Regulating Blockchain

Skadden

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The first 100 days of the Biden administration has coincided with a watershed period in the evolution of blockchain technology and cryptocurrencies. The price of Bitcoin has risen dramatically during that period, triggering increased interest in cryptocurrencies, including among traditional financial services firms. In addition, developments such as the explosion of nonfungible tokens (NFTs) and the direct listing of the cryptocurrency exchange Coinbase on Nasdaq have broadened public interest and awareness.

Finally, an announcement by the People's Bank of China that it was developing a digital yuan, a so-called central bank digital currency, has heightened concerns that, without clear regulatory guidance to support this industry, the U.S. could fall behind China in this technology sector, with possible fallout for American economic policy.

Much of the attention this spring has been on the Securities and Exchange Commission (SEC), which has brought a number of enforcement actions against cryptocurrency companies but has not, in the view of many, offered sufficient guidance to allow cryptocurrency providers and purchasers to easily determine whether a cryptocurrency is a security. Many hope that new SEC Chair Gary Gensler — a former Commodity Futures Trading Commission chairman and a professor at the Massachusetts Institute of Technology who taught blockchain technology and was a senior adviser to the MIT Media Lab Digital Currency Initiative — will champion an effort to provide such guidance.

"These innovations have been a catalyst for change," Gensler said during his confirmation hearing before the Senate Banking Committee. "Bitcoin and other cryptocurrencies have brought new thinking to payments and financial inclusion. But they've also raised new issues of investor protection that we still need to attend to." He indicated his intention to "work with fellow commissioners to both promote the new innovation but also, at the core, ensure for investor protection."

Another key area that has drawn considerable attention this year is the treatment of "unhosted wallets" (*i.e.*, cryptocurrency trading wallets in which individuals and not financial institutions hold their own keys). Toward the end of the Trump administration, the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) proposed a rule that would impose new reporting, record-keeping and verification requirements on banks and money services businesses with respect to virtual currency transactions involving unhosted wallets.

FinCEN contends that the proposed rule would allow law enforcement agencies to more effectively combat illicit finance risks associated with unhosted wallets. However, key industry players have expressed concern that the rule could have a chilling effect on their use — they tend to serve unbanked and underbanked populations — and may hamper the evolution and adoption of blockchain technology in the U.S. by forcing centralization on a nascent technology that is premised on decentralization. Early on, the Biden administration extended the comment period for the proposed rule, and FinCEN is now reviewing the thousands of comments it has received. Its decision could have a great impact on the direction of cryptocurrencies.