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SEC Eyes Further Crypto Regulation as Concerns over Conflicts of Interest Loom

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SEC Chair Gary Gensler appears to be readying the SEC for increasing oversight of cryptocurrency exchanges, the latest in a series of regulatory actions targeting the growing industry.

In prepared remarks at PLI's recent SEC Speaks conference, Gensler called on cryptocurrency platforms to register each function they perform with the SEC – for example, requiring crypto dealers, brokers, and lenders to separately register those functions with the SEC. Such a move could result in a dramatic shakeup in the crypto market, where there are currently several cryptocurrency platforms that perform all of these functions. This is in stark contrast to the traditional securities markets, in which such services are separated from each other.

The SEC's apparent push to disaggregate cryptocurrency business functions comes as the crypto market has come under increasing scrutiny. In January, the SEC proposed a rule that would significantly broaden the definition of "exchange," which would more firmly bring the cryptocurrency market under the SEC's regulatory purview. Gensler has publicly supported this effort, as he has consistently expressed skepticism of the state of the cryptocurrency market and made it a priority to enact rules that more explicitly regulate crypto.

Gensler's comments, and the SEC's corresponding actions, come on the heels of other developments that have affected the nascent industry. In March, North Korea stole approximately $30 million worth of digital tokens (the US government recently seized those stolen tokens). The last few months have also seen a marked drop in crypto's values, spooking some consumers. Perhaps most notably, in July, crypto lender Voyager Digital filed for bankruptcy, once again shaking confidence in the cryptocurrency market.

Even with Gensler's comments, and the SEC's proposed rulemaking, the regulatory outlook for cryptocurrency remains unclear. Proposed legislation in Congress (which would place most crypto under the CFTC's jurisdiction) appears unlikely to proceed in the near term. The SEC has brought some enforcement actions, including on matters related to conflicts of interest, which was the focus of Gensler's latest comments. (Our summary of the most recent such action can be found here.) But the crypto market is such a recent phenomenon that there is, naturally, little precedent to guide how existing statutes and regulations apply to it. While new rules could bring more stringent oversight to this space, it is also likely that individual enforcement actions and settlements could continue to build a body of precedent that bring more clarity to the SEC's role in regulating the emerging market.

This uncertain regulatory picture underscores the need for cryptocurrency companies and their counsel to stay informed about developments in securities laws and rulemaking, particularly as the SEC seeks to broaden its existing jurisdiction. Engaging with outside counsel can be essential in helping companies balance litigation risk with the opportunities that are part and parcel of a new (and dynamic) sector. Oftentimes, outside counsel can help companies navigate these risks without sacrificing the nimble and bold attitude that have helped these companies succeed in the first place – and, indeed, can help position these companies to succeed as the crypto market embarks on its next chapter.

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