

Blockchain and Law in Comparative Perspective

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OVERVIEW

- Digital asset market cap on 31 March 2022: \$2.144 trillion
- Total money spent on NFTs in 2021: \$25 billion
- Monthly investment into blockchain tech and apps: \$1.5 billion
- What kind of problems should be addressed with legislation/regulation and/or supervisory authorities?
- Blockchain is global, law is local. What does that mean?
- What is going to happen?

“BLOCKCHAIN” IS POTENTIALLY DISRUPTIVE TECHNOLOGY

- Disruptive innovation fundamentally changes the way consumers and businesses interact and operate.
- Disruptive technology replaces entire systems and existing structures.
- Example: electric automobiles
- Blockchain is potentially disruptive, changing the way we use the internet, and transact with each other.
- Blockchain transactions aim at **cutting out trusted intermediaries** like lawyers, commercial banks, central banks, securities- and commodities exchanges, etc.

WHY DO WE NEED REGULATORY OVERSIGHT?

- Blockchain-based transactions are increasingly being conducted in an open marketplace, peer-to-peer. Anyone with access to internet can participate.
- There are hundreds of thousands of sellers and millions of buyers of Blockchain services.
- The technology is poorly understood by most of them.
- Large amounts of money are being transacted.
- Traditional, long-standing, and sophisticated oversight of financial service providers is easily circumvented.
- The potential for fraud, tax evasion, money laundering, crime- and terrorism funding, etc. is significant.

WHAT KIND OF REGULATORY OVERSIGHT DO WE NEED?

- Blockchain applications are complicated and development is time consuming and expensive.
- Developers of the technology, developers of business applications, and investors supporting the developers, need **a predictable legal environment** to commit time and money.
- Regulatory guidance should provide reliable information what will be allowed, and on what conditions, in the foreseeable future.

FIRST OF THREE QUESTIONS

- 1) What would be the ideal regulatory environment for Blockchain and DLT technology that encourages the development of legitimate use cases of the technology while providing a high level of protection for investors, developers, users, consumers, tax collectors, public security, and the environment?

IDEALLY...

- Internet and Blockchain technology are **global and not subject to national borders**.
- Restrictive regulations in one country can be circumvented by moving operations to other countries.
- At the same time, companies complying with high quality protections in one country should be able to operate in other countries (passport system).

⇒ Regulation should be global.

Option 1: Common standards in int'l treaties and conventions

Option 2: Mutual recognition of high quality national standards

SECOND OF THREE QUESTIONS

2) As long we don't have a widely recognized and applied global convention, and we certainly don't seem to be willing to start some mutual recognition, what can the U.S. do to provide the best possible solution to the goals outlined in the first question at the national level?

IDEALLY...

- Drafting int'l conventions with 200 countries is hard, getting wide recognition and effective application is harder.
- We rarely even manage at the level of the wealthy Western democracies, let alone globally.
- However, high quality legislation/regulation by the most technologically advanced country would present **a model** many would follow in national law and mutual recognition.
- Unfortunately, our Federal Congress is too busy with self-enrichment, self-preservation and partisan posturing to achieve any meaningful regulation.

WHAT DO WE DO IN THE U.S. INSTEAD? 1 OF 3

- U.S. constitutional structures are dysfunctional. Powers are allocated based on 18th century notions of federalism.
- Regulation should follow the **subsidiarity principle**: Social and political issues should be dealt with at the lowest possible level, as close to the citizen as possible. The next higher level of government should only become responsible if efficient regulation at the lower level is impossible, ineffective or causes discrimination.
- Or, as the EU puts it: the higher level comes in only if and when the objectives of the regulation cannot be sufficiently achieved at the lower level by reason of their scale or effects, and can be better achieved at the higher level.

AND WHAT DO WE DO IN THE U.S. INSTEAD? 2 OF 3

In the absence of Federal legislation, the field is wide open for

- Federal agencies like the SEC, the CFTC, FinCEN, the Federal Reserve, OFAC, the IRS, and various SROs
- The legislatures of the several states
- and the regulatory agencies of the several states

THIRD OF THREE QUESTIONS

3) While we are waiting for clear legislative guidance from the Congress of the United States, i.e. in our current real-world situation, what can and what should the different actors do, i.e. the Federal agencies with direct powers, and the governments of the several states?

IDEALLY...

All the agencies and the state governments should start talking to each other and **pulling in the same direction**.

In that sense, Biden's executive order is a major step in the right direction.

We could do even better, however, by remembering also the full-faith-and-credit clause.

And the procedures and requirements for SEC or CFTC registration need to be streamlined, made more accessible, and cheaper.

AND WHAT DO WE DO IN THE U.S. INSTEAD? 3 OF 3

The **SEC** qualifies digital currencies as securities pursuant to laws and legal precedent from the 1930s and 40s, requires registration of issuers

The **CFTC** qualifies digital currencies as commodities pursuant to laws from the 1930s, requires registration of brokers and exchanges

The **IRS** qualifies digital currencies as property and NOT currency, collects capital gains taxes

FinCEN qualifies digital currencies as currency, requires KYC and AML procedures

The **Fed** is wondering whether to issue a federal stable coin

The **OCC** is gradually trying to bring banks into the crypto space to prevent their marginalization

The **CFPB** seems to be at least awake now, after Biden's executive order

And the **several states** are competing with inviting (Wyoming, Utah...) or uninviting (New York...) Blockchain businesses

FOR EXAMPLE, IF YOU WANT TO DO BUSINESS WITH CRYPTO IN NEW YORK...

You probably need to register with the SEC and with the CFTC

You definitely need to observe the rules of and report to FinCEN

You have to follow the rules of OFAC

You may need a license from OCC (for example if you are doing DeFi lending etc.)

And then you have to get a NY BitLicense.... Have fun with that:

THE NEW YORK BITLICENSE IN A NUTSHELL...

- \$5,000 application fee
- Organization chart
- Complex disclosures about identity and background of all owners, senior managers, and funds managers (incl. fingerprints etc.)
- Full financial disclosures for all of these, incl. verification of tax compliance, criminal record etc.
- Detailed description of the business model, customer base, marketing strategy, etc.
- Full disclosure of all banking arrangements
- Submission of all written policies and procedures, incl. insurance policies
- Explanation of the methodology of valuation of all virtual currencies AND maintenance of crypto in the full amount owed or obligated to any third persons
- Regular reporting requirements

If approved, license does not apply to any changes in the business model, and can be withdrawn at any time

= stricter than any obligation on traditional financial service providers in NYC

AND SPECIFICALLY FOR NFTs

- The SEC definition of investment contracts is broad enough to cover (most? all?) NFTs as **securities**
- The CFTC definition of **commodities** is broad enough to cover (most? all?) NFTs => the question will be about derivatives or futures trading

=> Issuers also have to comply with FinCEN and OFAC controls

The SEC, in particular, has become quite impatient with unregistered and unlicensed issuers...

=> I have been URGING issuers to register with the SEC

AND to incorporate in Wyoming only (or maybe Utah next)

And even that does not protect against NY BitLicense law, which is required for anyone engaging in virtual currency business „involving New York or a New York Resident“ regardless where they are based

WHAT ARE OTHER COUNTRIES DOING?

3 basic approaches

#1 prohibit everything (until their central bank/authorities have an official digital currency and control everything = China, Russia, India)

#2 allow everything (to attract investors and high tech jobs, devil may care = Wyoming, El Salvador)

#3 try to write sensible regulation without fully understanding what is going on and what will be needed beyond the present day (= EU, UK, Switzerland, Japan, Australia, Singapore, South Korea)

SPECIFICALLY, THE EU MiCA REGULATION

- In the absence of common EU law, the MSs can legislate (Estonia, Malta, etc.)
- The EU Draft **Regulation for Markets in Crypto Assets** has been intensely negotiated since 2018, likely to be adopted this year
- It is supposed to enter into force by 2024 for all 27 MSs
- It has 168 pages of legalese and is part of a 700 page „digital finance package“ of new EU legislation
- That is multiple times the volume of the UCC statutory language and competes nicely with the entire civil codes of France or Germany
- And it will be about 4 years outdated by the time it enters into force
- But otherwise, „A“ for effort

IN OTHER WORDS...

... there are golden opportunities for alternative legislative drafters, for example

- The ABA has presented a pretty decent “White Paper on Digital and Digitized Assets: Federal and State Jurisdictional Issues”
- The Uniform Law Commission has already drawn up the changes recommended for the UCC, including a new Article 12 on Controllable Electronic Records
- The Law Society of the UK has presented Legal and Regulatory Guidance for Blockchain

We just have to read and put together the best of everything 😊

Thank you for your time and attention!

I look forward to your questions and comments

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My presentations and publications are open access on
ResearchGate: <https://www.researchgate.net/profile/Frank-Emmert>