

The Regulatory Adventures of a Crypto Startup: The Saga Continues

This is the final part of a trilogy of articles about fictional FinTech startup NoDoubt Crypto and its journey through regulatory, legislative and enforcement review adventures.

By **Antonia Savaria** and **Caroline A. Morgan** | December 18, 2020

All good things come in threes. In 2018, we introduced you to NoDoubt Crypto LLC (NoDoubt Crypto), an innovative fictional FinTech startup in the digital assets or blockchain space. Through the eyes of NoDoubt Crypto, [we walked you through regulatory challenges](#) firms face. A year later, [we highlighted select regulatory developments](#), including new blockchain and crypto legislation. 2020 marks part three of the trilogy as we continue NoDoubt Crypto's journey and its regulatory, legislative and enforcement review adventures.

Don't Shy Away: Join the Crypto Party or ... Regulate It

On Oct. 31, 2020, NoDoubt Crypto cheered Bitcoin on its 12th birthday, celebrating the 12th anniversary of the release of Satoshi Nakamoto's [Bitcoin white paper](#). NoDoubt Crypto's mood dampened, however, when it realized that, even though blockchain technology and crypto were gaining worldwide industry popularity in 2020, regulators still shied away from the crypto party limelight. (Minor) exceptions noted, of course, further below.

The Alphabet Soup Thickens

NoDoubt Crypto is comfortable with the meaning and use of crypto acronyms and terms, like ICOs (Initial Coin Offerings), IEOs (Initial Exchange Offerings), STOs (Security Token Offerings), DAs (Digital Assets), Altcoins (Alternative Coins) and Stablecoins. The alphabet soup thickens as the crypto industry and regulators begin to use new acronyms and terms like open banking, CBDC (central bank digital currency) and DeFi (decentralized or open finance) (with the term [first introduced in 2018](#)), to name a few. These are all the talk in 2020, but only talk. Except in the Bahamas, whose Central Bank [tweeted](#) on Oct. 20, 2020 that its "Sand Dollar" is up and running, making it the world's first CBDC. That's great, but the "Sand Dollar" affects only Bahamian wholesale and retail [transactions](#) and NoDoubt Crypto needs to keep an eye on the regulatory changes in the United States.

That alphabet soup we mentioned is thickening on the regulatory front too as more federal financial regulators become active in blockchain this year.

Nothing Unusual From the Usual Suspects

Has the SEC been primarily regulating through enforcement? Considering the eighteen enforcement digital assets/ICO actions it brought in 2020 (through December 14), NoDoubt Crypto thinks so. Of

note are also SEC Commissioner Hester Peirce's—a big crypto supporter—speech introducing her [token safe harbor proposal](#) and her discussion on the Telegram case during her Singapore Blockchain Week [speech](#). Our brief review of Telegram is further below.

While last year the SEC issued three no-action letters to crypto businesses, this year, no-action relief was provided in [September](#) and [October](#) to ... FINRA. To FINRA? NoDoubt Crypto ponders. Also, while the first FINRA no-action letter provides regulatory workaround to broker-dealers that operate noncustodial alternative trading systems that trade digital asset securities issued and/or transferred using blockchain, the second FINRA no-action letter—while not directly addressing digital assets and blockchain—leaves NoDoubt Crypto more confused when it was followed by a [joint statement](#) of two SEC Commissioners who objected to the agency staff's no-action relief provided (to certain broker-dealers until April 2021 despite customer protection rule violations).

Speaking of FINRA, NoDoubt Crypto notes that: (1) FINRA issued a [regulatory notice](#) encouraging member firms that engage in digital assets activities to keep it in the know and NoDoubt Crypto recalls that similar reminders were also published in the previous two years; and (2) in July 2020, it held a [virtual conference](#) discussing developments in the digital assets space.

Crypto Moves by Major Banking Regulators

Square is becoming a bank!? Wondered NoDoubt Crypto when, in March 2020, the Federal Deposit Insurance Corporation (FDIC) [approved](#) Square's deposit insurance application to create a *de novo* industrial bank (together with a similar application by Nelnet). When in October 2020, Square bought \$50 million worth of crypto (approximately 1% of its total assets), [stating](#) "cryptocurrency is an instrument of economic empowerment and provides a way for the world to participate in a global monetary system," NoDoubt Crypto realized big shifts are happening in the crypto/blockchain space and was pleased to learn the FDIC had also [released a guide](#) to help FinTechs connect with banks.

With the stamp of approval of another banking regulator—the Office of the Comptroller of the Currency (OCC)—national banks are now authorized to [provide cryptocurrency custody](#) services to their customers, including by holding the unique cryptographic keys associated with cryptocurrency. The OCC noted that crypto custody is a modern form of the traditional bank activities of safekeeping and custody services, including both physical objects and electronic assets. This move will continue to foster banking relationships with crypto firms, like Coinbase and Gemini, both of which are clients of one of the major banks—JP Morgan—since May 2020 (currently for cash management services only) and are BitLicensed with the Department of Financial Services (DFS) in New York. The OCC engaged further with the FinTech/crypto community when it [sought comments](#) on digital innovation by banks.

Easing the Burden of the New York BitLicense

On the topic of the BitLicense, the DFS appears to have recognized that its stringent regulation is a big barrier of entry to many crypto firms. To that end, the New York regulator implemented several reforms, most significantly, seeking comments on a [proposed framework for a conditional BitLicense](#), with PayPal—the first firm to receive a conditional BitLicense (in partnership with Paxos) in October 2020, the [final guidance regarding the adoption or listing of virtual currencies](#), and more streamlined [application procedures](#).

The Blockchain Legislation Battle on the Hill

Regulators were not the only busy ones in 2020. The 116th Congress introduced [40](#) blockchain bills focusing on a variety of subjects from crypto use in money laundering to government use of blockchain technology. March brought the [Crypto-Currency Act of 2020](#), a proposed bill to clarify which Federal agencies regulate digital assets and to require those agencies to notify the public of any requirements to create or trade in digital assets. In December, lawmakers introduced the [Stablecoin Tethering and Bank Licensing Enforcement \(STABLE\) Act](#) to provide for the classification and regulation of stablecoins. The need to demystify blockchain is also evident in recent state legislation, as discussed below.

FinTechs Can Play in State Regulatory Sandboxes

NoDoubt Crypto is pleased to see a theme among blockchain bills in 2020 was the creation of blockchain advisory or study groups. New York, for example, introduced [legislation](#) focusing on studying the use of blockchain for state record keeping and referred a [bill](#) focusing on the use of blockchain technology to protect voter records and election results. Similarly, this year crypto-friendly Wyoming passed a [bill](#) establishing a Committee on Blockchain, Financial Technology and Digital Innovation Technology tasked with developing and introducing legislation to promote blockchain.

Using a Simple Agreement of Future Tokens (SAFT) Is Not That Simple

This year Telegram Group Inc. (Telegram) and later Kik Interactive Inc. (Kik) settled closely watched lawsuits brought by the SEC alleging monies raised for their tokens were an illegal offering of securities despite their SAFT feature.

March 2020 marked the beginning of the end for Telegram after the judge [granted](#) the SEC's motion for a preliminary injunction finding it showed a substantial likelihood of success in proving that Telegram's plan to distribute its token is an offering of securities. Telegram had argued it was not selling securities because it sold rights to future tokens (SAFT) that would only be distributed after its network launched. Telegram [settled](#) soon after the SEC's win.

Like Telegram, in Kik, the SEC argued Kik's token sale was an unregistered securities offering despite its SAFT feature. Interestingly, the judge in Kik declined to accept the SEC's argument that Telegram is binding. Kik [settled](#) soon after the judge [granted](#) summary judgment to the SEC. NoDoubt Crypto heeds that both Telegram and Kik demonstrate the SEC is scrutinizing SAFTs despite how token sales are characterized.

The SEC is not the only active litigant. This year private litigants brought several crypto class action lawsuits.

The Rise of Crypto Class Action Lawsuits

In April 2020, crypto-asset investors filed 11 class action [lawsuits](#) in New York against four major crypto-asset exchanges and seven digital token issuers. Whether the lawsuits survive depends on several factors, including whether they are time barred.

A threshold issue is whether plaintiffs can survive the one-year statute of limitations in the private right of action under the Securities Act. Plaintiffs allege defendants sold unregistered tokens in 2017 and though it could be contended the limitations period did not begin to run until April 3, 2019 when the SEC issued the [Framework for “Investment Contract” Analysis of Digital Assets](#), whether the Framework provided novel guidance in light of prior SEC enforcement actions is questionable.

FinHub Is Forging Ahead as a Stand-Alone

As we bid 2020 goodbye, FinHub bids the Division of Corporate Finance goodbye, as it becomes a [stand-alone office](#) within the SEC two years after it was launched. NoDoubt Crypto views this move as the regulator’s commitment to continue fostering and shaping the convergence of innovation and regulation. CFTC is also determined to forge ahead and develop a holistic framework to promote responsible innovation in digital assets as outlined in its [strategic plan](#) for 2020-2024.

Takeaway

In 2020, federal regulators showcased a deeper understanding of the DLT/blockchain/crypto process (cryptographic keys, exchange mechanisms, hot and cold wallets); recognized that financial markets are becoming increasingly more technological and applicable stakeholders need to leverage new technology, including blockchain; and continued to use a more collaborative approach to blockchain/crypto guidance and enforcement actions. As the legislative and regulatory landscape continues to evolve, novel litigation issues will arise and blockchain/crypto businesses—like NoDoubt Crypto—need to remain diligent in deciphering the nuances of federal vis-à-vis state and foreign jurisdiction developments.

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