

How The US And UK Differ On Crypto Regulation

By **Eric Martin, Daniel Csefalvay and Renato Mariotti** (May 30, 2023, 3:58 PM EDT)

The United States and the United Kingdom are two of the largest economies in the world, with strong social, political and economic ties. To quote playwright George Bernard Shaw, "England and America are two countries separated by the same language."

When it comes to regulating the rapidly developing crypto-asset market, there is a great deal of truth in Shaw's quip. In the U.K., we see a legislative approach with bespoke rules for cryptocurrency in the pipeline. The U.S., on the other hand, has taken a fragmented, and arguably hostile, approach, with the regulation of crypto-assets most often happening through enforcement.

The United Kingdom's Proactive Approach To Regulating Cryptocurrency

The U.K. has taken a proactive approach to regulating cryptocurrency. In April 2022, the British government announced its plan "to make the UK a global hub for cryptoasset technology and investment."^[1]

The government put muscle behind these words, introducing a "financial market infrastructure sandbox" to enable crypto — and traditional finance — firms to experiment and innovate.^[2] It also established a Cryptoasset Engagement Group to explore alongside industry players ways that the government may enhance the regulatory environment, including the U.K.'s tax system, to encourage further development of the crypto-asset market.

Critically, at the beginning of February, HM Treasury published a consultation and a call for evidence on how it proposes to regulate a broad suite of crypto-asset activities.^[3] The proposed requirements will be familiar to any U.K.-authorized firm, as they are broadly consistent with the approach to traditional finance and represent an attempt to create a level playing field across the regulatory perimeter between traditional finance and the digital asset sector.

The consultation builds on previous regulatory proposals, which focused on regulating stablecoins and the financial promotion of cryptocurrencies.^[4] This far-reaching set of proposals is designed to deliver on the ambition to position the U.K. as a supportive jurisdiction for crypto-related activity by providing firms with legal clarity in relation to the expected regulatory framework.

While the U.K.'s proposals for regulating the crypto-asset sector bear some similarities to the European Union's comprehensive Markets in Cryptoassets Regulation,^[5] HMT believes that the regime that will develop in the U.K., following the consultation, will be more agile, proportionate and better able to adapt to the industry's needs and technological developments in this space.^[6]

Not all stakeholders in the U.K. market, however, feel positive about HMT's approach. Some members of the U.K. Parliament believe that bringing crypto-assets into the financial services regulatory perimeter provides the industry with a degree of credibility that it should not have from a consumer protection perspective. They argue that the crypto-asset industry should be regulated more like the gambling industry.^[7]

While not necessarily as overtly opposed, the U.K. Financial Conduct Authority has expressed concerns about being required to regulate the sector without appropriate resourcing and regulatory powers to do so effectively.^[8]

The regulatory regime proposed by HMT will require the FCA to create and administer the detailed rules that will comprise the heart of that regime. Given the FCA's recalcitrance in this area, it remains to be seen just how it will approach the creation of those detailed rules and what they will mean for the industry.

The United States' Approach — Regulation by Enforcement?

Compared to the U.K. the U.S. approach to regulating crypto is fragmented, with various agencies at the state and federal levels responsible for regulating different aspects of the industry.

On the state side, Wyoming is leading the charge, enacting crypto-friendly legislation to attract investment from the digital asset industry.^[9] This is in contrast to New York, which requires anyone engaged in "virtual currency business activity" to apply for and receive a virtual currency license from the state.^[10] These licenses are difficult to obtain and subject its holders to strict regulations.

On the federal level, there are as many as 50 proposed pieces of legislation before Congress, none of which are gaining traction. Until recently, federal regulators took a cautious approach to regulating cryptocurrency, but that changed with the collapse of FTX in November.

Over the past five months, the U.S. Securities and Exchange Commission has taken center stage, aggressively pursuing enforcement actions against a variety of crypto-assets and activities.

After receiving a ruling in November from the U.S. District Court for the District of New Hampshire in SEC v. LBRY that LBRY token LBC is a security,^[11] the commission pursued stablecoins (Terraform and Paxos),^[12] earn lending programs (Genesis and Gemini),^[13] staking-as-a-service programs and insider traders who traded alleged crypto securities on the secondary market (SEC v. Wahi in the U.S. District Court for the Western District of Washington).^[14]

The SEC's claims rely on the broad theory that the underlying crypto-asset at issue in each of these cases is a security because, under the U.S. Supreme Court's 77-year-old test laid out under SEC v. W.J. Howey Co., it is an investment contract.^[15]

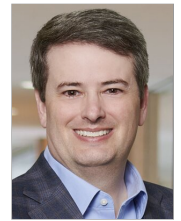
The SEC may be at the helm, but other regulators with an interest in crypto are not backing away either, creating more confusion than clarity. On March 27, the U.S. Commodity Futures Trading Commission filed a lawsuit against Binance, the world's biggest cryptocurrency exchange. In its 74-page complaint in CFTC v. Zhao before the U.S. District Court for the Northern District of Illinois, the CFTC referred to ether as a commodity.^[16]

Two weeks earlier, in a lawsuit filed against crypto exchange KuCoin, New York Attorney General Letitia James proclaimed that ether is a security under the Howey test.^[17] But when asked in a recent hearing by the chair of the House Financial Services Committee whether ether qualifies as a security, SEC Chair Gary Gensler equivocated for several minutes without providing a clear answer.^[18]

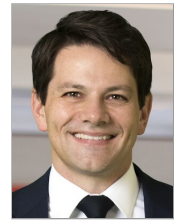
Rules That Don't Apply

In Grayscale v. SEC, Grayscale argued in its October opening brief before the U.S. Court of Appeals for the D.C. Circuit that the SEC arbitrarily rejected Grayscale's application to trade its spot bitcoin exchange-traded fund on exchange.^[19] Bitcoin is the only cryptocurrency that even the SEC concedes is not a security — however, the commission asserts that it has legitimate market manipulation concerns related to the fragmented and unregulated market for spot bitcoin.^[20]

A decision from the D.C. Circuit is pending, but the case offers a perfect illustration of the inherent catch-22 that crypto firms operating in the U.S. face: The



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SEC claims that crypto-assets are different than other assets and does not offer a straightforward path to registration, while also arguing that most crypto is a security and therefore existing regulatory rules apply and should be understood.

In testimony before Congress on March 9, Mike Belshe, CEO and co-founder of BitGo, questioned how the U.S. can expect to remain competitive in crypto technology if regulatory agencies lag in providing crypto-asset firms a basic regulatory framework.[21] The opaque regulatory landscape, coupled with increased regulatory scrutiny, will likely push many reasonable crypto players out of the U.S. market.

In late March, Brittex Inc. announced that it will be shuttering its U.S. operations, citing a regulatory environment that has made it "no longer feasible" to operate here.[22] This departure comes on the heels of crypto lender Nexo Inc. announcing its exit from the U.S. in December.[23]

In the U.K., the question of which crypto-assets and activities are to be considered securities still exists, but it is not accompanied by the threat of FCA enforcement. Rather than raising an "anti-crypto army"[24] as promised by Sen. Elizabeth Warren, D-Mass., the U.K. is cultivating a landscape that Prime Minister Rishi Sunak hopes will become the "jurisdiction of choice for crypto and blockchain technology." [25]

The Future

On May 23, the International Organization of Securities Commissions published a statement of 18 policy principles for member jurisdictions to follow in developing their approach to digital assets regulation.[26] Underpinning many of these statements of principle is a desire "to encourage optimal consistency in the way cryptoasset markets and securities markets are regulated within individual IOSCO jurisdictions, in accordance with the principle of 'same activities, same risks, same regulatory outcomes.'" [27]

Moreover, IOSCO Chair Jean-Paul Servais encouraged member jurisdictions to move as fast as possible to implement effective digital assets regulatory regimes based on the IOSCO policy principles.[28] While both the proposed U.K. digital assets regime and Markets in Cryptoassets Regulation in the EU already incorporate many of these IOSCO principles,[29] the U.S., with its current enforcement-led approach, seems much further away from those recommendations.

Whether market developments and industry pressure compel U.S. lawmakers and regulators to change track remains to be seen. Nevertheless, it is clear that the regulation of digital assets as financial products and services in many jurisdictions is becoming a reality.

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[3] HM Treasury, Future financial services regulatory regime for cryptoassets, GOV.UK 1 (Feb. 1, 2023), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1133404/TR_Privacy_edits_Future_financial_services_reg

[4] HM Treasury, U.K. regulatory approach to cryptoassets and stablecoins: consultation and call for evidence, GOV.UK, <https://www.gov.uk/government/consultations/uk-regulatory-approach-to-cryptoassets-and-stablecoins-consultation-and-call-for-evidence> (July 5, 2022).

[5] Camomile Shumba, With MiCA Past the Finish Line, U.K.'s Crypto Industry Calls for Rules of Its Own, CoinDesk <https://www.coindesk.com/policy/2023/04/21/with-mica-past-the-finish-line-uks-crypto-industry-calls-for-rules-of-its-own/> (Apr. 21, 2023, 12:56 PM).

[6] See HM Treasury, *supra* note 3, at 11.

[7] Treasury Committee, Consumer cryptocurrency trading should be regulated as gambling, Treasury Committee says in new report, U.K. Parliament (May 17, 2023), <https://committees.parliament.uk/committee/158/treasury-committee/news/195246/consumer-cryptocurrency-trading-should-be-regulated-as-gambling-treasury-committee-says-in-new-report/>.

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[9] See Sandali Handagama, Wyoming Lawmakers Pass Bill Prohibiting Forced Disclosure of Private Crypto Keys, CoinDesk, <https://www.coindesk.com/policy/2023/02/16/wyoming-lawmakers-pass-bill-prohibiting-forced-disclosure-of-private-crypto-keys/> (Feb. 16, 2023, 12:47 PM).

[10] N.Y. Fin. Serv. Law § 200.3 (McKinney 2021).

[11] *SEC v. LBRY*, No. 21-CV-260-PB, 2022 WL 16744741 (D.N.H. Nov. 7, 2022).

[12] Complaint at 1, *SEC v. Terraform Labs Pte Ltd. et al.*, No. 1:21-cv-01346 (S.D.N.Y. Feb. 16, 2023); see also Paxos, Paxos Issues Statement (Feb. 13, 2023), <https://paxos.com/2023/02/13/paxos-issues-statement/> (addressing SEC Wells notice receipt).

[13] Complaint at 1, *SEC v. Genesis Global Cap. LLC et al.*, No. 1:23-cv-00287 (S.D.N.Y. Jan. 12, 2023).

[14] Complaint at 1, *SEC v. Wahi et al.*, No. 2:22-cv-01009 (W.D. Wash. July 21, 2022).

[15] See generally *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

[16] Complaint at 1, *CFTC v. Zhao et al.*, No. 1:23-cv-01887 (N.D. Ill. Mar. 27, 2023).

[17] Petitioner's Memorandum of Law in Support of the Verified Petition at 4, *New York v. MEK Global Ltd. et al.*, No. 450703/2023 (N.Y. Sup. Ct. Mar. 9, 2023).

[18] Securities and Exchange Commission Oversight Hearing, CSPAN at 18:03 (Apr. 18, 2023), <https://www.c-span.org/video/?527459-1/securities-exchange-commission-oversight-hearing>.

[19] Brief of Petitioner at 3, *Grayscale v. SEC*, No. 1:22-cv-1142, (D.C. Cir. Oct. 11, 2022). <https://grayscale.com/wp-content/uploads/2022/10/GBTC-Lawsuit-Grayscale-Opening-Brief.pdf>.

[20] Reply Brief of Respondent at 34, *Grayscale v. SEC*, No. 1:22-cv-1142 (D.C. Cir. Dec. 9, 2022). <https://grayscale.com/wp-content/uploads/2022/12/Reply-Brief-of-Respondent-SEC-12092022.pdf>.

[21] Hearing Entitled Coincidence or Coordinated? The Administration's Attack on the Digital Asset Ecosystem Before the Subcomm. on Digital Assets, Financial Technology and Inclusion of the H. Comm. on Financial Services, 118th Cong. (2023) (statement of Mike Belshe, CEO, BitGo Inc.). <https://docs.house.gov/meetings/BA/BA21/20230309/115389/HHRG-118-BA21-Wstate-BelsheM-20230309.pdf>.

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[24] Billy Bambrough, Elizabeth Warren Is Building An 'Anti-Crypto Army' – Feeding Serious U.S. Bitcoin Ban Warnings, *Forbes* (Mar. 30, 2023, 4:15 PM), <https://www.forbes.com/sites/digital-assets/2023/03/30/elizabeth-warren-is-building-an-anti-crypto-army-feeding-serious-us-bitcoin-ban-warnings/?sh=5fb862dc71f6>.

[25] See Ryan Browne, Britain's new PM is a fan of crypto. There are hopes he'll give the industry a boost, *CNBC* <https://www.cnn.com/2022/11/01/what-rishi-sunak-as-pm-means-for-the-uk-crypto-industry.html> (Nov. 4, 2022).

[26] See generally IOSCO, Policy Recommendations for Crypto and Digital Asset Markets Consultation Report (May 2023), <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD734.pdf>.

[27] *Id.* at 1.

[28] See Laura Noonan & Scott Chipolina, Iosco calls on global regulators to be faster and bolder on crypto markets, *Fin. Times* (May 23, 2023), <https://www.ft.com/content/ea3806e3-d4e2-4823-a391-b84ee17c6039>.

[29] See generally *HM Treasury*, *supra* note 3.