Cryptic Regulation of Crypto-Tokens

By Joshua Gans

Comments by Eric Talley (Columbia)
Lots to like about this paper

- Obviously important topic
- Clearly written
- Honest about the regulatory challenge: The social value / costs of crypto-backed assets is still unclear, even to (particularly to?) regulators
- Proves I was onto something when in grad school I attempted to prod Joshua into joining me in getting a JD, too
  - (Sadly I failed, however)
Comments / Suggestions

• Targeting your audience
• The regulation of new asset classes: Multiple strategies, each with practical challenges
• The epistemically uncertain welfare-economics case for/against crypto assets
Targeting your audience (and message)

• The paper never comes clean about what audience it is attempting to “speak” to…
  • Economists?
  • Lawyers?
  • Regulators?
  • Laypersons?

• Or what thesis it is attempting to advance to that audience
  • Primer on Crypto? (Matt Levine has already dunked on all of us here)
  • Infomercial for a case in favor / against further development of crypto tokens?
  • Advocacy piece in favor of clearer rules (in the abstract)?
  • Attempt to offer clearer/better rules? (If so, what are they?)
The challenge of regulating new asset classes: Alternative strategies (focus on securities reg)

Ex Ante Regulation

• Regulator formulates bespoke rules ahead of the area’s development
• Problem: If asset class is too revolutionary, the appropriate type/level of regulatory oversight is unclear
  • This, in fact, was/is the “spiel” of many crypto assets.
• Added Constraint: Regulator’s decisions may be highly throttled by courts
  • Interpretation of mandate
  • Arbitrary/Capricious
  • Regulatory inconsistency

Ex Post Regulation by Litigation

• Regulator issues no rules ahead of time, but relies on “standards” (rather than rules)
• Problem: Standards are almost deliberately vague.
  • Can take time to determine how new asset class fits within the standard
  • Institutional “Learning” case by case
• Over time, clear precedent may emerge or severe splits reconciled by higher courts.
  • Can take years to unfold, however, leaving providers to play a multi-year guessing game
Ex Ante Regulation: Deference to agency rule-making is hardly a sure thing

- Interpreting regulatory mandate:
  - Pending US Supreme Court case challenging “Chevron” deference agencies have traditionally received in interpreting statutory mandate: *Loper Bright Enterprises v. Raimondo* (2023)
  - Statutory Ambiguity and the “Major Questions Doctrine”: *West Virginia v EPA* (2022)

- Arbitrary and/or Capricious promulgation (\& repeal) of agency rules
  - Several recent cases rejecting new regulations / & roll-backs under “State Farm” doctrine because of insufficient justification. *Business Roundtable v. SEC* (2011); *Dep’t Homeland Security v. UC Regents* (2020)

- Regulatory Inconsistency
  - Rejecting and vacating SEC’s refusal to allow trading of a bitcoin ETF in the light of SEC’s prior approval of trading on national exchanges of two bitcoin futures funds
  - “In the absence of a coherent explanation, this unlike regulatory treatment of like products is unlawful. We therefore grant Grayscale’s petition for review and vacate the Commission’s order”
Regulation by Litigation
A Different Set of Challenges

• Legal Standard for “Security” (*SEC v Howey* (1946)): contract, transaction or scheme that involves:
  1. An investment of money
  2. In a common enterprise
  3. With the expectation of profit
  4. To be derived from the efforts of a promoter or other third party

• Courts (even in the same prominent jurisdiction!) may not agree about application. See, e.g., SDNY
  • *SEC v Ripple* (2023) (Judge Torres): Finding factors 1-3 present for crypto asset, but hinging #4 on reasonable belief of parties on use of funds: institutional investors in private transactions (satisfied) versus retail investors buying/selling in anonymous markets (not satisfied)
  • *SEC v. Terraform Labs* (2023) (Judge Rakoff): Finding all four factors present, and hinging #4 on public advertising campaign in which promoter shilled the investment’s overall profitability and the promoter’s managerial and technical skills

• Second Circuit may resolve this difference, eventually(?). SCOTUS may resolve bigger splits. But that could take a decade.
The epistemically uncertain cost/benefit case for crypto assets

• Entirely unclear (still!)

• A new kind of money?
  • Needed?
  • Digital fiat currency backed by (a) credible monetary authority vs. (b) tech-bro’s Ted talk

• Anonymous Exchange?
  • Whether this is a bug/feature turns on one’s view of desirability of obscuring economic activity from public view (tax evasion; trafficking illegal goods; ransom payments)
  • Not entirely anonymous

• Decentralized verification / governance?
  • Benefit of distributed-ledger-based contracting, not crypto per se.
  • Discovering that DAU governance (e.g., voting protocols) also subject to manipulation.

• In the light of this uncertainty, should our regulatory goal be…
  • To pick the best regulation we can given what we know today? Or
  • To promulgate rules that generate better information for our future selves?