The Heavy Burden of Thin Regulation: Lessons Learned from the SEC's Regulation of Cryptocurrencies

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I. INTRODUCTION

The Trump Administration has taken a strong stance against regulation.[1] This includes not only ratcheting down the level of regulation and enforcement in general, but it also entails a strong dislike of the absolute number of regulations in existence.[2] For example, within two

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1. *See* Emily Rees Brown, *Public–Private Partnerships: HUD's Lost Opportunities to Further Fair Housing*, 21 LEWIS & CLARK L. REV. 735, 789 (2017) ("President Trump is certainly on record as being in favor of deregulation in almost every sector of the American economy."); Lisa Heinzerling, *Unreasonable Delays: The Legal Problems (So Far) of Trump's Deregulatory Binge*, 12 HARV. L. & POL'Y REV. 13, 13 (2018) ("President Trump has promised a historic rollback of regulation. In his early days in office, he produced a flurry of executive orders directing executive agencies to begin to undo a wide variety of regulatory measures put in place in the Obama administration."); Gillian E. Metzger, *The Supreme Court, 2016 Term: Foreword: 1930s Redux: The Administrative State Under Siege*, 131 HARV. L. REV. 1, 11 (2017) ("[T]he overall thrust since the Trump Administration came into office has been in a strongly deregulatory direction.").

2. *See* Roncevert Almond et al., *Regulatory Reform in the Trump Era—The First 100 Days*, 35 YALE J. ON REG. BULL. 29, 29 (2018) ("Within the first 100 days of his

weeks of taking office, President Trump issued his Executive Order on Reducing Regulation and Controlling Regulatory Costs (Executive Order), which provides, "Unless prohibited by law, whenever an executive department or agency . . . publicly proposes for notice and comment or otherwise promulgates a new regulation, it shall identify at least two existing regulations to be repealed."[3] Although some have questioned the legality of this Executive Order, the Trump Administration clearly has the power to advocate for the policy generally.[4]

In a certain regard, this policy of reducing the absolute number of regulations is laudable. The administrative state and the regulation associated with it have expanded massively since the first half of last century.[5] A reduced volume of regulation means that lawyers and society at large can be better versed in their legal obligations and potentially be

administration, President Donald J. Trump initiated a bold regulatory reform agenda intended to downsize the imprint and reduce the influence of the federal government."); Michael C. Blumm & Olivier Jamin, *The Trump Public Lands Revolution: Redefining "the Public" in Public Land Law*, 48 ENVTL. L. 311, 365 n.302 (2018) ("The President has claimed that deregulation is as important to the Trump agenda as tax cuts and claimed that the Administration blocked or delayed twenty-two rules for every new one issued.").

3. Exec. Order No. 13771, 82 Fed. Reg. 9339 (Feb. 3, 2017).

4. *See* Almond et al., *supra* note 2, at 49 ("On February 8, 2017, Public Citizen, Natural Resources Defense Council, and Communications Workers of America, filed a lawsuit in federal court claiming that Executive Order 13,771 and the accompanying Interim Guidance implementing the 2-for-1 Rule are unconstitutional because these actions direct federal agencies to engage in unlawful actions that will harm Americans, including plaintiff's members, in violation of the Take Care Clause."); Diana R.H. Winters, *Food Law at the Outset of the Trump Administration*, 65 UCLA L. REV. DISC. 28, 32–33 (2017) ("Soon after [Executive Order 13,771] was issued, several advocacy groups . . . filed suit . . . alleging that the EO violates separation of powers and the Take Care Clause of the U.S. Constitution, directs the heads of departments and agencies to take actions that exceed their authority, and violates the Administrative Procedure Act.").

5. *See* Thomas Merrill, *Presidential Administration and the Traditions of Administrative Law*, 115 COLUM. L. REV. 1953, 1957 (2015) ("The twentieth century witnessed the growth of the administrative state . . . . Administrative agencies became more numerous and were delegated large discretionary powers."); Peter E. Quint, *The Maryland Constitutional Law Schmooze: What Is a Twentieth-Century Constitution?*, 67 MD. L. REV. 238, 246 (2007) ("When the 'administrative state' began its impressive rise in the late-nineteenth and early-twentieth centuries, therefore, these developments in the United States basically relied on no explicit constitutional provisions, but rather on a proliferation of statutory solutions."); Jonathan Wood, *Standing up to the Regulatory State: Is Standing's Redressability Requirement an Obstacle to Challenging Regulations in an Over-Regulated World?*, 86 UMKC L. REV. 147, 148–49 (2017) ("The familiar story of the administrative state begins with the progressive movement in the late 19th century and the New Deal era in the early 20th century . . . . Today, administrative agencies wield broad power over nearly every aspect of our lives with minimal guidance from Congress how those powers should be used.").

less encumbered in their activities.[6] With that said, "thin regulation," as it will be termed, does have its downsides, including potential gaps in regulation, improper regulatory coverage, due process issues relating to notice, legitimacy concerns, and increased risk of market collapse relating to the regulated subject matter.[7]

To understand the problems with thin regulation, the best place to begin is with an emerging issue and explore how President Trump's policy of thin regulation interfaces with it. To that end, the recent advent and growing popularity of cryptocurrencies offer an excellent case study of the dangers of thin regulation. Although the United States Securities and Exchange Commission (SEC) has undertaken efforts to act in this area, the gaps that exist illustrate the problems with this regulatory approach.[8] Essentially, the SEC has tried to force cryptocurrencies into an existing regulatory structure that does not sufficiently mitigate the dangers that cryptocurrencies create.[9]

The remainder of this Essay is structured as follows. Part II provides a brief overview of cryptocurrencies and their regulation. Part III explores the harms and benefits of thin regulation. Finally, Part IV explains that the value of a thin regulatory approach is outweighed by the value of a well-reasoned, narrowly tailored one—which I will term "bespoke regulation."

II. A BRIEF OVERVIEW OF CRYPTOCURRENCIES AND THEIR REGULATION

To understand the benefits and harms of thin regulation, a few words ought to be said about the nature of cryptocurrencies and how they are currently regulated. The relatively recent creation of cryptocurrencies and the recent struggle to determine how to regulate them provide insight into how a thin regulatory approach functions and how it does not. To be clear, although the SEC has not explicitly adopted a thin regulatory approach, nor is it subject to President Trump's Executive Order, the SEC's approach of merely applying existing securities law

6. *See infra* Part III.A (discussing the benefits of thin regulation).

7. *See infra* Part III.B (discussing the harms of thin regulation).

8. Notably, although the Order discussed above does not cover the SEC, one would expect that the SEC would be making similar efforts to deregulate through ratcheting back existing regulation and reducing enforcement. Donald Trump nominated the current SEC Chairman, Jay Clayton, on January 20, 2017, the day that Trump was inaugurated president. *Biography: Chairman Jay Clayton,* U.S. SEC. & EXCHANGE COMMISSION, https://www.sec.gov/biography/jay-clayton (last visited Feb. 2, 2019).

9. *See* Jay Clayton, *Statement on Cryptocurrencies and Initial Coin Offerings*, U.S. SEC. & EXCHANGE COMMISSION (Dec. 11, 2017). https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11 (providing a summary of the SEC's views on the application of federal securities regulation to cryptocurrencies).

without adopting any new regulation is a thin regulatory approach because it creates no new regulation by merely repurposing an old regulatory scheme.

A. The Rise of Cryptocurrencies

A cryptocurrency is a virtual currency that is designed to be a medium of exchange.[10] Cryptocurrencies are not issued by a centralized authority or policed by a centralized regulator.[11] Cryptography is used to control generation of new units of the cryptocurrency and to verify transactions made in the cryptocurrency as well.[12] Crytocurrencies exist based upon decentralized ledger and blockchain technology that records transactions across a network of computers that typically number in the thousands.[13] Units of cryptocurrencies are commonly referred to as coins or tokens.[14]

10. *See* Jeffrey E. Alberts & Bertrand Fry, *Is Bitcoin a Security?*, 21 B.U. J. SCI. & TECH. L. 1, 1 n.1 (2015) ("The term 'cryptocurrency' refers to a digital currency that relies on the principles of cryptography to process and validate transfers."); Deidre A. Liedel, *The Taxation of Bitcoin: How the IRS Views Cryptocurrencies*, 66 DRAKE L. REV. 107, 109 (2018) ("In layman's terms, cryptocurrency is a pseudonymous digital payment system.").

11. *See* Mark Edwin Burge, *Apple Pay, Bitcoin, and Consumers: The ABCs of Future Public Payments Law*, 67 HASTINGS L.J. 1493, 1495 (2016) ("Cryptocurrencies like Bitcoin seek to use digital tokens that not only displace cash, but also displace the role of banks and other financial institutions whose systems were once thought indispensable to noncash transactions."); Jeremy Kidd, *FinTech: Antidote to Rent-Seeking?*, 93 CHI.-KENT L. REV. 165, 165 n.4 (2017) ("Cryptocurrencies are defined by their virtual-only existence and lack of a central repository, limiting the ability of governments to control their use and movement.").

12. *See* Sarah Jane Hughes & Stephen T. Middlebrook, *Advancing a Framework for Regulating Cryptocurrency Payments Intermediaries*, 32 YALE J. REG. 495, 504–05 (2015) ("A subset of virtual currency is 'cryptocurrency,' by which we mean an internet-based virtual currency in which the ownership of a particular unit of value is validated using cryptography. Cryptocurrencies are not legal tender and, thus, their use requires the consent of both parties to a transaction. They are not denominated in or backed by gold or silver. Economists call currencies backed by precious metals and the like 'commodity-based currencies.'"); Katie Szilagyi, *A Bundle of Blockchains? Digitally Disrupting Property Law*, 48 CUMB. L. REV. 9, 12 n.16 (2018) ("Cryptocurrencies can broadly be defined as online digital cash systems that rely on advanced cryptography techniques, including digital signatures and hash algorithms, both to ensure that transactions are carried out securely, and to create additional units of the currency itself.").

13. *See* Michèle Finck, *Blockchains: Regulating the Unknown*, 19 GERMAN L.J. 665, 668 (2018) ("Blockchain allows for value—including cryptocurrencies—to be traded between two parties without the involvement or approval of any other party."); Wulf A. Kaal & Craig Calcaterra, *Crypto Transaction Dispute Resolution*, 73 BUS. LAW. 109, 111 (2017) ("A cryptocurrency is a digital store of value, distributed anonymously across thousands of computers anywhere on the planet.").

14. *See* Sarah-Jane Morin, *Tax Aspects of Cryptocurrency with a Focus on the Tax Aspects of Initial Coin Offerings*, 32 PRAC. TAX LAW. 12, 16 (2018) ("The types of tokens

The first offering of a cryptocurrency is typically referred to as an initial coin offering (ICO).[15]

The history of cryptocurrencies is relatively brief and spans only a few decades. Many unsuccessful attempts were made to develop cryptocurrencies, and finally, in 2009, an anonymous programmer or group of programmers operating under the name Satoshi Nakamoto released Bitcoin.[16] Bitcoin has gained considerable popularity since it was introduced.[17] As a result, numerous other cryptocurrencies have appeared.[18] Regulators have struggled with how to regulate

generally vary from utility tokens (which provide the holder with access to a bespoke blockchain platform including products or services) to security tokens, which are generally more akin in substance to equity or debt instruments.").

15. *See* Sami Ahmed, *Cryptocurrency & Robots: How to Tax and Pay Tax on Them*, 69 S.C. L. REV. 697, 703 (2018) ("ICOs (initial coin offerings) refer to the first release of a new cryptocurrency that raises money through the use of crowdfunding."); Joan MacLeod Heminway, *Professional Responsibility in an Age of Alternative Entities, Alternative Finance, and Alternative Facts*, 19 TRANSACTIONS: TENN. J. BUS. L. 227, 241 (2017) ("Initial coin offerings involve the offer and sale of virtual assets—digital tokens or coins that act as mediums of exchange in commerce.").

16. *See* Shawn Bayern, *Of Bitcoins, Independently Wealthy Software, and the Zero-Member LLC*, 108 NW. U. L. REV. 1485, 1488 (2014) ("Bitcoin was developed between 2007 and 2009 by a programmer called Satoshi Nakamoto, though there is consensus that that was a pseudonym."); Asress Adimi Gikay, *Regulating Decentralized Cryptocurrencies Under Payment Services Law: Lessons from the European Unio*n, 9 CASE W. RES. J.L. TECH. & INTERNET 1, 4 (2018) ("The most dominant cryptocurrency that laid the ground for all cryptocurrencies is bitcoin, which was created by a person or a group identified pseudonymously as Satoshi Nakamoto."); Scott D. Hughes, *Cryptocurrency Regulations and Enforcement in the U.S.,* 45 W. ST. L. REV. 1, 3 (2017) ("After 20 years of failed attempts at making a private virtual currency, Bitcoin emerged.").

17. *See* Arthur J. Cockfield, *Big Data and Tax Haven Secrecy*, 18 FLA. TAX REV. 483, 524 (2016) ("The current most popular so-called cryptocurrency, a form of digital cash generated by the application of cryptography, is Bitcoin."); Edmund Mokhtarian & Alexander Lindgren, *Rise of the Crypto Hedge Fund: Operational Issues and Best Practices for an Emergent Investment Industry*, 23 STAN. J.L. BUS. & FIN. 112, 115 (2018) ("Over the last several years, few financial assets have generated returns comparable to those of cryptocurrencies. For example, Bitcoin, the largest cryptocurrency by market capitalization, has risen over 500,000,000% in value between its creation in January 2009 and January 2018, and 4,328% between December 2014 and December 2017."); Kevin V. Tu, *Perfecting Bitcoin*, 52 GA. L. REV. 505, 510 (2018) ("Since the first Bitcoin transaction in 2009, it has transcended obscurity and penetrated the public consciousness. Pop culture mentions of Bitcoin include cameos in the movie *Horrible Bosses 2* and an episode of *The Simpsons*, along with tweets by Snoop Dogg and Ashton Kutcher.").

18. *See* Ahmed, *supra* note 15, at 703 ("As of January 7, 2018, there were 1,384 different cryptocurrencies. They utilize a number of different blockchain networks as the technology framework that they employ. Some of the most common ones are Bitcoin, Ethereum, Bitcoin Cash, Ripple, and Litecoin."); Larissa Lee, *New Kids on the Blockchain: How Bitcoin's Technology Could Reinvent the Stock Marke*t, 12 HASTINGS BUS. L.J. 81, 82 (2016) ("Bitcoin has garnered much attention, ... Hundreds of other digital currencies . . .

cryptocurrencies.[19] The SEC, under the leadership of Jay Clayton, has decided to take a leading role in the regulation of cryptocurrencies using federal securities law.[20]

B. Cryptocurrencies and Federal Securities Regulation

Securities transactions involving cryptocurrencies are regulated by federal securities law in three main instances. First, a transaction in securities is covered by federal securities law if payment is made in a cryptocurrency, regardless of whether the cryptocurrency happens to be a security itself. For example, in *SEC v. Shavers*,[21] the United States District Court for the Eastern District of Texas held that an allegedly fraudulent investment scheme was covered by federal securities regulation, even though payments to invest in the scheme were made entirely in a cryptocurrency.[22] In that case, the SEC accused Trendon Shavers of using fraudulent misrepresentations to get investors to purchase interests in an investment scheme.[23] In determining that the interests were securities under federal securities law, the court held that it was irrelevant that the purchase of the interests was made in Bitcoin,

have since popped up and it is still unclear what effect these will have on the global economy."); Ors Penzes, *Cryptocurrencies: The New Species*, 42 NOVA L. REV. 417, 417–18 (2018) ("The sphere of cryptocurrencies is a new and unique one that represents a potentially huge volume of future trade, investment, and other revolutionary fiscal applications. Currently, the most widely known is Bitcoin, but there are other serious players in the game such as Ethereum, NEO, and Ripple, to name just a few.").

19. *See* Stephen T. Middlebrook & Sarah Jane Hughes, *Regulating Cryptocurrencies in the United States: Current Issues and Future Directions*, 40 WM. MITCHELL L. REV. 813, 814 (2014) ("Since virtual currencies first came into the marketplace in the 1990s, those responsible for monetary policy, federal anti-money-laundering and economic sanctions programs, along with federal and state consumer protection regulators, payment systems operators, businesses, and consumers have grappled with understanding how these 'currencies' work, whether they should be deemed 'lawful' payment methods in the United States, and, if so, the manner and extent to which they should be regulated."); Seth C. Oranburg, *Hyperfunding: Regulating Financial Innovations*, 89 U. COLO. L. REV. 1033, 1035 (2018) ("We are entering an era when innovation outpaces regulation . . . . Public watchdogs and legislatures lack the capacity to keep up with emerging FinTech like blockchain and cryptocurrency."); Lawrence J. Trautman & Alvin C. Harrell, *Bitcoin Versus Regulated Payment Systems: What Gives?*, 38 CARDOZO L. REV. 1041, 1097 (2017) ("Bitcoin and other virtual currencies present a particularly difficult and unique jurisdictional challenge to existing regulatory and enforcement agencies because of their ability to transcend national borders in a fraction of a second, and their anonymity due to encryption.").

20. *See* Clayton, *supra* note 9.

21. No. 4:13-CV-416, 2013 U.S. Dist. LEXIS 110018 (E.D. Tex. Aug. 6, 2013).

22. *Id.* at *6.

23. *Id.* at *3–4.

a cryptocurrency.[24] Writing for the court, United States Magistrate Judge Amos Mazzant stated, "[Bitcoin can] be exchanged for conventional currencies, such as the U.S. dollar, Euro, Yen, and Yuan. Therefore, Bitcoin is a currency or form of money, and investors wishing to invest . . . provided an investment of money."[25] As a consequence, if a securities transaction is conducted using a cryptocurrency, even if that cryptocurrency is not a security itself, it will be covered by federal securities law.

Second, if an investment, which involves some sort of activity relating to a cryptocurrency, qualifies as a security under the definition of security found in the Securities Act of 1933 (Securities Act)[26] and the Securities Exchange Act of 1934 (Exchange Act)[27] that investment will be covered by federal securities regulation, regardless of whether the underlying cryptocurrency is a security itself. For example, in September 2018, the SEC charged a hedge fund manager—Crypto Asset Management, LP—and its sole principal—Timothy Enneking—with alleged registration failures and misrepresentations relating to a fund that operated as an unregistered investment company while falsely marketing it as the "first regulated crypto asset fund in the United States."[28] The violations alleged by the SEC of section 5(a) of the Securities Act;[29] section 7(a) of the Investment Company Act;[30] section 17(a)(2) of the Securities Act;[31] and section 206(4) of the Investment Advisers Act of 1940[32] and Rule 206(4)-8[33] thereunder were in no way dependent on the fund holding crypto assets.[34] Although the securities involved related to cryptocurrencies, the federal securities law would have applied regardless of the subject matter in which the investment company was investing.[35] As a result, even if a cryptocurrency is not a

24. *Id.* at *4–5.

25. *Id.* at *5.

26. 15 U.S.C. §§ 77a to 77aa (2018).

27. 15 U.S.C. §§ 78a to 78qq (2018).

28. Crypto Asset Mgmt., LP, Securities Act Release No. 10544, Exchange Act Release No. 5004, Investment Company Act Release No. 33222, 2018 WL 4329663, at *3 (Sept. 11, 2018).

29. 15 U.S.C. § 77e (2018).

30. 15 U.S.C. § 80a-7 (2018).

31. 15 U.S.C. § 77q (2018).

32. 15 U.S.C. § 80b-6 (2018).

33. 17 C.F.R. § 275.206(4)-(8) (2018).

34. Crypto Asset Mgmt., LP, Securities Act Release No. 10544, Exchange Act Release No. 5004, Investment Company Act Release No. 33222, 2018 WL 4329663, at *3 (Sept. 11, 2018).

35. *Id.*

security, federal securities law will still apply if a security is involved that relates to a cryptocurrency, such as its development, investment, or trading.

Third, federal securities regulation will apply to transactions involving a cryptocurrency, if the cryptocurrency itself is a security. The Securities Act and Exchange Act both provide definitions of a security. Section 2(a)(1) of the Securities Act[36] provides the following:

> The term "security" means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.[37]

Section 3(a)(10) of the Exchange Act[38] provides the following:

> The term "security" means any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of

36. 15 U.S.C. § 77b(a)(1) (2018).

37. *Id.*

38. 15 U.S.C. § 78c(a)(10) (2018).

> not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.[39]

Despite the variation in the language of these provisions, they have been held to be equivalent, and any variation is not important for the purposes of this Essay.[40] The definitions include terms with well-settled meanings, such as note, stock, and bond. They also include terms that are more descriptive and broad enough to catch a wider range of investments. These terms include investment contract, transferrable share, and "in general, any interest or instrument commonly known as a 'security.'"[41]

If a cryptocurrency is determined to be a security, such a determination will likely be based on the characteristics of that cryptocurrency meeting the test for an investment contract. The term "investment contract" is not defined in the Securities Act or Exchange Act, and as a result, the Supreme Court of the United States in *SEC v. W.J. Howey Co.*[42] adopted the commonly used definition of that term.[43] In that case, writing for the majority, Justice Frank Murphy stated, "The test [for an investment contract] is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."[44] This test can be broken down into three questions. First, is there an investment of money? Second, is there a common enterprise? Third, is there an expectation of profits to come solely from the efforts of others? If all three of these questions are answered affirmatively, an investment contract exists, and with very limited exception, federal securities law applies.[45]

The SEC has concluded that some cryptocurrencies can be securities. In July 2017, the SEC issued a report based upon potential securities violations that the SEC decided not to pursue related to The DAO, an

39. *Id.*

40. *See* Landreth Timber Co. v. Landreth, 471 U.S. 681, 686 n.1 (1985) (holding that the Supreme Court has "repeatedly ruled that the definitions of 'security' in § 3(a)(10) of the 1934 Act and § 2(1) of the 1933 Act are virtually identical and will be treated as such in the [Supreme Court's] decisions dealing with the scope of the term"); MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW 11 (5th ed. 2009) (reporting that courts have consistently interpreted the definition of a security contained within § 2(a)(1) of the Securities Act and § 3(a)(10) of the Exchange Act "in an identical manner").

41. 15 U.S.C. §§ 77b(a)(1), 78c(a)(10).

42. 328 U.S. 293 (1946).

43. *Id.* at 301.

44. *Id.*

45. *Id.*

unincorporated organization.[46] The DAO was a decentralized autonomous organization, which is a "virtual" organization that exists via computer code and distributed ledger and blockchain technology. The DAO was designed to operate as a for-profit entity that would fund various "projects" using various assets obtained through the sale of DAO Tokens to investors. Holders of the tokens would share in the profits of The DAO's projects, and online platforms were to be used to create secondary trading in DAO Tokens for investors who wished to purchase or sell the tokens. Before any projects could be funded, a hacker stole roughly one third of The DAO's assets.[47] Applying the *Howey* test, the SEC determined that The DAO Tokens, a type of cryptocurrency, were securities for purposes of federal securities law.[48] This is because investors invested money to purchase The DAO Tokens in a common enterprise, The DAO, with an expectation of profit, i.e. the profits from The DAO projects.[49] The SEC's report does provide that not all cryptocurrencies are securities. The report states, "Whether or not a particular transaction involves the offer and sale of a security—regardless of the terminology used—will depend on the facts and circumstances, including the economic realities of the transaction."[50] However, the SEC failed to offer a bright line test as to which cryptocurrencies fall within the scope of federal securities law as securities and which cryptocurrencies do not.[51]

The SEC has struggled to provide additional guidance as to when cryptocurrencies are securities. On June 14, 2018, during a speech at the Yahoo Finance All Markets Summit: Crypto Conference, William Hinman, Director of the SEC's Division of Corporate Finance, did offer additional insight.[52] In determining whether a cryptocurrency is a security for purposes of federal securities regulation, he stated that the primary consideration is whether a third party drives the expectation of

46. Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934, Exchange Act Release No. 81207, 2017 WL 7184670 (July 25, 2017).

47. *Id.* at *1.

48. *Id.* at *8.

49. *Id.* at *8–10.

50. *Id.* at *14.

51. *See id.* Notably, at least one court has adopted the SEC's analysis that cryptocurrencies can be securities for purposes of federal securities law. *See* United States v. Zaslavskiy, No. 17CR647(RJD), 2018 U.S. Dist. LEXIS 156574, at *22 (E.D.N.Y. 2018).

52. *See* William Hinman, Dir., Div. of Corp. Fin., Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018), http://www.sec.gov/news/speech/speech-hinman-061418.

return.[53] To make this factual determination, he suggested a non-exhaustive list of questions:

> 1. Is there a person or group that has sponsored or promoted the creation and sale of the digital asset, the efforts of whom play a significant role in the development and maintenance of the asset and its potential increase in value?
>
> 2. Has this person or group retained a stake or other interest in the digital asset such that it would be motivated to expend efforts to cause an increase in value in the digital asset? Would purchasers reasonably believe such efforts will be undertaken and may result in a return on their investment in the digital asset?
>
> 3. Has the promoter raised an amount of funds in excess of what may be needed to establish a functional network, and, if so, has it indicated how those funds may be used to support the value of the tokens or to increase the value of the enterprise? Does the promoter continue to expend funds from proceeds or operations to enhance the functionality and/or value of the system within which the tokens operate?
>
> 4. Are purchasers "investing," that is seeking a return? In that regard, is the instrument marketed and sold to the general public instead of to potential users of the network for a price that reasonably correlates with the market value of the good or service in the network?
>
> 5. Does application of the Securities Act protections make sense? Is there a person or entity others are relying on that plays a key role in the profit-making of the enterprise such that disclosure of their activities and plans would be important to investors? Do informational asymmetries exist between the promoters and potential purchasers/investors in the digital asset?
>
> 6. Do persons or entities other than the promoter exercise governance rights or meaningful influence?[54]

Hinman also stated that, in determining whether the economic reality dictates that a cryptocurrency is a security for purposes of federal securities law, the SEC would focus on questions such as the following:

> 1. Is token creation commensurate with meeting the needs of users or, rather, with feeding speculation?

53. *Id.*

54. *Id.*

> 2. Are independent actors setting the price or is the promoter supporting the secondary market for the asset or otherwise influencing trading?
>
> 3. Is it clear that the primary motivation for purchasing the digital asset is for personal use or consumption, as compared to investment? Have purchasers made representations as to their consumptive, as opposed to their investment, intent? Are the tokens available in increments that correlate with a consumptive versus investment intent?
>
> 4. Are the tokens distributed in ways to meet users' needs? For example, can the tokens be held or transferred only in amounts that correspond to a purchaser's expected use? Are there built-in incentives that compel using the tokens promptly on the network, such as having the tokens degrade in value over time, or can the tokens be held for extended periods for investment?
>
> 5. Is the asset marketed and distributed to potential users or the general public?
>
> 6. Are the assets dispersed across a diverse user base or concentrated in the hands of a few that can exert influence over the application?
>
> 7. Is the application fully functioning or in early stages of development?[55]

Even though Director Hinman's insight does provide some additional guidance in regard to whether a cryptocurrency is a security for purposes of federal securities law, two things become apparent. First, determining whether a cryptocurrency is a security is a complex task that may not always have a clear answer until the SEC and the courts have a chance to speak on the particular matter. Second, because certain cryptocurrencies are not securities and may not otherwise be involved in securities transactions, the SEC's ability to regulate cryptocurrencies extends to some, but not all, cryptocurrencies.

III. THE BENEFITS AND HARMS OF THIN REGULATION

For purposes of this Essay, "thin regulation" is being used to designate reducing the absolute number of regulations for purposes of deregulation. This is the avowed regulatory approach of the Trump Administration as evidenced by the Executive Order, which was signed within two weeks of

55. *Id.*

President Trump taking office.[56] Cryptocurrencies provide a useful case study of thin regulation because of the relative newness of these digital assets and the attempts by the SEC to regulate them.[57] Although the SEC has not announced a policy of thin regulation, nor is it subject to President Trump's Executive Order, the SEC's attempt to repurpose existing regulation without promulgating new regulation is an example of a thin regulatory approach. As a consequence, the SEC's treatment of cryptocurrencies provides great insight into the benefits and harms of thin regulation.

A. The Benefits

Although this Essay ultimately concludes that the harms outweigh the benefits of thin regulation, this section begins by discussing the case in favor of thin regulation before laying out the case against it. The benefits include (1) reducing regulatory complexity, (2) harnessing the benefits of existing regulation, and (3) enabling beneficial deregulation.

1. Reducing Regulatory Complexity

Reducing the absolute number of regulations means that lawyers and society in general can better understand their legal obligations and, potentially, be less constrained in their activities. The burgeoning of the administrative state during the twentieth century has given birth to a massive amount of new regulation.[58] If a new legal issue can be subsumed within existing regulation or not regulated at all through a thin regulatory approach, adding to the massive body of federal regulation can be avoided.

In regard to cryptocurrencies, applying federal securities regulation to govern these digital assets does have its virtues because a new body of regulation does not have to be created to govern them. If a single body of regulation can be used broadly, lawyers and the rest of society can be better versed in that single body of law because they have only one body of regulation to learn and understand, rather than two. This seems to be the approach that the SEC is taking by applying existing federal securities law.[59]

56. *See supra* note 3 and accompanying text.

57. *See supra* Part II (providing a brief history of cryptocurrencies and their regulation).

58. *See supra* note 5 and accompanying text (discussing the dramatic growth of the administrative state and the regulation associated with it since the beginning of the twentieth century).

59. *See supra* Part II.B (exploring the regulation of cryptocurrencies).

2. Harnessing the Benefits of Existing Regulation

A thin regulatory approach also forces regulators to harness the power of existing regulation. Often, when a particular news story or a specific situation creates concern in a significant segment of society, regulators attempt to enact new regulation to demonstrate that they are addressing the issue, even if regulation existing at the time might be employed instead. As a consequence, redundant and extraneous regulation is promulgated. This generates the concern mentioned in the subpart above regarding the creation of additional regulatory complexity, especially because the new provision is redundant based on existing provisions. In addition, promulgating these duplicative provisions represents a missed opportunity. The passage of any new regulation creates questions and concerns about its interpretation and implementation that often have to be litigated to be resolved. If a thin regulatory approach is taken, and existing regulation is used, regulators can harness the power and relative clarity of existing provisions.

In regard to the regulation of cryptocurrencies, applying federal securities regulation has substantial merit because of the history and quality of that system of regulation. During the 1930s, Congress developed a system of federal securities regulation that helped to maintain the dominance of the United States capital markets throughout much of the twentieth century, and that has been fine-tuned and perfected throughout the intervening decades by way of Congressional enactments, extensive litigation, and substantial regulatory pronouncements by the SEC.[60] Applying this body of law to cryptocurrencies is attractive because of the high-quality system of securities law in the United States. This can be done relatively easily based on the three ways that cryptocurrencies can interface with federal securities law that were discussed in the last Part.[61] However, as will be discussed below, the marriage between the regulation of cryptocurrencies

60. *See* Kun Young Chang, *Reforming U.S. Disclosure Rules in Global Securities Markets*, 22 ANN. REV. BANKING & FIN. L. 237, 257 (2003) (asserting that the United States is "the worldwide leader in the field of securities regulations"); George W. Madison & Stewart P. Greene, *TIAA-CREF Response to a Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 99, 100 (2007) ("The SEC performs its task admirably—and sets the standard against which all other regulators around the globe are judged . . . . The SEC, with its track record and high standards for protecting investors, has historically been a leader in setting benchmarks for market regulation.").

61. *See supra* Part II.B (explaining that federal securities laws can be applied to cryptocurrencies in regard to securities transactions in which cryptocurrencies are used for payment, securities transactions in which activity underlying the securities relates to cryptocurrencies, and securities transactions in which the cryptocurrencies are securities themselves).

and the regulation of securities in the United States is not a perfect one because some cryptocurrencies do not fall within the purview of federal securities regulation.[62]

3. Enabling Beneficial Deregulation

A thin regulatory approach can also be beneficial because it facilitates deregulation. A complete discussion of the merits and harms of deregulation is beyond the scope of this Essay because they tend to vary significantly based on the area of the law and the subject matter being regulated. With that said, one major benefit of deregulation has already been mentioned, that is, reducing regulatory complexity. In addition, deregulation allows individuals and entities to potentially be less constrained in their activities, which arguably fuels competition, innovation, and economic growth.[63] Moreover, the United States Constitution was designed to create a limited federal government with significant liberty being afforded to citizens.[64]

Whether thin regulation has actually facilitated deregulation in regard to cryptocurrencies is a difficult question. The SEC has not promulgated formal regulations governing cryptocurrencies, but it has suggested that cryptocurrencies are covered by federal securities law in a number of ways. Whether applying federal securities law to cryptocurrency constitutes deregulation is hard to answer because the question becomes how cryptocurrencies would have been regulated if the SEC had not decided to take a leading role in regulating these digital assets. Cryptocurrencies could have been regulated relatively lightly, or Congress or some other regulator could have enacted a very draconian regulatory scheme. Regardless, thin regulation in many instances may yield beneficial deregulation that is helpful to society.

62. *See infra* Part III.B(1) (discussing that a regulatory gap exists in using federal securities regulation to regulate cryptocurrencies in regard to instances in which a cryptocurrency is not a security and securities are not otherwise involved).

63. *See* Steven A. Ramirez, *Diversity and Ethics: Toward an Objective Business Compliance Function*, 49 LOY. U. CHI. L.J. 581, 589 (2018) ("The Trump administration posits that deregulation will lead to greater economic growth.").

64. *See* Arthur H. Garrison, *NYPD Stop and Frisk, Perceptions of Criminals, Race and the Meaning of* Terry v. Ohio*: A Content Analysis of* Floyd et al. v. City of New York, 15 RUTGERS RACE & L. REV. 65, 150 (2014) ("The constitution established a government, a limited government, with limited powers. That is what makes the American republic a reality."); Christo Lassiter, *The New Race Cases and the Politics of Public Policy*, 12 J.L. & POL. 411, 445 (1996) ("The drafters framed a constitution which positioned a limited federal government to address . . . public problems of a new republic, and, being fearful of tyranny, they restrained the federal government from doing more."); David Luban, *The Conscience of a Prosecutor*, 45 VAL. U. L. REV. 1, 22 (2010) ("[T]he United States also has a constitution built on principles of limited government and individual rights.").

B. The Harms

Although significant benefits do exist to thin regulation, the harms of this approach outweigh them. This is especially true because, as will be discussed in the next Part, a different approach, bespoke regulation, provides a better means of achieving deregulatory goals. The harms of thin regulation include (1) potentially creating regulatory gaps, (2) generating overregulation, (3) incentivizing unintended regulatory coverage, (4) producing due process concerns, (5) imperiling the legitimacy of regulation, and (6) increasing the risk of market collapse relating to the regulated subject matter.

1. Creating Regulatory Gaps

A thin regulatory approach, unsurprisingly, is going to create regulatory gaps. Such an approach will encourage regulators to do more with less in terms of their regulatory agendas. In addition, it will encourage regulators to be judicious in terms of the issues they attempt to regulate. As a consequence, limiting the absolute number of regulations will create circumstances in which regulators either unintentionally miss issues that deserve regulatory attention or choose not to regulate such issues to meet the policy of thin regulation to which they have chosen to adhere.

Allowing the SEC to take the principal role in regulating cryptocurrencies has created a gap in regulation in which certain cryptocurrencies are not subject to federal securities regulation. The SEC under the leadership of Chairman Jay Clayton has strongly committed to regulating such digital assets.[65] The Trump Administration's commitment to thin regulation coupled with a Republican-led Congress has resulted in no specific regulatory scheme being developed to regulate cryptocurrencies. As discussed above, many securities transactions involving cryptocurrencies fall within the ambit of federal securities law, such as, securities transactions in which cryptocurrencies are used for payment, securities transactions in which activity underlying the securities relate to cryptocurrencies, and securities transactions in which the cryptocurrencies are securities themselves.[66] Still, instances exist in which securities law will not apply to cryptocurrencies at all. For example, securities law will not apply in instances where a cryptocurrency is not a security and securities are not otherwise involved. Other laws and regulations may help to fill these regulation gaps, but

65. *See supra* note 9 and accompanying text.

66. *See supra* Part II.B (discussing when cryptocurrencies fall within the ambit of federal securities regulation).

they still exist. With thin regulation, invariably, you run the risk of gaps in regulatory schemes and under regulation in general.

2. Generating Overregulation

In addition to creating the risk of under regulation, thin regulation also creates the risk of overregulation as well. This can occur in two ways. First, a regulator with a thin regulatory mandate or mindset might choose a blanket, catchall regulation, rather than a nuanced regulatory scheme to address a particular issue. This is because a blanket, catchall regulation would be counted as one regulation, while a nuanced regulatory scheme would likely be counted as multiple regulations and not meet the requirements of a thin regulatory approach. Second, to keep from adding to the absolute number of regulations, a regulator with a thin regulatory mandate or mindset might apply an overly harsh regulatory scheme, rather than enacting a new regulation or scheme of regulation to address a particular issue.

In regard to the regulation of cryptocurrencies, the first risk of overregulation—a regulator adopting a blanket, catchall regulation, rather than a more appropriate, nuanced regulatory scheme—is not an issue. Questions do exist in regard to the second risk of overregulation—namely, applying an overly harsh regulatory scheme. The SEC has fully and eagerly embraced regulating cryptocurrencies.[67] Questions linger, however, as to whether federal securities regulation is the right regulatory scheme for regulating these digital assets. This Essay does not take a strong position on this issue. One could make the case relatively easily, however, that cryptocurrencies are an exciting and new innovation and that the federal securities law is simply too draconian to allow for the full exploration of cryptocurrency's potential. Even if federal securities regulation is the best scheme for cryptocurrencies, one can imagine other instances in which applying existing regulatory schemes under a thin regulatory approach is simply not a proper solution for particular issues needing regulation.

3. Incentivizing Unintended Regulatory Coverage

A thin regulatory approach also incentivizes regulators to employ existing regulations in unintended ways. Such an approach provides a mandate for regulators to do more with less. As a consequence, when a new issue emerges, regulators have incentive to use existing regulation, rather than increasing the absolute number of regulations. In some instances, existing regulation will be used in ways that it was never intended to be used. This creates substantial concerns that the

67. *See supra* note 9 and accompanying text.

authorized legislative functions of certain regulators will be usurped in the attempt to further a thin regulatory agenda.

Cryptocurrencies, once again, provide an excellent example of this phenomenon. Congress promulgated federal securities regulation in the shadow of the Great Depression in large part to ensure the stability of the United States securities markets and allow businesses to obtain capital for purposes of economic growth and development.[68] The development of the internet during the second half of the twentieth century created numerous questions regarding how securities regulation should apply, and in many instances, regulators have already been able to adapt securities law to cyberspace.[69] When it comes to new financial products, however, the applicability of federal securities law is far less clear because these products have departed substantially from what Congress intended to regulate when it promulgated the Securities Act and the Exchange Act. Incentivizing regulators to adopt existing systems of regulation without substantial reflection or any rulemaking creates concerns that the regulatory intent of the original creators of the regulation is being ignored, and that the legislative function of the regulators who should be addressing the issue to act or refrain from acting is being appropriated.

4. Producing Due Process Concerns

A thin regulatory approach also creates due process concerns. The Fifth[70] and Fourteenth[71] Amendments to the United States Constitution each contain a due process clause that prevents the government from depriving individuals of "life, liberty, or property, without due process of

68. James D. Cox, *Choice of Law Rules for International Securities Transactions?*, 66 U. CIN. L. REV. 1179, 1187 (1998) ("The U.S. securities laws were enacted in the aftermath of the Great Depression and their history and content were much influenced by our experience and faith that fair and orderly markets are a cornerstone for not just economic stability, but social stability."); Lydie Nadia Cabrera Pierre-Louis, *Hedge Fund Fraud and the Public Good*, 15 FORDHAM J. CORP. & FIN. L. 21, 26 n.10 (2009) ("Congress established the SEC in 1934 to enforce the newly adopted 1933 Securities Act and the 1934 Exchange Act, to promote stability in the markets and, most importantly, to protect investors.").

69. *See* Olufunmilayo B. Arewa, *Securities Regulation of Private Offerings in the Cyberspace Era: Legal Translation, Advertising and Business Context*, 37 U. TOL. L. REV. 331, 331–32 (2006) ("What is often termed the cybersecurities era refers to the process by which securities regulation has been translated to changing technological and business practices in the last two decades, particularly since the advent of the Internet."); Michael L. Rustad, *Punitive Damages in Cyberspace: Where in the World Is the Consumer?*, 7 CHAP. L. REV. 39, 105 n.402 (2004) ("[T]he SEC has been active in extending federal securities law to the enforcement of predatory, anti-fraud and anti-competitive practices in cyberspace.").

70. U.S. CONST. amend. V.

71. U.S. CONST. amend. XIV.

law,"[72] and that applies to government action in civil and criminal matters.[73] Notice is a foundational aspect of due process in the United States.[74] A thin regulatory approach creates due process concerns in at least two ways. First, as previously discussed, a regulator with a thin regulatory mandate or disposition may opt to enact a blanket, catchall regulation, rather than increase the absolute number of regulations by enacting a nuanced regulatory scheme.[75] Under a thin regulatory approach, promulgating such a blanket, catchall regulation is very attractive because it likely results in a lower number of regulations, while reducing the chance of creating gaps in coverage of issues that need to be regulated. At the same time, such blanket, catchall regulations tend to be far less descriptive than nuanced regulatory schemes. As a result, due process concerns are created because individuals and entities may be less aware of what has been rendered unlawful. Second, a thin regulatory approach also creates concerns because it incentivizes regulators to adapt existing regulation.[76] When a regulator adapts an existing regulatory scheme for purposes of regulating an emerging regulatory issue, questions should always be raised regarding whether that particular scheme really was intended to address that emerging issue. If it was, then using that regulatory scheme is perfectly permissible. If it was not, the legislative function of that regulator is being usurped, and due process concerns exist regarding whether the public has received adequate notice of the behavior that has been rendered unlawful.

72. U.S. CONST. amend. XIV, § 1.

73. *See* U.S. CONST. amends. V, XIV.

74. *See* Niki Kuckes, *Civil Due Process, Criminal Due Process*, 25 YALE L. & POL'Y REV. 1, 2 (2006) ("If defining the substantive standards imposed by due process can seem challenging, procedural due process seems straightforward by comparison: a person may not constitutionally be deprived of 'life, liberty or property' by governmental action without notice and a meaningful opportunity to be heard."); Richard E. Levy, *The Tweet Hereafter: Social Media and the Free Speech Rights of Kansas Public University Employees*, 24 KAN. J.L. & PUB. POL'Y 78, 91 (2014) ("[D]ue process requires that people be given fair notice of what conduct is permitted and what is prohibited and that laws contain standards that protect against arbitrary and discriminatory enforcement."); Albert C. Lin, *Refining Fair Notice Doctrine: What Notice Is Required of Civil Regulations?*, 55 BAYLOR L. REV. 991, 992 (2003) (explaining that due process in the administrative law context "protects a regulated party from civil penalties or similar sanctions where it did not have fair notice of an agency's interpretation of a regulation.").

75. *See supra* Part III.B(2) (explaining that a thin regulatory approach may lead to overregulation because regulators are incentivized to adopt blanket, catchall provisions to avoid creating regulatory gaps).

76. *See supra* Part III.A(2) (explaining that a thin regulatory approach incentivizes regulators to adapt existing regulation, rather than promulgating new regulation).

In regard to the regulation of cryptocurrencies, due process concerns do exist. Obviously, this is not a situation in which a regulator has adopted a blanket, catchall regulation to meet thin regulatory goals. However, the SEC chose to take a leading role in regulating cryptocurrencies using federal securities law.[77] Arguably, this is perfectly permissible because the SEC is focused on instances in which cryptocurrencies fall within the purview of federal securities regulation, such as securities transactions in which cryptocurrencies are used for payment, securities transactions in which activity underlying the securities relate to cryptocurrencies, and securities transactions in which the cryptocurrencies are securities themselves.[78] Still, Congress promulgated securities regulation to stabilize the investment markets in the United States to give businesses a stable source of capital.[79] Applying this system of regulation to securities transactions where cryptocurrencies are used for payment and securities transactions where activity underlying the securities relate to cryptocurrencies seems like situations that are relatively easy applications to justify based on the intent of Congress. However, securities transactions in which the cryptocurrencies are securities themselves is more difficult. Congress obviously did not have cryptocurrencies in mind during the 1930s when it created the federal system of securities regulation. In addition, one can imagine a situation in which a regulator with a thin regulation mandate or disposition is even more aggressive with applying an existing system of regulation that is clearly not intended to apply to a given regulatory issue. In that type of situation, one would have a hard time arguing that those impacted by the activity being rendered unlawful were on notice of that unlawfulness without some sort of public pronouncement from the regulator.

77. *See supra* note 9 and accompanying text.

78. *See supra* Part II.B (exploring the three situations in which federal securities law applies to cryptocurrencies).

79. *See* Arthur R. Pinto, *The Nature of the Capital Markets Allows a Greater Role for the Government*, 55 BROOK. L. REV. 77, 77 (1989) ("[T]he securities laws were enacted during the New Deal to insure that our capital markets remain free from the abuses and fraud that Congress believed plagued both the sale and trading of securities."); Anthony Michael Sabino & Michael A. Sabino, *From* Chiarella *to* Cuban*: The Continuing Evolution of the Law of Insider Trading*, 16 FORDHAM J. CORP. & FIN. L. 673, 683 (2011) ("Viewed as one great edifice, our federal securities laws have proven to be a durable and effective means of assuring the sanctity of the American capital markets by imposing a discipline of transparency, disclosure, and honesty."); Elaine A. Welle, *Freedom of Contract and the Securities Laws: Opting out of Securities Regulation by Private Agreement*, 56 WASH. & LEE L. REV. 519, 568–69 (1999) ("Congress initially enacted the securities laws to restore investor confidence in the capital markets.").

5. Imperiling the Legitimacy of Regulation

A thin regulatory approach can also imperil the legitimacy of regulation. As discussed in the previous subpart, thin regulation can create due process concerns because of the limited notice that it provides regarding what is unlawful and what is legally permissible.[80] This is especially true if the regulator chooses to adopt a blanket, catchall regulation or if the regulator chooses to adapt an existing regulatory scheme to a new issue. One of the ways that a regulator may choose to deal with these concerns while remaining true to a thin regulatory mandate or disposition is by issuing informal regulatory guidance.[81] While this type of guidance can be useful, it does raise legitimacy concerns because it is usually made through the announcement of technocrats outside a formal process. As a consequence, individuals who are not democratically elected often provide this type of informal guidance, and such guidance can often be shielded from the input of the public.

The regulation of cryptocurrencies does create some of these concerns. As previously discussed, one of the circumstances in which a cryptocurrency can be regulated under federal securities law is if that cryptocurrency is a security.[82] If a cryptocurrency is going to be considered a security under federal securities law, such a conclusion will be reached because the cryptocurrency is a specific type of security, an investment contract. The definition of an "investment contract" is not found within the Securities Act and the Exchange Act, and consequently, the Supreme Court adopted a definition that has created uncertainty as to when a cryptocurrency will be considered a security. As a result, on June 14, 2018, during a speech at the Yahoo Finance All Markets Summit: Crypto Conference, William Hinman, Director of the SEC's Division of Corporate Finance, offered substantial guidance on when a cryptocurrency will be considered a security for purposes of the application of federal securities law.[83] While such a pronouncement is useful, it falls short of the Commissioners promulgating an official rule or even providing official guidance as to when a cryptocurrency is a security. One can imagine such informal guidance becoming much more

80. *See supra* Part III.B(4) (explaining the due process concerns created in some instances by the use of a thin regulatory approach).

81. *See supra* notes 52–55 (discussing informal guidance on when a cryptocurrency constitutes a security provided by William Hinman, Director of the SEC's Division of Corporate Finance, at the Yahoo Finance All Markets Summit: Crypto Conference).

82. *See supra* Part II.B (explaining when a cryptocurrency will be considered a security for purposes of federal securities law).

83. *See supra* notes 52–55 and accompanying text.

common when regulators have a thin regulatory mandate or disposition, which raises legitimacy concerns.

6. Increasing the Risk of Market Collapse

Finally, thin regulation is also harmful because it can lead to market collapse. When individuals lack confidence in a market, they will not invest in it, and even if they are willing to invest, they will not hold their investments for a long period of time. Because willingness to invest and willingness to hold investments are key to creating a stable market, this lack of confidence can lead to a market crash or the failure of the market completely.[84] Such was the case in regard to the stock market crash of 1929, which was only eventually cured, at least in part, by the adoption of federal securities law in the United States, which were designed, in part, to restore investor confidence.[85]

In regard to cryptocurrencies, the SEC is currently creating the perception that cryptocurrencies are regulated by the SEC under the Congressional mandates provided by the Securities Act and the Exchange Act. As discussed above, cryptocurrencies fall within the purview of federal securities law in regard to securities transactions in

84. *See* Brett Deforest Maxfield, *Ethics, Politics and Securities Law: How Unethical People Are Using Politics to Undermine the Integrity of Our Courts and Financial Markets*, 35 OHIO N. U. L. REV. 243, 274 (2009) ("What caused the Great Depression . . . in part was the lack of confidence of people in the integrity of the market after the crash. People were very slow to put faith in the stock market after the devastation caused by its crash."); Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193, 214–15 (2008) ("Panics can trigger market failures even outside the banking arena, however, such as when doubt arising over a market's future liquidity triggers a stampede to sell first while the market is still liquid, thereby inadvertently destroying the market's liquidity; or, as in the generic example of a systemic market meltdown, when contractual counterparties rush to try to close out their positions, causing prices to drop so sharply that one or more capital markets stop functioning (at least temporarily), which in turn leads to a vicious cycle in which investors lose confidence."); Omari Scott Simmons, *The Corporate Immune System: Governance from the Inside out*, 2013 U. ILL. L. REV. 1131, 1161 ("The [stock market] crash [of 1929] coincided with a crisis of confidence in the capital markets.").

85. *See* Jill Gross, *The Historical Basis of Securities Arbitration as an Investor Protection Mechanism*, 2016 J. DISP. RESOL. 171, 180 ("After the stock market crash of 1929 led to the Great Depression, a concerned Congress enacted the federal securities laws to restore investor confidence in and facilitate the healthy functioning of capital markets."); Robert A. Prentice, *The Inevitability of a Strong SEC*, 91 CORNELL L. REV. 775, 803 (2006) ("After the Great Crash of 1929, Congress attempted to restore investor confidence in the nation's markets. Its two primary tools, embodied in the Securities Act of 1933 and the Securities Exchange Act of 1934, were mandatory disclosure and punishment for fraudulent disclosures."); Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*, 58 BAYLOR L. REV. 139, 204 (2006) ("One of the fundamental purposes of securities regulation is to promote investor confidence and provide investor protection.").

which cryptocurrencies are used for payment, securities transactions in which activity underlying the securities relates to cryptocurrencies, and securities transactions in which the cryptocurrencies are securities themselves.[86] With that said, if the cryptocurrencies do not fall within one of those three categories, the SEC has no authorization to act.[87] Obviously, other provisions of federal and state law, such as the federal wire fraud statute,[88] protect individuals investing in cryptocurrencies.[89] Still, because of the approach being taken by the SEC, a risk is created that the public will lose confidence in cryptocurrencies in general and refuse to invest in them, based on concerns that many types of cryptocurrencies are not subject to the high-quality regulation of federal securities law. Whether such a failure is a good or bad thing is open to debate. However, cryptocurrencies are an interesting innovation, and it would be a shame to see them fail completely.

IV. THE PATH TOWARD BESPOKE REGULATION

Thin regulation has its benefits and drawbacks. On the positive side, this approach can reduce regulatory complexity, harness the benefits of existing regulation, and enable beneficial deregulation.[90] On the negative side, this approach can potentially create regulatory gaps, generate overregulation, incentivize unintended regulatory coverage, produce due process concerns, imperil the legitimacy of regulation, and increase the risk of market collapse relating to the regulated subject matter.[91] Based on this alone, the choice of whether thin regulation is a good or a bad thing turns on how important one views deregulation, which is an exceedingly complex question. Fortunately, a better approach exists.

For those interested in deregulation and perhaps for all those interested in creating better regulation generally, the approach that I propose—which I term "bespoke regulation"—has four main attributes.

86. *See supra* Part II.B (discussing the three situations in which the SEC has the power to regulate securities transactions involving cryptocurrencies).

87. *See supra* Part III.B(1) (explaining that a regulatory gap exists in using federal securities regulation to regulate cryptocurrencies in regard to instances in which a cryptocurrency is not a security and securities are not otherwise involved).

88. *See* 18 U.S.C. § 1343 (2018).

89. *Id.* ("Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined . . . or imprisoned not more than 20 years, or both.").

90. *See supra* Part III.A (discussing the benefits of thin regulation).

91. *See supra* Part III.B (discussing the harms of thin regulation).

First, regulation should be narrowly tailored to suit regulatory goals. Regulators must assess whether the regulation that they promulgate is properly drafted to regulate the intended behavior and only that content. In addition, they must completely amend, replace, or repeal regulation that is overly broad or extraneous. Second, regulators must eliminate redundant regulation. In considering whether to promulgate new regulation, regulators must consider whether comparable regulation already exists. If it does, regulators should issue official guidance that explains why and how the existing regulation will be applied. Third, regulators should engage in a cost-benefit analysis for each new piece of regulation and regularly engage in cost-benefit analyses of existing regulation to determine if the burden is worth the benefit of each piece of regulation. Fourth, regulators should assess how each proposed piece of regulation might function within other existing regulation, and regulators should regularly evaluate whether the regulatory system that they oversee is functioning correctly.

In contrast to thin regulation, bespoke regulation will help to ensure that regulation is better fitted to the issues being addressed and helps to avoid regulatory gaps and overregulation. Because regulators are charged with reflectively assessing regulation, rather than just simply mechanically reducing the number of regulations in existence, regulators are incentivized to be smart in regulatory decisions and to provide notice of what is lawful and unlawful, which lessens due process concerns. This transparency will help to increase the legitimacy of regulators adopting a bespoke regulation approach. When a market is being regulated under a bespoke regulatory approach, this should also help to increase market confidence because those investing in the market will have greater confidence that those regulating it are being thoughtful in their decisions.

Bespoke regulation obviously does have some drawbacks. First, this approach does not necessarily reduce regulatory complexity. In certain instances, it could lead to more complex regulatory schemes to meet regulatory goals in a thoughtful manner. With that said, not all beneficial deregulation involves simply repealing regulation. For example, in an effort to deregulate certain securities transactions and based on a mandate from Congress found in the Jumpstart Our Business Startups Act (JOBS Act),[92] the SEC recently adopted a complex regulatory scheme to exempt certain crowdfunded securities offerings from the registration requirements of federal securities law. One can argue about the merits of the choices made, but the expanded exemptions from federal securities

92. Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified as amended in scattered sections of 15 U.S.C.).

law does constitute deregulation, even though it did not reduce the absolute number of regulations. Although regulatory complexity is undesirable, it is necessary in certain instances. Remarkably, sometimes, it is necessary to achieve deregulatory goals.

Finally, for an elected official interested or wanting to convey an interest in deregulation or improving the efficiency of a regulatory system, a thin regulatory approach is much easier to convey to the public than a bespoke regulatory approach. In a word, thin regulation makes a good soundbite. In a democracy, elected officials are accountable to their constituents and part of that accountability is being transparent in terms of their policies and viewpoints. With that said, the ease of communicating a policy should not be valued over the quality of that policy. A thin regulatory approach is not necessarily mutually exclusive from a bespoke regulatory approach. President Trump's Executive Order or the related guidance could have stated an expectation of reducing the absolute number of regulations through a bespoke regulatory approach by regulators.[93] A bespoke regulatory approach could provide a mechanism for thoughtfully thinning existing regulation. Thin regulation alone puts a heavy burden on regulators that incentivizes hacking away at regulations without considering the implications of what they are cutting. A bespoke approach yields better results.

93. *See* Exec. Order No. 13771, *supra* note 3; *see also* Memorandum from Dominic J. Mancini, Acting Admin., Office of Info. & Regulatory Affairs, to Regulatory Policy Officers at Exec. Dep'ts & Agencies & Managing & Exec. Dirs. of Certain Agencies & Comm'ns, Guidance Implementing Executive Order 13371, Titled "Reducing Regulation and Controlling Regulatory Costs" (Apr. 5, 2017), https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/memoranda/2017/M-17-21-OMB.pdf.