



WASHINGTON NEEDS A PROCESS FOR... **CRYPTO POLICY**



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Washington Needs A Process For...Crypto Policy

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Technology, in all of its many forms, is a tool to implement policy, not a substitute for it. Before a technology can be chosen to implement a policy, the policy or, at the very least, the underlying objective must be identified. Using the example of the struggle of the United States to formulate a coherent national approach toward cryptocurrency, this article suggests that the technology in need of updating is the nation's core governing charter — i.e. the Constitution.

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INTRODUCTION

In truth, virtually any noun could follow the ellipsis in this article's title. The core institutions of our Constitutional structure are not working according to the design of our founding document. Nothing in the text of the Constitution or the immediately contemporaneous commentary suggests that the Framers imagined that the President would need to arbitrate a dispute between a small group of Senators and Representatives in order to move his legislative agenda forward. The Constitution does not mention the functional elements that have given rise to the current legislative quagmire — political parties and the Senate filibuster. Indeed, the fact that the founders did not contemplate the rise of political parties has led at least one prominent scholar to suggest that our Constitution has never really worked as planned.¹

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TECHNOLOGY IS COMPLEMENT TO POLICY, NOT A SUBSTITUTE FOR IT

It might seem odd to start a piece that sits within a volume devoted to the promise that technology has for solving regulatory problems with a nod to the latest example of the platonic ideal. But technology is simply a tool to further a defined end. Before regulators can harness technology to make their lives easier, they need to identify the core objectives within a specific regulatory domain, write rules to channel the behavior of market participants, and then deploy technology to ensure compliance and monitor the overall consequences.

Take speed limits as an example. Setting speed limits involves a myriad of factors. The short list includes the convenience of drivers, the safety of drivers, the safety of pedestrians (and bike riders), and the interests of downstream consumers both in the goods and services delivered via roads but the by-products of the use of those roads (e.g. emissions and noise). Regulators might resolve those concerns purely in favor of the convenience

of drivers and not set speed limits, or they might do as the U.S. has done and create a context specific regime — e.g. 15 miles per hour when kids are present near a school but 70 miles per hour on highways in unpopulated areas.

The technologies necessary to implement different speed limit regimes will vary. A no limit regime might not require any technology, though one could imagine regulators wanting to track accidents and monitor regimes to measure the effects of the no limit regime. The context specific regime will, on the other hand, require technologies for ensuring compliance. And the optimal technology to implement a particular regime might change over time. Today, the U.S. largely relies on humans armed with portable radars to track the speed of particular vehicles. When those humans spot a violator, they literally chase them down and issue a ticket. Soon, that might mean passive monitoring systems such as drones equipped with radar sensors and cameras. In the more distant future, it might mean technologies embedded in vehicles and roads that actively limit how fast vehicles can go. In short, the technology used to give effect to a particular regulatory regime follows the design of the regime itself.

The visible struggle of Congress to make laws and the President to execute them has made setting priorities difficult and translating those priorities into clear, stable rules virtually impossible. As a result, major segments of the U.S. economy are subject to complex regulatory regimes that seek to advance multiple objectives simultaneously. The introduction of new technologies compounds the problem as different regulators with different agendas then vie with one another to bring the new technology within the scope of their regulatory domain.

“ *It might seem odd to start a piece that sits within a volume devoted to the promise that technology has for solving regulatory problems with a nod to the latest example of the degree to which our government is falling short of the platonic ideal. But technology is simply a tool to further a defined end*

¹ Cass Sunstein, *What if a tyrant can't be booted out of office?* Bloomberg, Nov. 3, 2017 <https://www.bloomberg.com/opinion/articles/2017-11-03/what-if-a-tyrant-can-t-be-booted-out-of-office>.

03

THE BURGEONING CRYPTO INDUSTRY COULD BE A PROVING GROUND FOR GOOD POLICY (OR NOT)

The U.S. regulatory approach to crypto currency provides a recent and particularly salient example of the challenge it faces in developing coherent policy priorities. The crypto industry found itself at the center of U.S. regulatory attention this summer. Within the span of a few mid-summer weeks, Congress attempted to invent tax policy for the industry on the fly;² the Chairman of the SEC, asserting that the industry was completely unregulated, claimed dominion over it;³ and the President's working group on Financial Markets took on the job of recommending how one type of crypto currency, fiat backed crypto currencies, should be regulated.⁴

Three months later, there has been motion but little progress. The tax proposal that Congress made up on the fly is part of the infrastructure bill that the House has passed and that the President will (presumably) sign.⁵ The SEC has not initiated (much less concluded) a rule making to define what kind of instruments, digital and otherwise, constitute securities, preferring instead to let the issue percolate in the courts.⁶ The Working Group on Financial Markets issued its report on stablecoins and managed to document the *status quo*. The report notes that stable coins may present certain risks and calls on Congress to arbitrate the dispute between the SEC and CFTC about which agency should regulate them.⁷ There is little point in thinking about how to apply technology to address policy issues where the underlying policy does not exist.

Washington needs to resist chasing headlines in pursuit of more authority at the level of individual agencies and, instead, build a process to develop a foundation for a more coherent policy that would cover the entire government. This process necessarily starts with some humility. Regulators need to accept that they may not know all the answers. Indeed, they might not even be able to ask all the right questions. At this point, it is more important to get the right stakeholders in the room and identify the key first principles than design the optimal regulatory framework.

Again, crypto provides an example. Although the U.S. does not have a single regulator responsible for the industry, a number of agencies within the Federal government have regulated or could regulate certain aspects of it. The process of building a coherent policy for the industry should begin by canvassing all of the following for their views:

- **FinCEN.** The Financial Crimes Enforcement Network, an agency within the Treasury Department, is responsible for defining what types of businesses are considered financial institutions and what responsibilities different types of financial institutions have with regard to ensuring that their services are not used to facilitate crime or terrorist financing. It first exercised that authority over the crypto industry in 2013.⁸
- **CFTC.** The Commodities Fair Trading Commission has authority over spot markets for commodities as well as markets in which futures and other derivatives related to commodities and other assets are traded. It has exercised that authority over the crypto industry, bringing a series of enforcement actions against market participants and licensing several exchanges to support the trading of derivatives based on crypto currencies. It brought its first case in 2015.⁹

2 Taylor Locke, *The crypto tax provision in the infrastructure bill is 'potentially unworkable'—but Treasury may say it doesn't matter*, CNBC Aug. 16, 2021 <https://www.cnbc.com/2021/08/16/tax-foundation-infrastructure-bill-crypto-tax-provision-is-unworkable.html>.

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 Kollen Post, *Yellen convenes President's Working Group to discuss stablecoins next week*, *The Block*, Jul. 16, 2021 <https://www.theblockcrypto.com/linked/111743/yellen-convenes-presidents-working-group-to-discuss-stablecoins-next-week>.

5 See Information Reporting for Brokers and Digital Assets, H.R. 3684, Sec. 80603 at 2433-7 https://www.epw.senate.gov/public/_cache/files/e/a/ea1eb2e4-56bd-45f1-a260-9d6ee951bc96/F8A7C77D69BE09151F210EB4DFE872CD.edw21a09.pdf.

6 *SEC v. Ripple Labs, inc. et al.*, 20 Civ. 10832 (S.D.N.Y. Dec. 22, 2020).

7 Presidential Working Group on Financial Markets, *Report on Stablecoins*, Nov. 2021 https://home.treasury.gov/system/files/136/Stable-CoinReport_Nov1_508.pdf.

8 FinCEN, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, Mar. 18, 2013 <https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf>.

9 *In re Coinflip, Inc.*, CFTC Docket No. 15-29 (Sep. 17, 2015).

- **SEC.** The Securities and Exchange Commission regulates the issuance and sale of securities, the exchange of securities, and the business of providing investment advice. It has brought numerous cases against firms that have promoted or sold digital assets that the SEC believes to be a security.¹⁰ It has provided guidance to firms that certain kinds of digital assets are not securities. It also has broad rule making authority to define what a security is.¹¹ As noted above, it has not exercised that authority regarding digital assets, preferring instead to fight that battle in court.
- **OCC.** The Office of the Comptroller of the Currency regulates banks, including trust companies, that are chartered under the National Bank Act. In that capacity, it has the authority to determine the types of activities in which such entities can engage, including whether they can hold or issue digital assets. It has exercised that authority.¹²
- **Federal Reserve.** Federal Reserve Board regulates bank holding companies and certain other entities which are members of the Federal Reserve system. Congress has given it other regulatory and supervisory authority, too, including over payment systems.¹³ It is also a market participant in that it runs the largest settlement system in the United States.
- **CFPB and FTC.** The Consumer Financial Protection Bureau and the Federal Trade Commission have the ability to protect consumers against unfair and deceptive acts and practices. The FTC has used its authority to protect consumers against get rich quick schemes involving crypto currency.¹⁴ The CFPB also has the authority to protect consumers against abusive practices, and the authority to interpret various existing laws that regulate retail financial services. Of most direct relevance to the crypto industry is the Electronic Funds Transfer Act.¹⁵
- **The States.** Ours is, of course, a Federal system, and the powers not explicitly granted to the Federal government are reserved to the states.¹⁶ This includes the plenary authority to regulate any individual or business doing business within the physical bounds of a particular state or with the resident of a state. The states have

been very, very active in the crypto space led by the New York Department of Financial Services.

Having canvassed Federal and state governments for their views on the industry, the next task is to engage the industry and the public. The ultimate goal is to build a foundational policy framework that is tailored to the risks of the industry, that is flexible enough to allow for continued evolution, and that people will accept. Building that framework begins by asking some foundational questions:

- What distinguishes a crypto asset that is a commodity from a crypto asset that is a security from a crypto asset that is a payment instrument from a crypto asset that is a derivative?
- Assets and liabilities are the accounting versions of matter and anti-matter. You can't have one without the other. Who or what owns the liability associated with a given digital asset? Does the answer matter for purposes of informing how a given digital asset should be regulated?
- Could crypto currencies or a crypto currency emerge as an alternative to the dollar as a global reserve of wealth?
- What gaps exist in the current regulatory regime that could be exploited by people bent on defrauding users of crypto currency?
- Should a single Federal regulator have primary authority over the crypto industry? What role, if any, should the States play in regulating the industry?
- Is crypto more susceptible to use by criminals and terrorists than other technologies? If so, why?
- What should regulators try to avoid as they seek new authorities and establish new rules?
- What fundamental question about crypto does not receive enough attention?

Different answers to these questions will point in different directions about what the country's policy priorities regarding crypto should be. Take the third question on

10 *SEC v. Garza, et al.*, 3:15-cv-01760 (D. Conn. Dec. 1, 2015).

11 See, e.g. 15 U.S.C. §77b(a)(1).

12 OCC, Interpretive Letter #170 (Jul. 20, 2020).

13 See 12 U.S.C. §5454(a).

14 See *FTC v. Dluca, et al.*, 18-CV-60379 (S.D. Fla. Feb. 20, 2018).

15 Sec 15 USC § 1693 et seq.

16 U.S. Const. amend. X.

the list above — whether crypto currencies might emerge as an alternative to the dollar as a reserve of wealth. At first blush, the question might seem silly. The dollar has served as the world’s reserve currency since the end of World War II, and the rate currently demanded by investors for bonds issued by the U.S. government and by U.S. banks largely capitalized by those bonds suggests that people are not seriously worried about the end of that era. But people as diverse as Sen. Rand Paul and Matt Harris of Bain Capital Ventures have begun to wonder whether the era of dollar hegemony is on the wane and whether crypto currencies, specifically Bitcoin, may emerge as a viable alternative.¹⁷ If that is even a remote possibility, the entire discussion of crypto currency takes on a different cast. The challenge at the moment is that policy makers do not appear to be engaging in a serious way with any of these issues.

03

CONCLUSION

The Constitution conceives of a duet between Congress and the President. Congress takes the lead in making decisions about whether and how to act, and the President follows closely behind ensuring that Congress’s will is translated into action. Over the last two centuries, that duet has become a solo as Congress has receded into the role of cheerleader (when the White House and the relevant chamber majority are held by the same party) or scold (during periods of divided government).¹⁸ That is a problem for a host of reasons, but two issues loom particularly large. The President is not equipped to hear from, let alone balance the interests, of the many constituencies that make up the United States. And the volatility inherent in the U.S. political system ensures that the Presidency passes back and forth between the parties and when the shift happens, the new President invariably reviews and seeks to reverse the rules enacted by his predecessor.¹⁹

“Over the last two centuries, that duet has become a solo as Congress has receded into the role of cheerleader (when the White House and the relevant chamber majority are held by the same party) or scold (during periods of divided government)”

The larger point, here, is that technology is a tool to serve defined regulatory ends. It is not a substitute for the ends themselves. And that brings the discussion full circle. The Constitution is, itself, a technology.²⁰ It was devised and enacted to solve a particular set of problems at a particular moment in time. The Founders convened in Philadelphia in 1787 because it had become apparent that the pre-existing mechanism for coordinating the interests of the various states that had waged the War of Independence was not up to the task of “establish[ing] Justice, insur[ing] Domestic Tranquility, provid[ing] for the common defense, [or] promot[ing] the general Welfare.”²¹ The recent struggles of our leaders to achieve any meaningful amount of sustained consensus on virtually any policy dimension suggests that it might be time for a refresh. ■

17 See Axioms on HBO (Oct. 22, 2021) (quoting Sen. Rand Paul on the possibility of crypto becoming the global reserve currency) <https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKewjj4q32voT0AhUrCTQIHUOZCYIQtwJ6BAgDE-AM&url=https%3A%2F%2Fwww.youtube.com%2Fwatch%3Fv%3D6BA9NP-Dbjs&usg=AOvVaw06qxqjnZ2MHGxzCOqr1wN> and Matthew Harris, *The Future of Money: A Complete Revolution*, Oct. 22, 2021 <https://www.forbes.com/sites/matthewharris/2021/10/22/a-complete-revolution/?sh=4c16fad2f3a1>.

18 See The Lugar Center, Congressional Oversight Hearing Index <https://oversight-index.thelugarcenter.org/compare-committees-over-congresses/>.

19 See, e.g. President Biden, Executive Order 13992: Revocation of Certain Executive Orders Concerning Federal Regulation (Jan. 20, 2021) and Executive Order 14016: Revocation of Executive Order 13801 (Feb. 23, 2021).

20 See Linda Colley, *The Gun, The Ship, and The Pen: Warfare, Constitutions, and the Making of the Modern World* (2021).

21 U.S. Const. preamble.

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