fraud have always been a characteristic of the cryptocurrency market given its promised anonymity; it is therefore no surprise that Bitcoin rapidly evolved into “the preferred currency for criminal activities.”⁴ Now, with the significant attention cryptocurrencies have attracted, the “lack of regulation and the anonymity of digital money have created a ripe environment for fraudsters.”⁵ In 2021 alone, cryptocurrency frauds and scams resulted in \$14 billion in losses.⁶

At the same time, crypto has utterly failed to produce the benefits so often proclaimed with this supposed “innovation.” Supporters and promoters have zealously argued that cryptocurrencies offer the potential to revolutionize the financial system, largely by eliminating the need for intermediaries to facilitate financial transactions.⁷ Doing so, according to enthusiasts, will not only make financial transactions more efficient but will also enable greater access to the financial system, and the wealth-building opportunities it provides, for the unbanked and underbanked.⁸ Further, they argue, by purportedly helping the poor gain access to wealth-building opportunities in the financial system, cryptocurrency will serve as a tool of social justice by helping reduce inequality, allowing marginalized communities, such as Black and Latino Americans and the LGBTQ communities, “to build wealth in communities that have been left out of the discriminatory banking system that we have today.”⁹

Yet, like the other claims, none of these benefits have materialized, nor do they appear on the horizon. In fact, the evidence is to the contrary as communities of color in particular appear to have been targeted by crypto predators and therefore have suffered disproportionate losses from the “crypto carnage.”

What it Means to Comply with Securities Laws

“No honest business need fear the SEC” – Joseph Kennedy, First Chairman of the SEC

[manipulation-in-digital-assets-whitepaper-v2-1.pdf](#).

³ Gary Gensler, Remarks Before the Aspen Security Forum, (Aug. 3, 2021). <https://www.sec.gov/news/public-statement/gensler-aspen-security-forum-2021-08-03>.

⁴ Eswar Prasad, *The Brutal Truth About Bitcoin*, N.Y. TIMES (Jun. 14, 2021), <https://www.nytimes.com/2021/06/14/opinion/bitcoin-cryptocurrency-flaws.html>.


⁵ Alexander Osipovich, *Crypto Frauds Target Investors Hoping to Cash In on Bitcoin Boom*, WALL ST. J. (Jun. 7, 2021), <https://www.wsj.com/articles/crypto-frauds-target-investors-hoping-to-cash-in-on-bitcoin-boom-11623058380>.

⁶ MacKenzie Sigalos, *Crypto Scammers Took a Record \$14 Billion in 2021*, CNBC (Jan. 6, 2022), <https://www.cnbc.com/2022/01/06/crypto-scammers-took-a-record-14-billion-in-2021-chainalysis.html>.

⁷ See Better Markets, Fact Sheet: Cryptocurrencies—The Next Big Thing Or The Next Gold Rush 2 (Mar. 9, 2022) (explaining that the claim of cryptocurrency enthusiasts is “if an algorithm can be relied upon to provide a financial product or service securely and verifiably, then there is no need for the infrastructure and personnel of the traditional financial system, and individual providers of financial products or services can interact directly with individual consumers. For example, stocks could be bought and sold without the presence of a broker-dealer, or a loan could be made without a bank or even a dedicated peer-to-peer lending platform.”), https://bettermarkets.org/wp-content/uploads/2022/03/BetterMarkets_FactSheet_Cryptocurrencies_3-9-2022.pdf.

⁸ See John O. McGinnis & Kyle Roche, *Bitcoin: Order Without Law in the Digital Age*, 94 IND. L.J. 1497, 1531 (2019).

⁹ Marquise Francis, “*Bitcoin is Absolutely a Tool for Social Justice*”: Ex-Government Regulator Turned Crypto Adviser, Yahoo! News (Jan. 15, 2022), <https://news.yahoo.com/Bitcoin-tool-for-social-justice-ex-government-regulator-turned-crypto-adviser-123417764.html>.



Full and honest disclosure is the cornerstone of securities regulation, and the SEC's primary mission is investor protection.

The \$100 trillion U.S. capital markets are premised on the fundamental idea that when you raise capital from the investing public, those investors are entitled to full and fair disclosures necessary to make informed investment decisions. Section 5 of the Securities Act prohibits the sale of securities, unless an exemption applies, prior to:

- filing a registration statement with the SEC;
- making available a prospectus to prospective investors including information relating to operations, financial condition, results of operations, risk factors, and management.

These disclosures are designed to provide basic, material information to the SEC and prospective investors about the enterprise, and they are subject to antifraud and materially false or misleading statement liability. All of these requirements and prohibitions are ultimately designed to protect investors and the integrity of the markets. Importantly, every single legitimate financial firm in the country that offers, trades, clears, or deals with securities complies with these foundational investor protection laws.


Intermediaries are subject to registration and oversight.

All of the intermediaries and gatekeepers are subject to oversight in the securities markets, including broker-dealers, investment advisers, auditing firms, and others. Consider broker-dealers. Broker-dealers serve multiple functions in the securities markets, including soliciting potential investors, handling customer funds and assets, and charging fees for those services. Section 15(a) of the Securities Exchange Act requires persons acting as broker-dealers to register with the SEC and join a self-regulatory organization. Broker-dealers are required to comply with SEC and SRO rules, including recordkeeping and reporting obligations, regulatory examinations, and important rules against conflicts of interest.

Specifically, to ensure that broker-dealers avoid conflicts of interest, Section 11(a) of the Securities Exchange Act prohibits broker-dealers that are members of an exchange from making transactions on that exchange for their own account. Additionally, broker-dealers are subject to various duties, including the duty of fair dealing; duty of best execution; regulation best interest; customer protection rules; and net capital rules to name a few. Broker-dealers are also subject to various antifraud provisions of the Securities Exchange Act prohibiting manipulative or deceptive practices.

Exchange regulation is another key component.

Exchange regulation dates back to the passage of the Securities Exchange Act of 1934 and the establishment of the SEC. Exchanges are “any organization, association, or group of persons...which constitutes, maintains, or provides a marketplace or facilities for bringing together purchases and sells of securities...” and they must register as a national securities exchange with the SEC. Under Section 6 of the Securities Exchange Act, exchanges must enact rules to govern their members (which are subject to review by the SEC); ensure fair access for its members; comply with rules designed to protect systems, capabilities, and integrity; discipline members for violations; establish rules to prevent fraud and manipulative acts or practices; and deny membership to non-registered broker-dealers.



Like every other law-abiding, legitimate financial firm in the U.S., the crypto industry can and must comply with the securities laws, and crypto’s complex, conflict-ridden, and overlapping business models cannot obscure that fact.

Since publication of the Bitcoin whitepaper in 2008, one of the premises of cryptocurrencies has been the claimed decentralized nature of peer-to-peer financial transactions without the need of a third-party financial intermediary. However, the largest players in today’s cryptocurrency ecosystem, the cryptocurrency exchanges, are far removed from this decentralized philosophy. In fact, they have gone in the opposite direction and centralized all of the roles of traditional financial intermediaries into one entity while claiming this model represents desirable “innovation” in finance. These crypto firms have become the issuer, broker-dealer, exchange, and clearing agency all under one roof and in some instances they also have a hedge fund engaged in principal proprietary trading on their platforms, often against their own customers.

As objectively proved over many decades, there are inherent conflict of interests between these different roles and that is why the securities regulatory framework does not allow such combinations. Imagine if Robinhood, Citadel’s market-making business and hedge fund, the New York Stock Exchange, and clearing agencies were all wrapped up within one entity with little regulation and less transparency. That is precisely the role being played by centralized cryptocurrency exchanges in today’s crypto markets, which they want exempted from meaningful oversight and investor protections.


Centralized cryptocurrency exchanges have made billions of dollars by serving traditional financial roles—issuer, broker-dealer, exchange, and clearing agency—within the cryptocurrency ecosystem. If these centralized cryptocurrency exchanges are going to serve as traditional issuers, broker-dealers, exchanges, and clearing agencies, then they need to be held to the same standards that apply to similar entities performing similar functions in traditional finance. To exempt them from this framework would be to hold them to a much lower standard than we hold financial intermediaries in other areas of our securities markets. That would not only legitimize and institutionalize unfair competition but also pose unacceptable risks to investors and the stability and integrity of our markets.

The laws and rules applicable to securities and related securities activities have been clear, black letter law and rules for many decades. Those laws and rules have been consistently applied to financial products of all types regardless of claims that they are somehow unique or imbued with a distinguishing type of innovation. The courts have largely agreed with this assessment. It is important to remember that of the more than 100 enforcement cases brought against cryptocurrency companies and actors, we are not aware of the SEC losing any such case.

How Commodities Regulation Fits In

The CFTC’s primary mission is to regulate the derivatives markets, which means the trading of futures, options, and swaps contracts. Thus, to the extent that any cryptocurrency-based derivative is being offered and traded, such as the Bitcoin futures contracts, the CFTC has the authority to regulate those activities. That includes registration, books and records, capital and margin, antifraud, and other requirements.

The CFTC also has the authority to police fraud and manipulation in the underlying commodities markets, not



just the derivatives markets.¹⁰ While that does not represent a comprehensive regulatory framework for any cryptocurrency that might in fact be a “commodity,” it is nevertheless another existing enforcement tool that can be brought to bear on certain illegal activities involving cryptocurrencies.

Filling Claimed Gaps: First, Do No Harm to the Time-Tested Securities Regulatory Framework


Preserve the SEC’s jurisdiction.

To the extent policymakers believe that measures are necessary to fill regulatory gaps in the crypto market, the first order of business is not to weaken the time-tested investor and market protections that the securities laws and rules have provided for nearly 90 years. This framework has led to the most liquid, broadest, and deepest capital markets in the world. Comparatively, it is important to remember that the global cryptocurrency industry is only roughly 1% of the U.S. capital markets. It would be unwise to upend our \$100 trillion capital markets and our traditional securities regulatory framework to bend to a nascent and unproven industry that has yet to confer economic utility or benefits. Amending our securities regulatory framework with special carveouts for cryptocurrency actors would undermine the strength of the U.S. capital markets by treating entities performing similar functions—such as issuers, broker-dealers, exchanges, clearing agencies—differently based not on their activity but on the type of industry in which they claim to be conducting business. In short, landmark legislation for this nascent and unproven industry would likely confer legitimacy and access to institutional investments for companies like FTX, without providing adequate investor and market integrity protections or countervailing benefits.

The problem is not, as the industry has claimed, that complying with the law and, for example, registering with the SEC, “is not possible.” It is entirely possible; depending on whether it was registering securities for sale to investors or registering as an exchange, broker-dealer, custodian, or clearing house, that would require crypto to, for example:

- a) ensure disclosures and representations were fully accurate and materially complete;
- b) establish systems and controls to protect customer assets, prevent internal theft (like commingling or embezzlement) and external hacks;
- c) eliminate conflicts of interests or mitigate them while fully disclosing them;
- d) maintain accurate books and records;

¹⁰ CEA § 6(c)(1) makes it illegal “to use or employ, or attempt to use or employ, in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Commission shall promulgate” CEA § 6(c)(3) makes it illegal “directly or indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity.” CEA § 9(a)(2) makes it a felony “to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or of any swap, or to corner or attempt to corner any such commodity”

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- e) implement robust and effective management, risk, legal, and compliance programs;
 - f) submit to routine examinations and supervision by the SEC and SROs like FINRA; and
 - g) institute margin, liquidity, capital, and related protections to fulfill their obligations and prevent contagion in the event of severe volatility, significant losses, and crashes as we've been seeing for almost a year now.

Complying with those rules is entirely possible and done every day by hundreds if not thousands of legitimate financial firms, companies, and individuals. However, such compliance with basic, foundational rules would interfere with crypto's profit-maximizing predatory business model. It should not be controversial to require the crypto industry to follow the same investor protection and financial stability rules that all other legitimate businesses already follow.

Do not legitimize crypto and allow it to expand its reach into the financial system.


An overarching peril in carving out special rules and safe harbors for crypto is the risk of legitimizing crypto and increasing its interconnectedness with the broader financial system, while at the same time failing to provide adequate protections for investors. Virtually any legislation will endow crypto with an aura of legitimacy, which crypto will market relentlessly as a seal of approval if not endorsement. That will spark another wave of enthusiasm among retail investors, who stand to lose yet more in addition to the trillions of dollars in capital that has evaporated in just the last couple of years. Yet after fourteen years of promises, Bitcoin and other digital commodities still have no independently verifiable use case to support any actual, legitimate economic activity. In fact, just the opposite is true: the industry has proven itself full of charlatans and criminals relentlessly engaging in predatory, illegal, and criminal conduct. Furthermore, conferring legislative legitimacy will expand the shadow banking system. That will invite, if not guarantee, regulatory arbitrage where yet more risk migrates from the more regulated financial system into the shadows.

There is also the likelihood that, if digital commodities have legislative and regulatory legitimacy, banks will do more business with crypto firms, and bank holding companies might even create crypto subsidiaries that will engage directly in crypto activities as well as create, trade, and hold innumerable crypto-related derivatives. As a result, the core of the banking system will likely become increasingly interconnected with the crypto industry, which makes contagion much more likely and poses a direct threat to the stability of the financial system. With no legitimate use case or any economic productive value, it does not make sense to confer legislative legitimacy on such an industry and financial activity.

Other traps and pitfalls.

Finally, any changes in the law to accommodate the crypto industry must carefully avoid a host of other missteps. For example, it would be a grave mistake to:

- expressly define the nature of any specific crypto asset identified by name, thus in effect creating a permanent safe haven that would be mimicked by other crypto promoters and ultimately reengineered under the same label to circumvent regulation;
- allow a self-certification regime for crypto offerings or platforms, which side-steps thorough and



independent regulatory review and approval;

- fail to establish a primary mandate for investor protection and thus fail to ensure that the regulator’s principal obligation in rulemaking, oversight, and enforcement is to protect investors;
- preempt the authority of state authorities to regulate crypto, and thus repeat the same mistake made prior to the 2008 financial crisis when the states were barred from addressing abuses in the subprime mortgage market;
- fail to adequately fund any agency, including especially the SEC, so it can meet the huge challenges posed by crypto, which, as an industry, has engaged in an unprecedented level of predatory, illegal, and criminal conduct;

For More Information

For more resources and information about the regulation of crypto, see the collection of materials that Better Markets has prepared and collected on its webpage: [“Everything You Need To Know About FTX, Sam Bankman-Fried, Crypto, The SEC, CFTC, The Revolving Door And The Influence Industry.”](#)

To talk to one of our experts, contact Anton Becker, Communications Director, at 201-675-8049 [or abecker@bettermarkets.org](mailto:abecker@bettermarkets.org).



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