# Regulating Blockchain and Crypto Technology via Enforcement

## In brief…

Existing financial regulations are unclear with regard to cryptocurrencies, yet the SEC's method of "regulation by enforcement" leaves crypto firms confused and out of compliance. Congress should step in to offer a clear legal framework for crypto governance in the United States.

By: Sarah Hay | June 18, 2024

On June 5, 2024, the George Washington University Regulatory Studies Center and Law School hosted an event titled Regulation by Enforcement: Blockchain and Crypto. The event convened industry professionals, academics, and government experts to discuss the various methods of regulating cryptocurrencies (crypto). The first discussion of the event, moderated by Regulatory Studies Center Director Roger Nober, covered the implications of regulating the emerging crypto industry through enforcement actions.

The panelists highlighted that existing financial regulations are not working for the current state of the crypto industry. Current financial regulations were not designed with crypto in mind, so both firms and financial regulators face challenges in determining how the regulations should apply. Projects that have tried to comply with existing financial regulations have ended up "dying" because compliance led to difficult and less efficient processes for buying and selling on the blockchain, per Todd Phillips, assistant professor of business at Georgia State University. Other companies have preemptively contacted the Securities and Exchange Commission (SEC) to ensure regulatory compliance, but the agency often responds to these companies with enforcement actions.

The SEC's actions in the crypto space are an example of "regulation by enforcement"—the use of case-by-case legal actions against stakeholders to build agency precedent on a subject, in lieu of rulemaking. Most panelists seemed to agree that regulation by enforcement is not a desirable method of governance for cryptocurrencies. Jai Massari, founder and chief legal officer of Lightspark, pointed out that regulating by enforcement can be a reasonable strategy in more mature industries when it is clear how the regulations apply to a given case. In the case of crypto, Massari noted that the way financial regulations apply is murky, making regulation by enforcement inappropriate for the industry.

Phillips characterized the SEC's current approach to crypto regulation as a "political and legal strategy." While the agency does have prosecutorial discretion, crypto firms lack clarity about which companies will face enforcement actions. Massari stated that many of the companies targeted with legal action are companies that have tried to comply with regulations, as opposed to known "bad actors" in the crypto space. Additionally, pursuing individual enforcement actions creates further uncertainty for crypto firms because each case could result in a different outcome. There is also no requirement that these cases in the lower courts result in outcomes that are legally consistent with each other; rather, each decision is subject to the judge presiding over the matter and the facts of the specific case.

Due to the uncertain regulatory environment, crypto firms have more limited development opportunities in the United States. Some firms choose not to pursue crypto at all. Others move abroad. Ripple's Lauren Belive, head of public policy and government, noted that firms have found success in Dubai, Brazil, and the United Kingdom because they have regulatory certainty in those regions. Rather than continuing to hash out political and governance issues like in the United States, firms operating abroad can focus on functional business discussions and decisions. Massari cautioned that as other countries develop regulatory strategies for crypto, the United States could become a "regulation-taker" rather than a "regulation-maker," minimizing its ability to influence global policy and practice in this emerging field.

The group concluded that it is time for Congress to step in and eliminate the uncertainty crypto firms face, and Congress should act before the Supreme Court rules on any crypto regulation case. If the question of investment contracts ends up before the Supreme Court, the Court is likely to curtail the SEC's authority across the board, as noted by Miller Whitehouse-Levine, CEO of the DeFi Education Fund. Rather than leaving these questions for the Supreme Court to decide, Congress has a role to play in ensuring consistency in how crypto is treated at the federal level. For example, Congress could clarify how existing financial tests, such as the *Howey* Test, apply to crypto. The clarity that comes from a legislative framework would allow for clearer consumer protections and more space for innovative companies to continue to develop crypto technology.