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Cryptocurrency: Regulate or Facilitate? How States' Approaches to Cryptocurrency Can Be Applied on a Federal Level

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Cryptocurrency: Regulate or Facilitate? How States' Approaches to Cryptocurrency Can Be Applied on a Federal Level

By Kelly Mahoney

ABSTRACT

Within the past two years, the cryptocurrency market exceeded a record \$2 trillion. As of November 2021, there are seventy-five million Bitcoin (a type of cryptocurrency) users and counting. Many states have implemented regulations and policies in response to this massive growth of the crypto market. While some states like Wyoming and Texas welcome cryptocurrency other states, such as New York and Washington, are more apprehensive and seek to constrain cryptocurrency due to its volatility and novelty. In contrast, federal agencies are still debating on how to address cryptocurrency, and glimpses of federal regulation can be seen through the 2021 Infrastructure and Jobs Act. Ultimately, this Comment analyzes the different approaches states have used to regulate or facilitate cryptocurrency and provides a recommendation of whether any of these tactics could be applied on a federal level.

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I. INTRODUCTION

In April 2021, the “expanding cryptocurrency market . . . exceeded a record \$2 trillion.”¹ “Bitcoin and other cryptocurrencies [recently] emerged as a new asset class that” produced “extraordinary returns over the past decade.”² By November 2021, there were more than seventy-five million users of Bitcoin, which increased from around three million in 2014.³ Cryptocurrencies, like Bitcoin and Ethereum, have proven resilient in recent years.⁴ Additionally, 55% of Bitcoin investors began investing in 2021, which exemplifies the drastic growth seen in the cryptocurrency industry.⁵ In the United States, despite the cryptocurrency growth, Federal and State governments are conflicted on how to deal with cryptocurrencies.⁶ There is virtually no consensus between the states and federal agencies on how to regulate cryptocurrency and to what extent.⁷

Sections II and III of this Comment provide background on the history of cryptocurrency along with how federal financial regulation has evolved over time.⁸ Sections IV and V address the

¹ Pete Schroeder, *EXCLUSIVE U.S. Treasury, Financial Industry Discuss Cryptocurrency ‘Stablecoins,’* REUTERS, <https://www.reuters.com/technology/exclusive-us-treasury-financial-industry-discuss-cryptocurrency-stablecoins-2021-09-10/> (Sept. 10, 2021, 3:33 PM).

² Nathan Reiff, *Where Is the Cryptocurrency Industry Headed in 2021?*, INVESTOPEDIA, <https://www.investopedia.com/where-are-cryptocurrencies-headed-2019-4580342> (Aug. 25, 2021).

³ Emily Flitter, *Banks Tried to Kill Crypto and Failed. Now They’re Embracing It (Slowly)*, NY TIMES (Nov. 1, 2021), <https://www.nytimes.com/2021/11/01/business/banks-crypto-bitcoin.html>.

⁴ *Id.*

⁵ Alex Gailey, *55% of Bitcoin Investors Started in the Last Year. 5 Things You Should Know if You’re New to Crypto*, TIME (Apr. 19, 2022), <https://time.com/nextadvisor/investing/cryptocurrency/things-to-know-for-new-crypto-investors>.

⁶ *See infra* Sections VI–IX.

⁷ *Id.*

⁸ *See infra* Sections II & III.

reasoning behind regulating cryptocurrency and what parties win and lose from increased regulation, as well as assess the benefits and risks of such regulations.⁹

Sections VI–VIII introduce the two cryptocurrency approaches adopted by state governments.¹⁰ First, Section VII discusses the “facilitator” approach, which is when state governments promote cryptocurrency technology by passing very favorable regulations exempting cryptocurrencies from state security laws and/or money transmission statutes.¹¹ Section VII highlights Wyoming, Nevada, and Florida as “facilitator” states.¹² Second, Section VIII discusses the “regulator” approach, which focuses on implementing restrictions for cryptocurrency to be contained rather than expanding the new asset class.¹³ Section VIII highlights New York and Washington as “regulator” states.¹⁴ By comparing these states, Section X considers the benefits and weaknesses of each regulation.¹⁵

Ultimately, the comparisons between differing approaches will produce a more cohesive approach to cryptocurrency regulation and further provide guidance on what regulations the federal government could implement. This paper recommends using a hybrid between the facilitator and the regulator approach to address cryptocurrency on a federal level.

⁹ *See infra* Sections IV & V.

¹⁰ *See infra* Sections VI–VIII.

¹¹ *See infra* Section VII.

¹² *Id.*

¹³ *See infra* Section VIII.

¹⁴ *Id.*

¹⁵ *See infra* Section X.

II. WHAT IS CRYPTOCURRENCY?

Cryptocurrency is decentralized digital money that users exchange in peer-to-peer transactions and is recorded on public global ledgers, known as blockchain technology.¹⁶ Blockchain technology serves as a ledger and is “a record of asset ownership and transfers, much like a land registry.”¹⁷ When a person owns cryptocurrency, that ownership involves possessing a “private key” which, “when matched with the public blockchain, allows owners to access their cryptocurrency and transfer it to another person.¹⁸ A public key is synonymous with a bank account number for physical currency.¹⁹

“Unlike the U.S. Dollar . . . , there is no central authority that manages and maintains the value of a cryptocurrency.”²⁰ To further explain this idea, imagine two children brought lunch to school and they want to trade their snacks: an apple and a cookie.²¹ Now, their parents (a.k.a. the bank) are not with them at school and cannot monitor this trade.²² The children’s exchange is the exact concept that cryptocurrency is digitizing.²³ “How does one child confirm the origin or destination of the item received? How does either child know whether the intended recipient

¹⁶ Kate Ashford, *What Is Cryptocurrency?*, FORBES, <https://www.forbes.com/advisor/investing/what-is-cryptocurrency/> (June 6, 2022, 7:23 PM).

¹⁷ Dennis Chu, *Broker-Dealers for Virtual Currency: Regulating Cryptocurrency Wallets and Exchanges*, 118 COLUM. L. REV. 2323, 2326 (2018).

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ Ashford, *supra* note 16.

²¹ *See* Stephen Wilks, *The Reimagined Schoolyard: Cryptocurrency’s Adoption in Tomorrow’s International Monetary Order*, 2020 B.C. INTELL. PROP. & TECH. F. 1, 34 (2020).

²² *See id.*

²³ *See id.*

received the items bargained for,” rather than some other child?²⁴ Additionally, “cryptocurrencies represent digital transfers of money” and “are designed to address the *double-spending problem*, which uses encryption to prevent duplication by ensuring parties to a transaction send and receive money as agreed.”²⁵ Furthermore, due to the absence of financial institutions, managing “tasks are broadly distributed among cryptocurrency’s users via the internet.”²⁶

In order to understand cryptocurrency even further, several terms need to be defined, such as “blockchain technology,” “cryptocurrency exchange,” “online cryptocurrency wallet,” and “initial coin offerings.” First, “blockchain technology” is the “backbone” of cryptocurrency systems “because it performs many of the roles done by a central authority,” such as banking, like using “traditional electronic payments.”²⁷ As mentioned above, blockchain technology refers to an open, distributed ledger that records transactions in code.²⁸ This technology records transactions in “blocks” that are linked together on a “chain” of previous cryptocurrency transactions.²⁹ “When people buy, exchange[,] or spend cryptocurrency, the transactions are recorded on a blockchain.”³⁰ As more people use cryptocurrency, the use of widespread blockchain could become more

²⁴ *Id.*

²⁵ *Id.*

²⁶ Ashford *supra*, note 16.

²⁷ Killian Steer, *Cryptocurrency Mining: The Challenges It Faces and How Regulations Can Help*, 20 N.C. J. L. & TECH. ON. 301, 306 (2019).

²⁸ David Rodeck & Benjamin Curry, *What is Blockchain?*, FORBES, <https://www.forbes.com/advisor/investing/what-is-blockchain> (Apr. 28, 2022, 1:16 PM).

²⁹ *Id.*

³⁰ *Id.*

popular.³¹ Because blockchain is maintained through a decentralized process, once a transfer is recorded on the blockchain, it is virtually impossible to reverse it.³²

Second, a “cryptocurrency exchange” is an online marketplace that facilitates buying and selling cryptocurrencies, fiat currency, and other virtual currencies, such as exchanging bitcoins for U.S. dollars.³³ This platform connects buyers and sellers respectively to their “bid” and “ask” price.³⁴ The user deposits fiat money with the exchange by sending funds to the exchange prior to the execution of their trade.³⁵ Cryptocurrency exchanges can be centralized, meaning they are managed by one corporate authority, like a brokerage company that facilitates the security of trades, or cryptocurrency exchanges can be decentralized.³⁶ However, decentralized cryptocurrency exchanges generally distribute verification powers to anyone willing to join a network and certify transactions.³⁷

Third, an “online cryptocurrency wallet” refers to “a service that stores and safeguards cryptocurrency on behalf of the customers.”³⁸ When buying digital currency, a customer can leave the “keys” to their coins within their account on the exchange platform.³⁹ But a customer can also

³¹ *Id.*

³² *Id.*

³³ Farran Powel & Benjamin Curry, *The Best Crypto Exchanges of 2023*, FORBES, <https://www.forbes.com/advisor/investing/best-crypto-exchanges/> (Feb. 1, 2023, 8:54 AM).

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

³⁸ Chu, *supra* note 17, at 2327.

³⁹ Kendall Little, *A Crypto Wallet Can Help Keep Your Coins Safe. Here’s How to Decide If You Need One*, TIME (Jul. 15, 2021), <https://time.com/nextadvisor/investing/cryptocurrency/best-bitcoin-cryptocurrency-wallet>.

move them off the exchange platform and into a personal cryptocurrency wallet, which may be connected to the Internet, called a “hot wallet,” or a completely offline device, called “cold storage.”⁴⁰ Since a user must have a private key to access their cryptocurrency, “wallet providers hold [the] keys on behalf of their customers;” thus, acting as their cryptocurrency “custodians.”⁴¹ Conversely, when cryptocurrency customers use an online wallet, they do not possess access to their private keys but instead “must trust their wallet providers to hold the cryptocurrency on their behalf.”⁴²

Lastly, “initial coin offerings” (ICOs) are a “new development in the cryptocurrency world.”⁴³ Unlike the traditional initial public offering (IPO), which involves raising money in capital markets, ICOs “do not represent an ownership interest or dividend right and do not have the primary goal of value creation.”⁴⁴ “ICOs offer a more direct benefit derived from the company’s future business” because “[t]he tokens allow the purchaser access to the business, to participate in a share of the returns and provide an opportunity for resale on the secondary market.”⁴⁵ However, ICOs usually “occur before a product [is] created or becomes functional,

⁴⁰ *Id.*

⁴¹ Chu, *supra* note 17, at 2327–28.

⁴² *Id.* at 2328.

⁴³ Avery Minor, *Cryptocurrency Regulations Wanted: Iterative, Flexible, and Pro-Competitive Preferred*, 61 B.C. L. Rev. 1149, 1158 (2020).

⁴⁴ Brian MacNiven, *Initial Coin Offerings: Striking a Balance Between Protecting Investors and Fostering Growth*, 14 RUTGERS BUS. L. REV. 1, 3–4 (2019).

⁴⁵ *Id.* at 2.

making them a fairly risky investment because the true value and potential success of the product is unclear.”⁴⁶

Now that the processes and terminology surrounding cryptocurrency have been discussed, it is important to understand how cryptocurrency grew to today’s volume.

A. HISTORICAL BACKGROUND ON CRYPTOCURRENCY

Before cryptocurrency, transacting parties had to transfer funds through a third-party intermediary such as a bank or other financial institution.⁴⁷ “Many . . . features of today’s cryptocurrencies were first proposed in the 1990s.”⁴⁸ B-Money was one of the first cryptocurrency proposals.⁴⁹ In 1998, “Wei Dai, a computer engineer[,] . . . published an essay introducing” B-Money.⁵⁰ However, B-Money failed to launch because of issues with processing power demand,⁵¹ but “it laid the framework for future cryptocurrencies by proposing many of” what would be cryptocurrencies’ features, such as the requirement for “computational work to facilitate transactions, community verification,” and creating a community where communication was on a peer-to-peer level.⁵²

⁴⁶ Minor, *supra* note 43, at 1158.

⁴⁷ Elizabeth Nevle, *Tales from the Crypt: Global Trends in the Taxation of Cryptocurrency*, 24 CURRENTS: J. INT’L ECON. L. 116, 117 (2021).

⁴⁸ Steer, *supra* note 27, at 311.

⁴⁹ *Id.* The creator of B-money described it as a “scheme for a group of untraceable digital pseudonyms to pay each other with money and to enforce contracts amongst themselves without outside help.” Nathan Reiff, *B-Money*, INVESTOPEDIA (Oct. 25, 2021), <https://www.investopedia.com/terms/b/bmoney.asp>.

⁵⁰ Reiff, *supra* note 49.

⁵¹ *Id.* Dai and other engineers attempted to launch B-Money but the crypto faced increasing processing power demand that it could not supply, lowering its effectiveness and eventually causing the platform to shut down. *Id.*

⁵² Steer, *supra* note 27, at 311.

On October 31, 2008, at the apex of the United States' financial crisis, a person under the pseudonym Satoshi Nakamoto introduced cryptocurrency to the world when he or she posted a link to a white paper called "Bitcoin: A Peer-to-Peer Electronic Cash System" to a cryptography mailing list.⁵³ The Nakamoto white paper outlined the concept for Bitcoin as a decentralized digital currency.⁵⁴ This concept "was revolutionary because [it was] the first time the double-spending problem could be solved without . . . third-party intermediaries."⁵⁵ "Transactions are verified, and double-spending is prevented, through the use of public-key cryptography."⁵⁶

On January 3, 2009, the blockchain launched when participants first mined the genesis block, the first block of its kind.⁵⁷ Bitcoin had almost no value for the first few months of its existence.⁵⁸ Six months later, in April 2010, trading began and the value of one Bitcoin was approximately 14 cents.⁵⁹ The first ever cryptocurrency transaction is believed to have taken place in Florida when Laszlo Hanyecz "paid 10,000 bitcoins to get two pizzas delivered from Papa

⁵³ *Id.* Accord Wayne Duggan, *The History of Bitcoin, the First Cryptocurrency*, U.S. NEWS (Aug. 31, 2022), <https://money.usnews.com/investing/articles/the-history-of-bitcoin>.

⁵⁴ Duggan, *supra* note 53.

⁵⁵ Nevle, *supra* note 47.

⁵⁶ *Id.* at 118.

⁵⁷ *Id.* at 117.

⁵⁸ *Id.*

⁵⁹ *Id.*

John's.”⁶⁰ “If the buyer had hung onto those Bitcoins, at today’s prices they would be worth more than \$100 million.”⁶¹

As Bitcoin increased in popularity and the idea of decentralized and encrypted currencies caught on, the first alternative cryptocurrencies appeared in circulation.⁶² On April 18, 2011, Namecoin, the second cryptocurrency, launched.⁶³ Currently, “[m]ore than 5,000 cryptocurrencies exist . . . with Bitcoin being the most common”⁶⁴ However, Bitcoin still dominates compared to other cryptocurrencies, with more than “sixty percent of the virtual currency market [and] with more than 18 million units valued around \$9,000 (U.S.) per coin.”⁶⁵

III. HISTORY OF FINANCIAL REGULATION

To comment wisely on what can be done to regulate cryptocurrency, an assessment of previous financial regulations must be made. Throughout the United States’ history, the government has struggled to implement effective financial regulation, particularly in the early nineteenth century.⁶⁶ Financial Regulation first emerged between 1791 and 1863.⁶⁷ From the First

⁶⁰ Casey Bessemer, *Cryptocurrency: Legality and Role Within US Financial Institutions*, 36 SYRACUSE J. SCI. & TECH. L. 3, 3 (2020).

⁶¹ Bernard Marr, *A Short History of Bitcoin and Cryptocurrency Everyone Should Read*, FORBES (Dec. 6, 2017), <https://www.forbes.com/sites/bernardmarr/2017/12/06/a-short-history-of-bitcoin-and-cryptocurrency-everyone-should-read/?sh=2be977543f27>.

⁶² *Id.* The alternative cryptocurrencies, sometimes known as altcoin, generally try to improve on the original Bitcoin design by offering greater speed, anonymity or some other advantage. *Id.*

⁶³ Nevle, *supra* note 47, at 118.

⁶⁴ Wilks, *supra* note 21.

⁶⁵ *Id.*

⁶⁶ Paul Peretz & Jean Reith Schroedel, *Financial Regulation in the United States: Lessons from History*, 69 PUBLIC ADMIN. REV. 603, 603 (2009).

⁶⁷ *Id.*

Bank of the United States' establishment in 1791 to the National Banking Act of 1863, American banking regulation was an experimental interaction of federal and state legislation.⁶⁸ In 1791, Treasury Secretary Alexander Hamilton put the U.S. on a bimetallic gold and silver standard as a reaction to colonial inflation, making the country more vulnerable to international flows of specie because of inflation concerns.⁶⁹ The notes issued by banks to lenders based on reserves of specie also became a form of currency.⁷⁰ At the time, states regulated these specie and notes, resulting in a high degree of uneven regulation in this historical period, also known as the “free banking era.”⁷¹ For example, some states with strong economies had firm regulations and did reasonably well during downturns.⁷² Comparatively, other states with weaker economies had extremely weak regulations and regularly failed during downturns.⁷³ “The free banking era, characterized . . . by a complete lack of federal control and regulation, [would end] with the National Banking Act of 1863 (and its later revisions in 1864 and 1865), which aimed to replace the old state banks with nationally chartered” banks.⁷⁴

However, regulatory oversight came to fruition in 1887 with the formation of the Interstate Commerce Commission, an entity to oversee a burgeoning railroad industry.⁷⁵ Slowly but surely,

⁶⁸ Mathew Johnston, *A Brief History of U.S. Banking Regulation*, INVESTOPEDIA, <https://www.investopedia.com/articles/investing/011916/brief-history-us-banking-regulation.asp> (Oct. 6, 2021).

⁶⁹ Peretz & Schroedel, *supra* note 66. Specie refers to money in coin. *Id.*

⁷⁰ *Id.*

⁷¹ *Id.* at 604.

⁷² *Id.*

⁷³ *Id.*

⁷⁴ Johnston, *supra* note 68.

⁷⁵ Minor, *supra* note 43, at 1154.

regulatory oversight became a “part of the nation’s fabric.”⁷⁶ Next, Regulation D under the Securities Act of 1933, and the Digital Millennium Copyright Act (DMCA) safe harbors for Internet Service Providers (ISP), “are examples of regulations that had a pro-competitive impact on their respective industries” since they provided more “stability and direction.”⁷⁷ “Regulation D created an inexpensive and frictionless avenue for small emerging companies to raise venture capital by exempting them from otherwise strict securities reporting requirements, spurring the growth of dot-com companies in the 1990s.”⁷⁸ The DMCA safe harbors offered necessary “protection to ISPs from accusations of copyright infringement perpetuated by their users, allowing user-based websites like . . . Google to evolve into the powerhouse [it is] today.”⁷⁹

A. BACKGROUND ON FEDERAL FINANCIAL REGULATION

“Federal financial regulation encompasses varied and diverse markets, participants, and regulators.”⁸⁰ Financial Regulation “evolved over time,” and new regulation is usually “added in response to failures or breakdowns in financial markets,” and authority can be “trimmed back during financial booms.”⁸¹ Thus, financial regulation has been a “piecemeal evolution” with “powers, goals, tools, and approaches” that “vary from market to market.”⁸² “Regulators

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ CONG. RSCH. SERV., WHO REGULATES WHOM? AN OVERVIEW OF THE U.S. FINANCIAL REGULATORY FRAMEWORK 1(2020), <https://sgp.fas.org/crs/misc/R44918.pdf>.

⁸¹ *Id.* at 2.

⁸² *Id.*

implement policy using” powers that “vary by agency.”⁸³ Powers fall into the following categories: (1) Licensing, chartering, or registration; (2) Rulemaking; (3) Oversight and Supervision; (4) Enforcement; and (5) Resolution.⁸⁴ All of these powers can be used to regulate cryptocurrency.⁸⁵

However, “[h]ow financial regulation is applied” can vary partly due to “the different characteristics of various financial markets and partly [due to] the historical evolution of [that] regulation.”⁸⁶ The different types of regulation are (1) Prudential; (2) Disclosure and Reporting; (3) Standard Setting; (4) Competition; and (5) Price and Rate Regulations.⁸⁷ First, prudential regulation refers to “ensur[ing] an institution’s safety and soundness,” focusing on risk management and mitigation.⁸⁸ This type of regulation may be pursued to achieve taxpayer protection, consumer protection, or financial stability, all goals that are significant to cryptocurrency.⁸⁹

Second, disclosure and reporting regulation is “meant to ensure that all relevant financial information is accurate and available to the public and regulators so that the former can create well-informed financial decisions and the latter can effectively monitor activities.”⁹⁰ Because there

⁸³ *Id.*

⁸⁴ *Id.* at 2–3

⁸⁵ *Id.* at 2.

⁸⁶ *Id.* at 6.

⁸⁷ *Id.* at 5–6.

⁸⁸ *Id.* at 5.

⁸⁹ *Id.*

⁹⁰ *Id.*

are thousands of cryptocurrencies, obstacles arise in terms of the practicality of regulating disclosures and keeping disclosed information updated.

Third, standard setting regulating refers to “prescrib[ing] standards for products, markets, and professional conduct.”⁹¹ “Regulators set permissible activities and behavior for market participants.”⁹² Standard setting across thousands of cryptocurrencies may be difficult, especially because cryptocurrency is based on a decentralized currency. There is no government entity setting standards for this asset, which is a problem in ensuring that cryptocurrencies agree to the standards.

Fourth, competition regulation refers to “ensur[ing] that firms do not exercise undue monopoly power” and do not engage in collusion or price fixing nor “corner specific markets.”⁹³ The best example of this type of regulation is antitrust laws. This regulation is less applicable to cryptocurrency because there is usually a fixed number of coins.⁹⁴ For example, Bitcoin is valuable because of its scarcity.⁹⁵ “There are 18.7 million bitcoins in circulation,” nearing the cryptocurrency’s “maximum threshold of 21 million.”⁹⁶

Lastly, price and rate regulations refer to “set[ting] a maximum or minimum price[], fee[], premium[], or interest rate[].”⁹⁷ “[P]rice and rate regulation is relatively rare in federal regulation”

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.* at 6.

⁹⁴ *Id.*

⁹⁵ Mackenzie Sigalos, *Bitcoin’s Wild Price Moves Stem From Its Design – You’ll Need Strong Nerves to Trade It*, CNBC (May 19, 2021, 8:37AM), <https://www.cnbc.com/2021/05/19/why-is-bitcoin-so-volatile.html>.

⁹⁶ *Id.*

⁹⁷ CONG. RSCH. SERV., *supra* note 80, at 6.

and is more common for states.⁹⁸ “State-level examples [of this] are state usury laws” that “cap interest rates[] and state insurance rate regulation.”⁹⁹

IV. BENEFITS OF CRYPTOCURRENCY

Cryptocurrencies are extremely relevant to most business and financial firms because they allow for increased market efficiencies and reduced transaction costs.¹⁰⁰ The benefits of using cryptocurrency are the following: privacy and security, efficiency, irrevocability, inexpensive, and global.

First, for privacy and security, unlike cash and credit cards, cryptocurrencies are digital and encrypted; therefore, customers cannot be ripped off in a transaction, and it is much harder to steal cryptocurrency compared to a wallet filled with cash.¹⁰¹ There is currently no transaction mechanism that is more safe and secure than cryptocurrency.¹⁰² Additionally, no personal information is required to complete a transaction through privacy coins.¹⁰³ Privacy coins obfuscate information about their users, including identities and other transactional information.¹⁰⁴ There are two ways for privacy coins to provide privacy. First, some privacy coins focus on anonymity which

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ Vivian A. Maese, Alan W. Avery, Benjamin A. Naftalis, Stephen P. Wink & Yvette D. Valdez, *Cryptocurrency: A Primer*, 133 BANKING L.J. 468, 469 (2016).

¹⁰¹ *The Benefits of Using Cryptocurrency*, NASDAQ (Feb. 27, 2017), <https://www.nasdaq.com/articles/the-benefits-of-using-cryptocurrency-2017-02-27>.

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Privacy Coins 101*, LEGALEXAMINER.COM (Sept. 23, 2021) <https://www.legalexaminer.com/technology/crypto/privacy-coins-101/>.

hides the identities of the people behind transactions.¹⁰⁵ Second, some privacy coins focus on untrace-ability to prevent people or computers from following a transaction trail.¹⁰⁶

Second, for efficiency, transferring and buying cryptocurrency is settled instantaneously, in contrast with credit card transactions or wire transfers require days to settle.¹⁰⁷ When investors use cryptocurrency, especially when purchasing real property, it eliminates middlemen, such as brokers and lawyers, who inevitably raise the costs of already expensive transactions.¹⁰⁸ Cryptocurrency can act like “a large property rights database” and can be used to execute and enforce two-party contracts which eliminate brokerage and legal fees.¹⁰⁹

Third, cryptocurrency transaction costs are generally less than one percent if an intermediary is used compared to the customary 2.5 percent credit card processing fee.¹¹⁰ All cryptocurrency is designed for low-cost, no-fee transactions which is how the new asset increased in popularity.¹¹¹

Finally, cryptocurrency has a global appeal since neither buyer nor seller requires a bank account, and there are no transaction fees.¹¹² Engaging in international business often comes with an exchange rate risk. A transaction can be subject to fees associated with exchanging one

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* However, it is important to note that this privacy is only for privacy coins and not cryptocurrency as a whole.

¹⁰⁷ Maese, *supra* note 100.

¹⁰⁸ *The Benefits of Using Cryptocurrency*, *supra* note 101.

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² Maese, *supra* note 100.

cryptocurrency for another.¹¹³ Cryptocurrencies are universally recognized at a given value which saves time in determining a price for a transaction.¹¹⁴ Cryptocurrency is increasingly adopted around the world, making transactions faster and simpler in a global market.¹¹⁵

V. RISKS TO CRYPTOCURRENCY

Despite cryptocurrency's novelty and benefits, there are several risks that may detract from its stability or prevent its broader market adoption. Risks associated with cryptocurrency include facilitating illegal activity, creating a wide entrance of investing in cryptocurrency but narrow exit (usually caused by technological constraints and currency inconvertibility), its volatility, fraudulent activity, money laundering, and environmental concerns.

First, according to the Treasury Department, cryptocurrency poses a significant detection problem by facilitating illegal activity, including tax evasion and other crimes.¹¹⁶ However, this risk is minimal, so cryptocurrency users should not worry about it, but it is something to be aware of.¹¹⁷ The reason why this is a minimal concern is that the number of cryptocurrency transactions that result in crime is relatively low.¹¹⁸ According to a 2021 report from Chainalysis, a blockchain data platform providing research to government agencies, financial institutions, and companies worldwide, criminal activity represented 2.1% of all cryptocurrency transaction volume

¹¹³ *The Benefits Of Using Cryptocurrency*, *supra* note 101.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ Thomas Franck, *U.S. Treasury Calls for Stricter Cryptocurrency Compliance with IRS, Says They Pose Tax Evasion Risk*, CNBC (May 20, 2021), <https://www.cnbc.com/2021/05/20/us-treasury-calls-for-stricter-cryptocurrency-compliance-with-irs.html>.

¹¹⁷ *Id.*

¹¹⁸ *Id.*

in 2019, roughly \$21.4 billion in transfers.¹¹⁹ In 2020, the criminal share of all cryptocurrencies fell to 0.34%, equating to \$10 billion in transaction volume.¹²⁰ According to the United Nations, it is estimated that between 2% and 5% of global GDP (\$1.6 to \$4 trillion) annually is connected to money laundering and illicit activity.¹²¹ Thus, criminal activity using cryptocurrency transactions is much smaller proportionally than such activity using fiat currency, and its frequency is going down year by year.¹²²

Second, “cryptocurrencies [may] provide criminal organizations with a new means of committing fraud, money laundering, and a host of other financial crimes.”¹²³ This risk is due to the decentralized status of digital currencies.¹²⁴ “When a cryptocurrency exchange is hacked and customers' holdings are stolen . . . there is frequently no standard practice for recovering the missing funds.”¹²⁵ Digital currency startups and developers have thus focused efforts on developing protected processes for holding cryptocurrency.¹²⁶

¹¹⁹ Hailey Lennon, *The False Narrative of Bitcoin's Role In Illicit Activity*, FORBES (Jan. 19, 2021), <https://www.forbes.com/sites/haileylennon/2021/01/19/the-false-narrative-of-bitcoins-role-in-illicit-activity/?sh=2d65fd523432>.

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.*

¹²³ Nathan Reiff, *What Are the Legal Risks to Cryptocurrency Investors?*, INVESTOPEDIA (Jan. 28, 2022), <https://www.investopedia.com/tech/what-are-legal-risks-cryptocurrency-investors/>.

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *Id.*

Third, cryptocurrencies continue to be digitally minted and grow continuously, lowering barriers to entry.¹²⁷ These “lower[] barrier[s] . . . create[] a wide entrance [to invest in cryptocurrency] and a very narrow exit” out of cryptocurrency investing.¹²⁸ “[T]echnological constraints, currency inconvertibility and few counterparties with whom to trade” may bar the exit.¹²⁹

Fourth, unexpected changes in market sentiment can lead to sharp and sudden changes in price.¹³⁰ It is not uncommon for a cryptocurrency’s value to drop by hundreds or even thousands of dollars.¹³¹ High volatility means that a security’s value can potentially spread out over a larger range of values and the price of the security can change dramatically over a short time period in either direction.¹³² For example, in May 2021, Bitcoin plunged by 30%, and Ether, another cryptocurrency, dropped over 40%, in less than twenty-four hours.¹³³ However, both cryptocurrencies regained substantially at the end of that day.¹³⁴ This is the norm for cryptocurrencies; “[h]uge run-ups [of currencies] and equally drastic falls.”¹³⁵ Volatility is the price

¹²⁷ Dante Alighieri Disparte, *Beware of Crypto Risks – 10 Risks to Watch*, FORBES (Jul. 21, 2018), <https://www.forbes.com/sites/dantedisparte/2018/07/21/beware-of-crypto-risks-10-risks-to-watch/?sh=48e5c1f85f17>.

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ MacKenzie Sigalos, *Bitcoin’s Wild Price Moves Stem From its Design — You’ll Need Strong Nerves to Trade It*, CNBC (May 20, 2021), <https://www.cnbc.com/2021/05/19/why-is-bitcoin-so-volatile.html>.

¹³¹ *Id.*

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ *Id.*

crypto-investors must pay for a limited supply of coins and for the lack of a central bank controlling that supply.¹³⁶

VI. INTRODUCTION: STATES' APPROACHES TO CRYPTOCURRENCY

There is no uniformity with respect to how businesses dealing with cryptocurrencies are treated among the states. States addressing cryptocurrency have generally taken one of two approaches.¹³⁷ First, states have adopted a “facilitator approach” to promote cryptocurrency and blockchain technology use.¹³⁸ States have passed “very favorable regulations exempting cryptocurrencies from state securities laws.”¹³⁹ The rationale behind this is to leverage investment in cryptocurrency technology; thus, stimulating local economies and improving public services.¹⁴⁰ Second, other states adopted a “regulator approach” with varying degrees of restrictions for cryptocurrency.¹⁴¹

VII. FACILITATOR APPROACH

Several state and local governments are seeking to attract cryptocurrency businesses by facilitating Bitcoin adoption. Meeting the banking industry’s needs and attracting business is a possible benefit of instilling a facilitator approach. The reasoning behind this is banks’ approach to cryptocurrency: (1) “experimenting with cryptocurrency offerings and” (2) “lobbying regulators

¹³⁶ Sigalos, *supra* note 130.

¹³⁷ *See infra* Sections VI & VII.

¹³⁸ *Blockchain & Cryptocurrency Laws and Regulations 2023*, GLOB. LEGAL INSIGHTS, [HTTPS://WWW.GLOBALLEGALINSIGHTS.COM/PRACTICE-AREAS/BLOCKCHAIN-LAWS-AND-REGULATIONS/USA](https://www.globallegalinsights.com/practice-areas/blockchain-laws-and-regulations/usa) (last visited Nov. 14, 2021).

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

to create rules that work in the banks' favor."¹⁴² These next sections will highlight Wyoming, Nevada, and Texas. Wyoming utilizes a special-purpose depository institution and decentralized autonomous organizations to facilitate cryptocurrency.¹⁴³ Nevada debated a bill authorizing banks that would provide "custodial services" to cryptocurrency.¹⁴⁴ Texas created pro-crypto laws and low energy costs to create a Bitcoin Mining Community within the state.¹⁴⁵

A. WYOMING

Wyoming's regulations are several "of the most crypto-friendly in the United States."¹⁴⁶ Wyoming passed upwards of twenty laws making crypto exempt from "normal money processing rules" and "crypto transactions free from state taxes."¹⁴⁷ First, in 2019, Wyoming's legislature passed a charter for banks providing services for digital assets called a "special purpose depository institution."¹⁴⁸ A special purpose depository institution (SPDI) is a bank "that receive[s] deposits and conduct[s] other activity incidental to the business of banking, including custody, asset servicing, fiduciary asset management and related activities."¹⁴⁹ Wyoming approved three

¹⁴² Flitter, *supra* note 3.

¹⁴³ *See infra* Section VII(a).

¹⁴⁴ *See infra* Section VII(b).

¹⁴⁵ *See infra* Section VII(c).

¹⁴⁶ Emma Newbery, *These 5 U.S. States Are the Best for Crypto Investors*, MOTLEY FOOL (Jan. 2, 2022), <https://www.fool.com/the-ascent/cryptocurrency/articles/these-5-us-states-are-the-best-for-crypto-investors/>.

¹⁴⁷ *Id.*

¹⁴⁸ Gina Chon, *Cryptocurrency's Wild West is in Wyoming*, REUTERS (Jul. 7, 2021), <https://www.reuters.com/breakingviews/cryptocurrencys-wild-west-is-wyoming-2021-07-07/>.

¹⁴⁹ *Special Purpose Depository Institutions*, WYO. DIV. OF BANKING, <https://wyomingbankingdivision.wyo.gov/banks-and-trust-companies/special-purpose-depository-institutions> (last visited Mar. 14, 2023).

applications for this new type of bank.¹⁵⁰ One of these applications was for Kraken Bank, a bitcoin trading platform.¹⁵¹ The SPDI will consist of two roles: (1) maintaining a traditional role where “[c]ustomers can make deposits” and (2) providing cryptocurrency services such as “stor[ing] or transfer[ring] cryptocurrencies that may be traded on Kraken’s exchange.”¹⁵² Starting an SPDI that has cryptocurrency services allows customers to seamlessly put converted bitcoin into an account without needing a middleman such as JP Morgan.¹⁵³ Customers can also avoid additional fees from using middlemen.¹⁵⁴ This SPDI charter also gives banks the right to hold the bitcoin “key.”¹⁵⁵

However, since a bank that can cater to cryptocurrencies is a novel concept, there are uncertainties associated with pursuing this option which Wyoming should consider. One problem with these “crypto-banks” is that they do not possess the full backing traditional banks have.¹⁵⁶ Due to the cryptocurrency aspect, the Federal Deposit Insurance Corporation (FDIC) does not back fiat deposits.¹⁵⁷ This creates a serious concern as to how crypto-banks can operate reliably if not backed by an entity such as the FDIC.¹⁵⁸ However, the FDCI is looking to provide a clearer path for banks and clients that are looking to hold cryptocurrencies in order to keep control over the

¹⁵⁰ Chon, *supra* note 148.

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ Chon, *supra* note 148.

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

fast-developing asset.¹⁵⁹ In October 2021, FDIC chair, Jelena McWilliams, said that “a team of U.S. bank regulators is trying to provide a roadmap for banks to engage with crypto assets.”¹⁶⁰ This team’s goal is “to ensure cryptocurrency policy coordination among the three main U.S. bank regulators - [the] FDIC, [the] Federal Reserve and [the] Office of the Comptroller of the Currency.”¹⁶¹

Additionally, whether crypto-banks “will get typical privileges with the U.S. Federal Reserve” is unknown.¹⁶² The Federal Reserve allows traditional banks to “not only safely park deposits at the central bank but [also to] transfer money in an efficient way.”¹⁶³ However, the Federal Reserve is “exploring policy responses to the rise of cryptocurrencies.”¹⁶⁴ During a press conference on September 22, 2021, “Federal Reserve Chair Jerome Powell acknowledged that the Fed[ederal Reserve] is actively assessing whether it should create a central bank digital currency (CBDC).”¹⁶⁵ Thus, creating a CBDC would allow crypto banks, such as the one in Wyoming, to acquire a master account with the U.S. Federal Reserve.¹⁶⁶

¹⁵⁹ Echo Wang, *U.S. regulators exploring how banks could hold crypto assts – FDIC chairman*, REUTERS (Oct. 26, 2021), <https://www.reuters.com/business/finance/us-regulators-exploring-how-banks-could-hold-crypto-assets-fdic-chairman-2021-10-26/>.

¹⁶⁰ *Id.*

¹⁶¹ *Id.*

¹⁶² Chon, *supra* note 148.

¹⁶³ *Id.*

¹⁶⁴ Mark Kolakowski, *Where the Fed Stands on Crypto and Digital Currencies*, INVESTOPEDIA (Oct. 13, 2021), <https://www.investopedia.com/where-the-fed-stands-on-crypto-and-digital-currencies-5205377>.

¹⁶⁵ *Id.*

¹⁶⁶ *Id.* Banks with master accounts are eligible to deposit funds at the Fed and tap the global payments system. *Id.*

Wyoming also became the first state in the U.S. to adopt an entirely new legal framework for Decentralized Autonomous Organizations (DAOs).¹⁶⁷ This makes Wyoming the first U.S. state to clarify the legal status of, and legally recognize as a separate entity, a decentralized autonomous organization, and its members.¹⁶⁸ This helps lay the foundation for a formal, legal entity structure for those participating in unincorporated groups whose governance is generally coded into smart contracts.¹⁶⁹ A DAO is essentially “an internet community with a shared bank account,” says investor and creator of many DAOs, Cooper Turley.¹⁷⁰ As he explains, a DAO allows “a small group of people [to] come together to form a chat group, and then [] decide to pull capital together, [typically] using an Ethereum wallet.”¹⁷¹ DAOs use the same blockchain technology as cryptocurrency.¹⁷²

B. NEVADA

Nevada is another state incorporating and facilitating cryptocurrency transactions. Nevada addressed digital assets relating to cryptocurrency in Assembly Bill No. 324, which was introduced on March 17, 2021, to revise the state’s laws relating to digital assets.¹⁷³ The bill did the following:

¹⁶⁷ Adriana Hamacher, *America’s First Legal DAO Approved in Wyoming*, DECRYPT (Jul. 5, 2021), <https://decrypt.co/75222/americas-first-dao-approved-in-wyoming>; see *Decentralized Autonomous Organization (DAO): Frequently Asked Questions*, WYO. SEC’Y OF STATE BUS. DIV., https://sos.wyo.gov/Business/Docs/DAOs_FAQs.pdf (last visited Mar. 12, 2023).

¹⁶⁸ *Decentralized Autonomous Organization (DAO): Frequently Asked Questions*, *supra* note 168.

¹⁶⁹ *Id.*

¹⁷⁰ Taylor Locke, *What are DAOs? Here’s What to Know About the ‘Next Big Trend’ In Crypto*, CNBC (Oct. 25, 2021), <https://www.cnbc.com/2021/10/25/what-are-daos-what-to-know-about-the-next-big-trend-in-crypto.html>.

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ A.B. 324, 2021 Leg., 81st Reg. Sess. (Nev. 2021).

(1) classified digital assets for the purposes of such assets under the Uniform Commercial Code (UCC); (2) authorized a bank to provide certain custodial services for digital assets; (3) sought forth certain requirements for the provision of such custodial services; (4) exempt an operator of a peer-to-peer digital currency platform from certain provisions governing persons engaged in the business of transmitting money; (5) revised the definition of virtual currency for the purposes of provisions exempting virtual currencies from taxation; and (6) provided other matters properly relating thereto.¹⁷⁴ Although the bill ultimately failed, it nevertheless serves as an example of how states are beginning to handle digital assets.

Nevada's bill refers to "custodial services," which means the safekeeping, servicing, and management of customer currency and digital assets.¹⁷⁵ If a bank provides custodial services to digital assets, then the bank shall be deemed a securities intermediary.¹⁷⁶ Under Nevada Revised Statutes, NRS 104.8102(m)(2), a securities intermediary means "[a] person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity."¹⁷⁷

Additionally, a bank may provide custodial services upon providing sixty days' written notice to the Commissioner.¹⁷⁸ A bank that decides to provide custodial services shall maintain control over a digital asset in the custody of the bank.¹⁷⁹ The bank enters into an agreement with

¹⁷⁴ *Id.*

¹⁷⁵ *Id.* at §5. The term "custodial services" includes the exercise of fiduciary and trust powers involving the exercise of discretion. *Id.*

¹⁷⁶ *Id.* at §11. *See also* NEV. REV. STAT. ANN. § 104.8102 (2013).

¹⁷⁷ NEV. REV. STAT. § 104.8102 (2013).

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

each customer to provide custodial services in which the customer elects one of the following relationships for each digital asset of the customer held in custody: “(1) custody under a bailment as a nonfungible or fungible asset;”¹⁸⁰ or (2) custody under a bailment where “[t]he bank shall not be liable for any loss suffered with respect to a transaction . . . except for liability consistent with fiduciary and trust powers as a custodian.”¹⁸¹

C. TEXAS

In recent years, Texas has rapidly become more and more involved in the cryptocurrency industry as state and federal lawmakers try to lay the groundwork for a blockchain technology explosion.¹⁸² In 2021, the state passed several bills to improve the regulatory framework for crypto, including a bill that recognizes the legal status of cryptocurrencies and paves the way for banks to provide custody services for cryptocurrency.¹⁸³ Texas created pro-crypto laws and low energy costs which are proving appealing to the Bitcoin Mining Community.¹⁸⁴ Crypto Mining is the process by which new cryptocurrencies are entered into circulation and transactions of existing digital coins are verified.¹⁸⁵ It is also the way the network confirms new transactions and is a critical component of the blockchain ledger's maintenance and development.¹⁸⁶ "Mining" is performed

¹⁸⁰ A.B. 324 §§ 2-10, 81st Leg. (Nev. 2021).

¹⁸¹ *Id.*

¹⁸² James Pollard, *Texas Republicans Want to Make the State the Center of the Cryptocurrency Universe*, TEX. TRIB. (Oct. 28, 2021), <https://www.texastribune.org/2021/10/28/texas-republicans-blockchain-bitcoin/>.

¹⁸³ *Id.*

¹⁸⁴ Newbery, *supra*, note 146.

¹⁸⁵ Euny Hong, *How Does Bitcoin Mining Work?*, INVESTOPEDIA (May 5, 2022), <https://www.investopedia.com/tech/how-does-bitcoin-mining-work/>.

¹⁸⁶ *Id.*

using sophisticated hardware that solves an extremely complex computational math problem.¹⁸⁷ For example, Bitcoin must be “mined” to verify transactions and safeguard the distributed ledger.¹⁸⁸ The mining process produces Bitcoins and serves to add transactions to the blockchain in the form of “blocks.”¹⁸⁹ Industry leaders say they are drawn to Texas’s cheap energy and aversion to regulation.¹⁹⁰ For example, North America’s largest bitcoin mine, which is owned and operated by Whinstone U.S., is located sixty miles northeast of Austin, Texas.¹⁹¹

In 2022, there were thousands of pounds of bitcoin mining equipment in transit from China to Texas, part of a multi-month caravan, as Texas Governor Greg Abbott makes courting the cryptocurrency industry a pinnacle part of his re-election campaign.¹⁹² Texas is looking to pick up on China’s missed opportunity, as the Chinese government restricts and forces bitcoin mining operations to relocate or go underground, ensuring that Texas will have a major role to play in the cryptocurrency industry.¹⁹³

Additionally, Texas enacted the Virtual Currency Bill, HB 4474.¹⁹⁴ This bill recognized cryptocurrency and other blockchain-based virtual currencies in its Uniform Commercial Code.¹⁹⁵

¹⁸⁷ *Id.*

¹⁸⁸ Peretz, *supra* note 66.

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ *Id.*

¹⁹² Leigh Cuen, *How Texas is Becoming a Bitcoin Mining Hub*, TECHCRUNCH (Feb. 11, 2022), <https://techcrunch.com/2022/02/11/how-texas-is-becoming-a-bitcoin-mining-hub/>

¹⁹³ *Id.*

¹⁹⁴ Virginia Hammerle, *When Virtual Becomes Reality: Cryptocurrency Comes Riding Into Texas*, DALLAS MORNING NEWS (Jul. 25, 2021), <https://www.dallasnews.com/sponsored/2021/07/25/when-virtual-becomes-reality-cryptocurrency-comes-riding-into-texas/>.

¹⁹⁵ *Id.*

HB 4474 settles clearly defines Virtual Currencies as “a digital representation of value”¹⁹⁶ that (1) “is used as a medium of exchange, a unit of account, or store of value”¹⁹⁷ and (2) “is not legal tender.”¹⁹⁸ The bill also distinguishes Virtual Currencies from merchants’ rewards programs, as well as gaming tokens, requiring virtual currencies to be “taken from or exchanged with the merchant for legal tender, bank credit, or virtual currency.”¹⁹⁹

VIII. REGULATOR APPROACH

Next, some states have adopted the regulator approach which focuses more on containing cryptocurrency. States utilizing a regulator approach engage in cryptocurrency with caution because of the risks and unknowns with cryptocurrency as mentioned above. Most states taking this approach engaged in “standard setting,” which is one of the financial regulator powers which is when regulators set permissible activities and behavior for market participants.²⁰⁰ This Comment will analyze two states’ regulator approaches to cryptocurrency: New York and Washington. New York implemented a business license for virtual currency activities.²⁰¹ Lastly, Washington proposed a 1% wealth tax on intangible financial assets of more than \$1 billion.²⁰²

¹⁹⁶ H.B. 4474, 87th Leg., Reg. Sess. (Tex. 2021).

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework*, CONGRESSIONAL RESEARCH SERVICE, 1, 1 <https://sgp.fas.org/crs/misc/R44918.pdf> (last updated Mar. 10, 2020). *See also supra* Section III(a).

²⁰¹ *See infra* Section VIII(a).

²⁰² *See infra* Section VIII(c).

A. NEW YORK

In June 2015, New York became the first state in the U.S. to regulate virtual currency companies through state agency rulemaking.²⁰³ In 2015, New York created “BitLicense,” which is a term used for a business license for virtual currency activities, issued by the New York State Department of Financial Services (NYDFS) under Regulation 23, Part 200 of the New York Codes, Rules and Regulations (NYCRR).²⁰⁴ The Regulation defines “Virtual Currency Business Activity” as the conduct involving various activities involving New York or a New York Resident.²⁰⁵ More specifically, people residing in, located in, having a place of business in, or conducting business in New York count as New York residents under these regulations.²⁰⁶

Next, the “following types of activities” that are referred to in 23 NYCRR 200.2(q) are as follows:

(1) receiving Virtual Currency for Transmission or Transmitting Virtual Currency, except where the transaction is undertaken for non-financial purposes and does not involve the transfer of more than a nominal amount of Virtual Currency; (2) storing, holding, or maintaining custody or control of Virtual Currency on behalf of others; (3) buying and selling Virtual Currency as a customer business; (4) performing Exchange Services as a customer business; or (5) controlling, administering or issuing a Virtual Currency.²⁰⁷

²⁰³ *Virtual Currency Business Activity*, NEW YORK DEPARTMENT OF FINANCIAL SERVICES, https://www.dfs.ny.gov/virtual_currency_businesses (last visited Feb. 9, 2023).

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ *Id.*

Ultimately, the license’s purpose is to ensure that “New Yorkers have a well-regulated way to access the virtual currency marketplace and that New York remains at the center of technological innovation and forward-looking regulation.”²⁰⁸

However, since New York established BitLicense in 2015, the regulation has experienced much scrutiny.²⁰⁹ One contention is that BitLicense negatively affects both companies and consumers in New York.²¹⁰ “New York state residents have dramatically limited trading options in crypto.”²¹¹ “The residents can only buy and sell coins from money transmitters registered in the state—of the hundreds of organizations offering services in the sector, only [twenty] have been issued BitLicenses in the last six years.”²¹² “No other state similarly curtails consumer trading options in crypto” like New York.²¹³

Another criticism is the application process to obtain BitLicense. New York tried to address these concerns by re-vamping the application process in 2020 with the goal to make it easier for some companies to receive a conditional license.²¹⁴ However, the most arduous parts of the application and adherence processes were largely left untouched.²¹⁵

²⁰⁸ *Id.*

²⁰⁹ Alex Adelman, *Kill the BitLicense*, COINDESK (Oct. 19, 2021) <https://www.coindesk.com/policy/2021/10/19/kill-the-bitlicense/>.

²¹⁰ *Id.*

²¹¹ *Id.*

²¹² *Id.*

²¹³ *Id.*

²¹⁴ *Id.*

²¹⁵ *Id.*

Most recently, New York continues to be hesitant about allowing more cryptocurrency and is apprehensive about the possible consequences.²¹⁶ For example, on May 3, 2021, New York Senate Bill S6486D (2021-2022) established a moratorium on consolidated operations that use proof-of-work authentication methods to validate blockchain transactions.²¹⁷

B. WASHINGTON

Similarly, “Washington, a state that is home to a thriving tech scene, passed a bill in 2017 that requires cryptocurrency exchanges to maintain cash reserves equivalent to the transacted volume on their platform.”²¹⁸

Additionally, Washington lawmakers proposed a one percent wealth tax on intangible financial assets of more than \$1 billion, including virtual currency.²¹⁹ “As part of an effort to reduce inequality and offset the state’s lack of an income tax, Washington state legislators are proposing a [one percent] a] levy on wealth over \$1 billion.”²²⁰ “Lawmakers say the tax would raise about \$2.5 billion a year in revenue and would only apply to so-called nontangible financial assets, or financial investments like stocks or options.”²²¹ “Jared Walczak of the Tax Foundation wrote that

²¹⁶ See N.Y. Senate Bill S6486D (2021-2022).

²¹⁷ N.Y. Senate Bill S6486D (2021-2022). This bill further provides that New York will only authorize the operation of a cryptocurrency mining center following the completion of a full generic environmental impact statement review and finding that such center will not adversely affect the state greenhouse gas emission targets in the Climate Leadership and Community Protection Act of 2019. *Id.*

²¹⁸ Rakesh Sharma, *More U.S. States May Roll Out Cryptocurrency Regulations*, INVESTOPEDIA, <https://www.investopedia.com/news/majority-us-states-are-still-acknowledge-cryptocurrencies/> (updated Jun. 25, 2019).

²¹⁹ H.B. 1406, 66th Leg., Reg. Sess. (WA. 2019).

²²⁰ Robert Frank, *Jeff Bezos would Owe \$2 Billion a Year in State Taxes if Washington Passes Wealth Tax*, CNBC, <https://www.cnbc.com/2021/02/08/jeff-bezos-would-owe-2-billion-in-state-taxes-under-washington-wealth-tax.html> (updated Feb. 8, 2021).

²²¹ *Id.*

97% of the revenue from the tax would come from four billionaires[:]” Jeff Bezos, Bill Gates, MacKenzie Scott and Steve Ballmer.²²² “Noel Frame, the state representative who introduced the bill, said the lowest earners pay 18% of their income in state taxes while the top 1% pay 6% of their income in state taxes.”²²³ Conclusively, even though this tax is on a small margin of people, it is still an example of restrictive regulation of cryptocurrency.

IX. BACKGROUND OF FEDERAL GOVERNMENT’S APPROACH TO CRYPTOCURRENCY

Before discussing a recommendation for federal regulation of cryptocurrency, it is important to focus on what, if anything, the federal government has done to try to regulate cryptocurrencies. As cryptocurrency continues to gain popularity, federal agencies are deliberating on how to handle it. The following section discusses how cryptocurrency is addressed in different facets of the federal government.

A. 2021 INFRASTRUCTURE INVESTMENT AND JOBS ACT

“On November 15, 2021, President Biden signed into law HR 3684, the ‘Infrastructure Investment and Jobs Act, commonly referred to as the ‘infrastructure bill,’” which can possibly have sweeping implications for the cryptocurrency ecosystem.²²⁴ The infrastructure bill “allocates funding and other resources focused on roads and bridges, water infrastructure, resilience, internet, and cybersecurity, among other areas.”²²⁵ Also contained in the 1,039 pages of the infrastructure

²²² *Id.*

²²³ *Id.*

²²⁴ *Infrastructure Bill’s New Reporting Requirements may have Sweeping Implications for Cryptocurrency Ecosystem*, GIBSON DUNN (Nov. 18, 2021), <https://www.gibsondunn.com/infrastructure-bills-new-reporting-requirements-may-have-sweeping-implications-for-cryptocurrency-ecosystem/>.

²²⁵ *Id.*

bill are three pages describing cryptocurrency transactions.²²⁶ Even though “cryptocurrency transactions [] have little to do with infrastructure, this bill c[an] have [] dramatic implications for millions of United States businesses and consumers who’ve embraced cryptocurrency for its efficiency, transparency, and accessibility.”²²⁷ Ultimately, there are three key takeaways for cryptocurrency in the infrastructure bill.

First, the infrastructure bill “extends traditional reporting requirements for certain transactions involving over \$10,000 in physical cash to transactions involving a newly defined category of “digital assets,” including cryptocurrencies.”²²⁸ Second, the infrastructure bill “could require businesses to collect new types of information and” report details of crypto transactions to the IRS, “in circumstances that bear little resemblance to cash purchases[,]” if the new reporting obligation is implemented.²²⁹ Third, it is critical for stakeholders in the cryptocurrency industry “to advocate for regulators to adhere to the traditionally narrow scope of the cash-reporting requirement when it comes to digital assets, to educate legislators and regulators alike on the privacy and democratic values served by peer-to-peer blockchain technologies, and to explain the pitfalls of creating disincentives for consumers to participate in the regulated system of digital transactions.”²³⁰

The infrastructure bill defines the term “digital asset” as “any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as

²²⁶ *Id.*

²²⁷ *Id.*

²²⁸ *Id.*

²²⁹ *Id.*

²³⁰ *Id.*

specified by the Secretary.”²³¹ The infrastructure bill amends the anti-money-laundering “cash reporting” requirements of 26 U.S.C. § 6045 to encompass transactions in “digital assets.”²³² Section 6050I requires businesses that “receive” over \$10,000 in cash (or other untraceable instruments like cashiers’ checks and money orders) to file a Form 8300 with the IRS, which includes the name, address, and taxpayer identification number, among other information, of both the payer and the beneficiary (usually the recipient) of the transaction.²³³ However, Section 6050I does not apply to transactions at financial institutions, which are subject to parallel requirements under the Bank Secrecy Act.²³⁴ Section 6050I also does not apply to traceable electronic transactions involving credit cards, debit cards, or peer-to-peer payment services like PayPal and Venmo.²³⁵ This indicates that this bill would not require Form 8300 to report receiving greater than \$10,000 of digital assets in the course of business.²³⁶

Additionally, one provision in the infrastructure bill would require each “broker,” which will mainly be exchanging, to report their cryptocurrency gains in a type of 1099 form.²³⁷ “Brokers’ will also have to disclose the names and addresses of their customers.”²³⁸ For tax

²³¹ Infrastructure Investment and Jobs Act, 117 P.L. 58, § 80603(b)(1)(B), 135 Stat. 429, 1340.

²³² *Id.*

²³³ *Id. Infrastructure Bill’s New Reporting Requirements May Have Sweeping Implications for Cryptocurrency Ecosystem*, GIBSON DUNN (Nov. 18, 2021) <https://www.gibsondunn.com/infrastructure-bills-new-reporting-requirements-may-have-sweeping-implications-for-cryptocurrency-ecosystem/>.

²³⁴ *Id. See* 31 U.S.C. §§ 5312, 5313.

²³⁵ *Id.*

²³⁶ *Id.*

²³⁷ Taylor Locke, *President Joe Biden to Sign the Bipartisan Infrastructure Bill into Law—Here’s how Crypto Investors will be Impacted*, CNBC (Nov. 15, 2021), <https://www.cnbc.com/2021/11/09/how-bipartisan-infrastructure-bill-will-impact-crypto-investors.html>.

²³⁸ *Id.*

purposes, a “‘broker’ or exchange must send a Form 1099-B to both the Internal Revenue Service (IRS) and their customer.”²³⁹ “The customer uses information from the 1099-B to calculate their preliminary gains and losses, which is reported on their own tax return.”²⁴⁰ However, “these 1099s are going to be inaccurate for the most part because these exchanges don’t have visibility into what you have in your self-custody wallet or what you’re doing in decentralized finance, or DeFi, applications.”²⁴¹ With a self-custody wallet, investors own their private keys and cryptocurrency holdings, rather than using a third party, such as an exchange.”²⁴² “Things could get tricky if an investor has both self-custody wallets and exchange wallets.”²⁴³

For example, “if an investor were to send \$100,000 worth of bitcoin from their self-custody wallet to their Coinbase wallet and sell the funds, Coinbase would be required to issue a 1099” form “saying that the investor sold \$100,000.”²⁴⁴ But Coinbase will not know how much the investor initially paid for the bitcoin because it didn’t happen on the exchange.”²⁴⁵ As a result, Coinbase will not know the investor’s cost basis, which may lead to an overstated 1099.”²⁴⁶

²³⁹ *Id.*

²⁴⁰ *Id.*

²⁴¹ *Id.*

²⁴² *Id.*

²⁴³ *Id.*

²⁴⁴ *Id.*

²⁴⁵ *Id.*

²⁴⁶ *Id.*

However, these “provisions will not take effect until January 2024, and in the meantime, lobbyists within the cryptocurrency industry plan to push for amendments and standalone bills to adjust the provisions.”²⁴⁷

B. STABLECOINS

In 2021, U.S. Federal Reserve Chairman Jerome Powell and Security and Exchange Commission (SEC) Chairman Gary Gensler both expressed concern over the lack of cryptocurrency regulation.²⁴⁸ In response, a recent report from the Biden administration outlines proposed legislation that would bring more regulation to the cryptocurrency market.²⁴⁹ The report mentions new proposed cryptocurrency regulation and highlights three specific proposals.²⁵⁰ All three proposals mention the use of stablecoin.²⁵¹

Stablecoins are a class of cryptocurrencies that attempt to offer price stability and are backed by a reserve asset.²⁵² Stablecoins have gained traction because they attempt to offer the best of both worlds: (1) the instant processing and security or privacy of payments of cryptocurrencies; and (2) the volatility-free stable valuations of fiat currencies.²⁵³ A basket of legal currencies or

²⁴⁷ *Id.*

²⁴⁸ *Id.*

²⁴⁹ Ryan Haar, *U.S. Officials Send Mixed Messages on Crypto Regulation. Here’s What It All Means for Investors*, TIME (Nov. 2, 2021) <https://time.com/nextadvisor/investing/cryptocurrency/crypto-regulation-talks-heat-up/>.

²⁵⁰ John Puterbaugh, *The Biden Administration Wants New Legislation to Regulate Stablecoins. Here’s What That Means for Investors*, TIME (Nov. 2, 2021) <https://time.com/nextadvisor/investing/cryptocurrency/biden-admin-regulations-stablecoins/>.

²⁵¹ *Id.*

²⁵² *Id.*

²⁵³ *Id.*

commodities, such as gold, most often provides the benchmark of stablecoins.²⁵⁴ Thus, one of the ultimate goals of stablecoin promoters “is to remedy one of the two congenital defects” of crypto-assets, their “volatility expressed in the legal tender”.²⁵⁵ Stablecoin also tries to mitigate scalability, meaning “the limited capacity to process a large volume of transactions.”²⁵⁶ Stablecoin can remedy this by adopting validation procedures more centralized than the “proof of work” used by “historical” crypto-assets such as Bitcoin.²⁵⁷

In September 2021, Stablecoins’ market cap climbed to “roughly \$125 billion.”²⁵⁸ The three proposals for new cryptocurrency regulation through utilizing stablecoin are: (1) Stablecoin issuers should be required to be insured as depository institutions; (2) Stablecoin issuers and platforms should be subject to federal oversight, and required to meet appropriate risk-management standards; and (3) Stablecoin issuers should be required to comply with restrictions on commercial entity affiliation and to promote interoperability among stablecoins.²⁵⁹ The report relies on stablecoin because the Biden Administration believes that stablecoins have the potential for future innovation to expand point-of-sale payment options for American consumers, even while highlighting the need for new regulation.²⁶⁰

²⁵⁴ Anastasia Melachrinou & Christian Pfister, *Stablecoins: A Brave New World?*, 4 STAN. J. BLOCKCHAIN L. & POL’Y 1 (2021).

²⁵⁵ *Id.*

²⁵⁶ *Id.*

²⁵⁷ *Id.*

²⁵⁸ Pete Schroeder, *U.S. Treasury, Financial Industry Discuss Cryptocurrency ‘Stablecoins,’* REUTERS (Sept. 10, 2021) <https://www.reuters.com/technology/exclusive-us-treasury-financial-industry-discuss-cryptocurrency-stablecoins-2021-09-10/>.

²⁵⁹ *Id.*

²⁶⁰ *Id.*

On January 7, 2021, commenting on Stablecoins, the Office of the Comptroller of the Currency (OCC) “said national banks and federal savings associations may use new technologies, including independent node verification networks... and related stablecoins, to perform bank-permissible functions.”²⁶¹

C. TREASURY DEPARTMENT

The U.S. Treasury has previously engaged in some cryptocurrency restrictions. For example, in September 2021, the U.S. sanctioned Suex, a cryptocurrency exchange, for its alleged role in laundering ransoms for cyberattacks.²⁶² This marked the first such action against a virtual currency exchange and followed a string of cyberattacks that crippled several industries and even threatened U.S. government agencies.²⁶³ Additionally, the U.S. Treasury put the cryptocurrency industry on notice over rising ransomware attacks.²⁶⁴ The U.S. Treasury Department reported the average amount of reported ransomware transactions per month in 2021 was \$102.3 million.²⁶⁵ The Treasury informed the crypto community and noted they must not “directly or indirectly” facilitate deals prohibited by U.S. sanctions.²⁶⁶ Deputy Treasury Secretary Wally Adeyemo stated, “[t]reasury is helping to stop ransomware attacks by making it difficult for criminals to profit from

²⁶¹ Mengqi Sun, *OCC Says Banks Can Use Stablecoins in Payments*, WSJ (Jan. 7, 2021), <https://www.wsj.com/articles/occ-says-banks-can-use-stablecoins-in-payments-11610068515>.

²⁶² Lauren Feiner, *U.S. Treasury Sanctions Cryptocurrency Exchange for Alleged Role in Ransomware Attacks*, CNBC (Sept. 21, 2021), <https://www.cnbc.com/2021/09/21/us-treasury-sanctions-cryptocurrency-exchange-suex.html>.

²⁶³ *Id.*

²⁶⁴ Daphne Psaledakis, *U.S. Treasury Puts Crypto Industry on Notice Over Rising Ransomware Attacks*, REUTERS (Oct. 15, 2021), <https://www.reuters.com/business/finance/us-treasury-warns-crypto-industry-preventing-sanctions-violations-2021-10-15/>.

²⁶⁵ *Id.*

²⁶⁶ *Id.*

their crimes, but we need partners in the private sector to help prevent this illicit activity.”²⁶⁷ The U.S. Treasury is advised virtual currency exchanges to use geolocation tools to block access from countries under U.S. sanctions.²⁶⁸ Hackers use ransomware to take down systems that control everything from hospital billing to manufacturing.²⁶⁹ They stop only after receiving hefty payments, typically in cryptocurrency.²⁷⁰

X. RECOMMENDATION

Cryptocurrency is ever-expanding in the United States and globally. Cryptocurrency expanded to the point where it is considered a global currency, but there are discrepancies between how nations are handling the topic. For example, in September of 2021, China’s most powerful regulators banned all crypto transactions and mining, which harmed major coins and pressured crypto and blockchain-related stocks.²⁷¹ However, in the United States, states have different approaches to cryptocurrency: some states regulate cryptocurrency through laws, such as licensing and taxing; others facilitate it through creating banks that can accommodate cryptocurrencies; and some states adopt a combination of both regulation and facilitation. Under the facilitator approach, state and local governments attract cryptocurrency businesses through crypto-friendly banks that are hot spots for Bitcoin mining.²⁷² Conversely, the regulator approach seeks to create standards

²⁶⁷ *Id.*

²⁶⁸ *Id.*

²⁶⁹ *Id.*

²⁷⁰ *Id.*

²⁷¹ Kenneth Rapoza, *China ‘Banned’ Crypto. Can the SEC Try Doing the Same?*, FORBES (Oct. 11, 2021), <https://www.forbes.com/sites/kenrapoza/2021/10/11/china-banned-crypto-can-the-sec-try-doing-the-same/?sh=62700393455c>.

²⁷² *See supra*, section VII.

before cryptocurrency gets out of hand rather than giving it more tools to expand.²⁷³ Thus, I recommend a hybrid between the facilitator and the regulator approach.

A. CRITIQUE OF THE FACILITATOR APPROACH

First, Wyoming implemented a “special purpose depository institution” charter for banks that provide services for digital assets..²⁷⁴ This type of bank that “incorporates cryptocurrency into a consumer’s portfolio allows customers to effortlessly put converted Bitcoin into an account without the need of multiple middlemen.”²⁷⁵ However, the fact that these “crypto-banks” are not fully backed raises concerns about their longevity and consumer security. Thus, crypto-banks should focus on stablecoins first until the backing issue is fully resolved.

Second, Texas created pro-crypto laws and low energy costs, which appeal to the Bitcoin Mining Community.²⁷⁶ However, it is important to consider Bitcoin mining’s environmental implications. For most of Bitcoin’s short history, its mining process has remained energy-intensive.²⁷⁷ According to some estimates, “the cryptocurrency’s mining process consumes as much electricity as entire countries.”²⁷⁸ The environmental concern comes from the estimated carbon footprint generated by the power plants providing that energy.²⁷⁹ And it is not just mining that uses

²⁷³ *See supra*, section VIII.

²⁷⁴ *See supra*, section VII(A).

²⁷⁵ *Id.*

²⁷⁶ *See supra*, section VII(C).

²⁷⁷ Jake Frankenfield, *Bitcoin Mining*, INVESTOPEDIA (Feb. 15, 2022), <https://www.investopedia.com/terms/b/bitcoin-mining.asp>.

²⁷⁸ *Id.*

²⁷⁹ John Bogna, *What is the Environmental Impact of Cryptocurrency?*, PC MAGAZINE (Jan. 8, 2022), <https://www.pcmag.com/how-to/what-is-the-environmental-impact-of-cryptocurrency#:~:text=The%20most%20obvious%20environmental%20impact,new%20digital%20coins>

lots of power—a single Bitcoin transaction is estimated to burn 2,292.5 kilowatt hours of electricity, enough to power a typical U.S. household for over 78 days.²⁸⁰ But Bitcoin proponents have released studies that claim that the cryptocurrency is powered largely by renewable energy sources.²⁸¹

Additionally, Bitcoin mining can affect local communities. For example, the Texas power grid is struggling with “fluctuating energy prices and sporadic service” and Bitcoin mining is considered to aggravate this situation.²⁸² “The price of power per hour is all over the place, routinely going negative.”²⁸³ Rolling blackouts at moments of peak power consumption no longer come as a surprise.”²⁸⁴ “However, Texas’s growing Bitcoin mining community believes it can help fix it.”²⁸⁵ “Crypto enthusiasts believe the fix to this problem is actually to add another electricity consumer into the mix.”²⁸⁶

B. CRITIQUE ON REGULATORY APPROACH

The regulatory approach is highlighted in New York and Washington’s approach to cryptocurrency.²⁸⁷ Licensing and taxes have been used to hold cryptocurrency to certain

%20are%20created.&text=Electricity%20may%20seem%20like%20a,atmosphere%20and%20worsens%20climate%20change.

²⁸⁰ *Id.*

²⁸¹ *Id.*

²⁸² Mackenzie Sigalos, *Bitcoin Miners Say They’re Helping to Fix the Broken Texas Electricity Grid – and Ted Cruz Agrees*, CNBC (Dec. 5, 2021), <https://www.cnbc.com/2021/12/04/bitcoin-miners-say-theyre-fixing-texas-electric-grid-ted-cruz-agrees.html>.

²⁸³ *Id.*

²⁸⁴ *Id.*

²⁸⁵ *Id.*

²⁸⁶ *Id.*

²⁸⁷ *See supra*, section VIII.

standards.²⁸⁸ In New York, BitLicense created a set of standards that made a reasonable attempt to set standards but still give people personal autonomy. BitLicense looks to regulate business transactions and set aside transactions that are for non-financial purposes.²⁸⁹ For example, merely “selling the coins you have mined, in a private, non-commercial transaction, does not require a BitLicense.”²⁹⁰ However, other Virtual Currency-related activities that a miner engages in may require a BitLicense.²⁹¹

C. OVERALL CONCLUSION

For the federal government to successfully develop cryptocurrency protocol, both approaches, regulating and facilitating, must be assessed. Setting standards is appropriate in order to make sure cryptocurrency does not get out of hand. However, virtual assets are gaining popularity and are not going away anytime soon; thus, consumers and investors should be able to engage with more options available.

²⁸⁸ *See supra*, section VIII.

²⁸⁹ *See supra*, section VIII(A).

²⁹⁰ *See supra*, section VIII(A).

²⁹¹ *See supra*, section VIII(A).