Topic 5.2: Regulatory Landscapes

Global Approaches to Digital Finance Regulation

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From Technical Risks to Regulatory Responses

Where We Left Off (Topic 5.1)

In T5.1 we saw what goes wrong *technically* — hacks, exploits, smart contract failures, and exchange collapses. Now we ask: **how do governments try to PREVENT these problems?** That is regulation.

T5.1 showed us:

- Technical vulnerabilities
- Smart contract exploits
- Exchange failures
- Loss of user funds

T5.2 asks:

- Who should prevent these problems?
- What rules exist today?
- How do different countries approach this?
- What trade-offs arise?

Key connection: Every major crypto disaster we studied in T5.1 led to new regulations. Today we study those regulatory responses.

Learning Objectives

By the end of this topic, you will be able to:

1. **Compare** major regulatory frameworks across jurisdictions (US, EU, Asia)
2. **Explain** the policy rationale behind key digital finance regulations
3. **Apply** the Howey Test to determine security classification of tokens
4. **Analyze** how regulation shapes innovation trajectories in different markets
5. **Understand** why identical technology receives different regulatory treatment
6. **Evaluate** trade-offs between consumer protection and innovation

Core Skill

Regulatory analysis is essential for any digital finance professional—whether building products, investing, or advising clients.

Why Should YOU Care About Crypto Regulation?

Regulation is not just for lawyers — it affects everyone who uses, builds, or invests in digital finance.

1. **Which products you can access:** Regulations determine whether you can buy certain tokens, use certain exchanges, or access DeFi in your country
2. **Whether your investments are protected:** If an exchange fails, regulation decides whether you get your money back — or lose everything
3. **Which innovations succeed or fail:** Many promising projects have shut down not because the technology failed, but because regulation made them impossible
4. **Your career:** Understanding regulation is a major competitive advantage in digital finance — employers value it highly

Real Example

When MiCA took effect in the EU, Tether (USDT) was delisted from some European exchanges. Millions of users had to switch stablecoins overnight — all because of regulation.

Prerequisites: Financial Regulation Basics

Why do we regulate financial markets?

Market Failures Addressed:

- **Information asymmetry**—issuers know more than investors
- **Systemic risk**—interconnected failures cascade
- **Externalities**—fraud harms market confidence
- **Public goods**—market integrity benefits all

Core Regulatory Goals:

- Consumer/investor protection
- Market integrity and fairness
- Financial system stability
- Prevention of illicit finance
- Capital formation efficiency

The Challenge

Digital finance challenges traditional regulatory assumptions: borderless, pseudonymous, automated, and often decentralized.

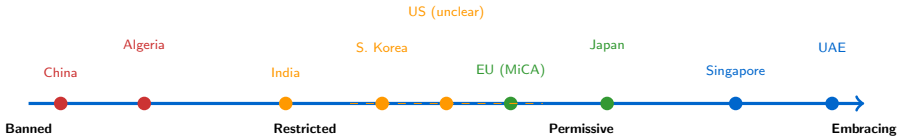
Prerequisites: Key Regulatory Concepts

Concept	Definition
Securities regulation	Rules governing investment contracts, requiring disclosure and registration
AML/KYC	Anti-Money Laundering / Know Your Customer—identity verification and transaction monitoring
Money transmission	Transferring funds on behalf of others—requires licensing
Prudential regulation	Rules ensuring financial institutions remain solvent
Consumer protection	Safeguards against fraud, manipulation, unfair practices
Regulatory arbitrage	Choosing favorable jurisdictions to minimize compliance

Key insight: The same crypto activity may trigger multiple regulatory regimes simultaneously.

Global Overview: The Regulatory Spectrum

Every country approaches crypto regulation differently. Before we dive into specific jurisdictions, here is the big picture:



Key Takeaway

There is no single "right" approach. We will study the US (complex, fragmented), EU (comprehensive framework), and Asia (full spectrum from ban to innovation hub) in detail.

Note: We spend more time on the US because it is the largest crypto market and its regulatory approach is the most complex. Other jurisdictions often follow or react to US decisions.

How to Read Any Regulatory Framework

When evaluating any country's approach to crypto regulation, ask these four questions:

1. **Who regulates?**
   Is there one regulator or many? Do they coordinate or compete?
2. **What is classified as what?**
   Is a token a security, a commodity, a payment instrument, or something new?
3. **What is banned vs. permitted?**
   Can you trade, issue tokens, run an exchange, offer DeFi services?
4. **How are consumers protected?**
   Are there insurance schemes, disclosure requirements, or investor limits?

Use This Framework

As we study each jurisdiction, apply these four questions. You will see how the same technology receives very different regulatory treatment depending on how each country answers them.

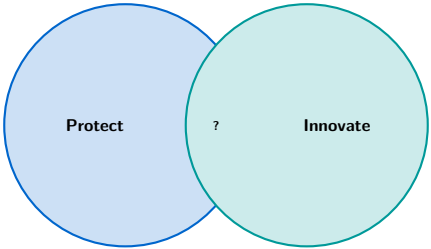
The Regulatory Challenge

What regulators want:

- Consumer protection
- Market integrity
- Financial stability
- Anti-money laundering
- Tax compliance
- National security

What innovators want:

- Permissionless access
- Privacy
- Speed to market
- Global reach
- Minimal compliance costs
- Regulatory clarity



United States: The Big Two Regulators

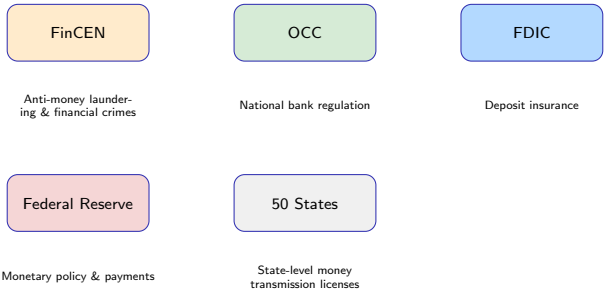
The central question in US crypto regulation:

- Is a crypto token a **security** (regulated by the SEC)?
- Or is it a **commodity** (regulated by the CFTC)?
- Bitcoin and Ethereum: classified as **commodities**
- Many other tokens: the SEC argues they are **securities**

Why This Matters

Securities face strict rules: registration, disclosure documents, and restrictions on who can buy. Commodities face lighter regulation. The classification determines everything.

United States: Supporting Regulatory Agencies



Key Issue: No Single Regulator

No single agency is in charge of crypto. Jurisdictional conflicts between all these agencies create uncertainty and "regulation by enforcement" — meaning regulators do not write new crypto-specific rules. Instead, they use existing laws and punish companies that break them. Think of it as: *"we will tell you the rules by punishing those who break them."*

US: The Howey Test

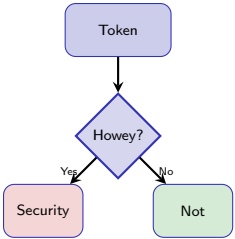
Is it a security?
A token is a security if it involves:

1. **Investment of money**
2. **In a common enterprise**
3. **With expectation of profits**
4. **Derived from others' efforts**

Analogy: Think of buying a rental property managed by someone else:

1. You invest money (buying the property)
2. In a common enterprise (the building has multiple investors)
3. Expecting profits (rental income)
4. From others' efforts (the property manager does the work)

→ This is an "investment contract" = a security.



SEC Position:

- Most ICOs (Initial Coin Offerings — a way for crypto projects to raise money by selling tokens directly to the public, similar to an IPO for stocks) were securities
- Many tokens are securities
- ETH and BTC are NOT securities

SEC vs. CFTC: Jurisdictional Divide

Aspect	SEC	CFTC
Jurisdiction	Securities	Commodities
Key test	Howey Test	Not a security
Bitcoin	Not a security	Commodity
Ethereum	Not a security (debated)	Commodity
Most altcoins	Often securities	Spot market limited
Stablecoins	Unclear	Limited jurisdiction
Exchanges	Securities exchanges	Derivatives exchanges

Term: *Spot market* = buying or selling for immediate delivery, as opposed to futures or options (which are contracts about future prices).

The Gap

Spot markets for crypto commodities (like Bitcoin) fall into a regulatory gap—CFTC has limited authority over spot trading, SEC claims none. Nobody is clearly in charge.

FinCEN: AML/KYC Requirements

Financial Crimes Enforcement Network (FinCEN)—enforces the Bank Secrecy Act (BSA, 1970), the foundation of US anti-money-laundering law. The BSA requires banks and financial businesses to report suspicious transactions to help detect money laundering.

Who must register?

- Crypto exchanges
- Custodial wallet providers
- Crypto ATM operators
- Payment processors
- As Money Services Businesses (MSBs — businesses that transfer money, cash checks, or exchange currencies, including many crypto exchanges)

Requirements:

- Customer identification (KYC)
- Transaction monitoring
- Suspicious Activity Reports (SARs — filed when a business spots something unusual)
- Currency Transaction Reports (CTRs — required for transactions over $10,000)
- Record keeping (5 years)

Key Point

AML/KYC requirements apply regardless of whether tokens are securities or commodities. All crypto businesses touching fiat or custody must comply.

Checkpoint: US Regulation So Far

Let's Pause and Recap

We have covered a lot of US-specific content. Here are the key points so far:

1. **Multiple regulators** — The US has many agencies (SEC, CFTC, FinCEN, OCC, 50 states) with overlapping authority. No single "crypto regulator" exists.
2. **The key question:** Is a crypto token a **security** or a **commodity**? The answer determines which rules apply.
3. **The Howey Test** helps decide — think of the rental property analogy: if you invest money, in a group venture, expecting profits from someone else's work, it is a security.
4. **AML/KYC applies to everyone** — regardless of token classification, all crypto businesses must verify customer identities and report suspicious activity.
5. **"Regulation by enforcement"** — the US currently makes rules by suing companies, rather than writing clear guidelines first.

Coming next: Enforcement actions, state-level regulation, and how tokens can legally be issued.

US Enforcement Actions (2023–2024)

Target	Allegation	Status
Coinbase	Operating unregistered exchange (running a trading platform without SEC approval)	Ongoing litigation
Binance	Multiple securities violations	$4.3B settlement
Kraken	Unregistered staking service (staking = locking up tokens to earn rewards)	$30M settlement
Ripple (XRP)	Unregistered securities	Partial win for Ri
Terraform	Securities fraud (UST)	Founders charged

Regulation by Enforcement

The US lacks comprehensive crypto legislation. SEC and CFTC establish rules through lawsuits rather than clear guidelines — companies often do not know they are breaking a rule until they are sued.

US State-Level Regulation: BitLicense Example

In the US, states can create their own financial regulations on top of federal rules. New York's BitLicense (2015) was the first state-level crypto-specific license.

Requirements:

- Application fee + capital reserves
- Comprehensive cybersecurity program
- AML/KYC compliance plan
- Consumer protection measures
- Books and records requirements
- Regular examinations

Impact:

- Many companies exit NY market
- High compliance costs
- Lengthy approval process
- But: regulatory clarity
- Other states: Wyoming (friendly), Texas (mixed)

The 50-State Problem

Each US state has different money transmission rules. Operating nationally requires up to 50 separate licenses.
Analogy: Imagine opening a restaurant — you would need a different license in every state, plus a federal one. Now imagine doing that in 50 states simultaneously. That is the challenge facing crypto companies in the US.

US: If Your Token Is a Security, What Are Your Options?

If the Howey Test says your token is a security, you have two main paths:

Path	What It Means in Plain English
Reg D (Private Placement)	Sell only to **accredited investors** — people wealthy enough (income over $200K/year or net worth over $1M) or experienced enough that regulators assume they can handle risky investments. No public advertising allowed in most cases.
Reg A+ (Mini-IPO)	A simplified version of a full public offering. Less paperwork than a traditional IPO, and **anyone** can invest (with limits). Maximum raise: $75M.

Other options: Reg S (sell only outside the US), Reg CF (crowdfunding up to $5M through registered portals). All exemptions have strict requirements — violations trigger enforcement.

Key Terms

Prospectus = detailed document explaining the investment and its risks (like a product manual for investors).
Accredited/qualified investor = someone wealthy or experienced enough that regulators assume they can handle risky investments.

From US Fragmentation to EU Harmonization

Change of Approach

We have just seen the US approach: multiple agencies, overlapping authority, regulation by enforcement, and significant uncertainty. Now let's see a very different model.

The EU asked: "What if we wrote clear rules *before* problems happen, instead of suing companies after the fact?"

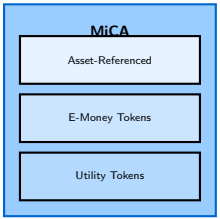
European Union: MiCA Framework

Markets in Crypto-Assets (MiCA):

- First comprehensive crypto regulation
- Effective 2024–2025
- Harmonized across 27 countries
- Clear licensing requirements

Key Provisions:

1. Crypto-Asset Service Providers (CASPs) licensed
2. Stablecoin issuers must hold reserves
3. Whitepaper requirements for token issuance
4. Consumer protection rules
5. Market manipulation prohibited



Not covered:
DeFi, NFTs (mostly), CBDCs

MiCA: Token Categories

Category	Definition	Requirements
Utility Tokens	Provide access to goods/services on a platform	Whitepaper, fair marketing, basic disclosure
Asset-Referenced Tokens (ARTs)	Value references multiple assets, commodities, or currencies	Authorization, reserve requirements, no interest payments
E-Money Tokens (EMTs)	Pegged 1:1 to single fiat currency	E-money institution license, 1:1 redemption, segregated reserves
Other crypto-assets	BTC, ETH, and similar	Lighter touch, no issuer requirements

Key Distinction

MiCA creates clear categories with proportionate requirements—unlike the US binary security/commodity debate.

MiCA: Stablecoin Rules

Asset-Referenced Tokens (ARTs):

- Backed by multiple assets
- Issuer must be authorized
- Reserve requirements
- No interest payments
- If "significant": stricter rules

E-Money Tokens (EMTs):

- Single fiat currency reference
- Must be e-money institution
- 1:1 redemption rights
- Segregated reserves

Significance Thresholds

"Significant" ART/EMT if:

- 10M+ holders
- 5 billion euros+ market cap
- 2.5M+ daily transactions
- 500 million euros+ daily value

Higher capital, stricter oversight.

Impact on USDT/USDC:
Must comply or delist from EU exchanges.

MiCA: Crypto-Asset Service Providers (CASPs)

Services requiring CASP license:

- Custody and administration
- Operating a trading platform
- Exchange of crypto for fiat
- Exchange of crypto for crypto
- Execution of orders
- Placing of crypto-assets
- Transfer services
- Advice on crypto-assets
- Portfolio management

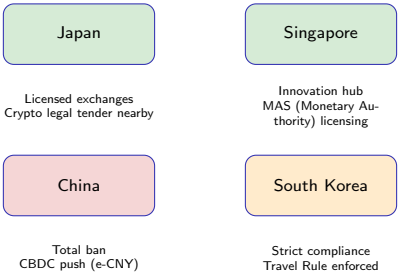
CASP Requirements:

- Authorization in one EU member state (passportable — meaning the license is usable across all EU countries)
- Minimum capital requirements
- Governance and organizational requirements
- Safeguarding of client assets
- Complaints handling procedures

Passporting

Once licensed in one EU country, CASPs can operate across all 27 member states — a major advantage over the US 50-state problem.

Asia: Diverse Regulatory Approaches



Analogy — Travel Rule: Like registered mail — the sender and receiver must be identified for transfers above a certain amount. South Korea enforces this strictly.

Key insight: Asia demonstrates the full spectrum from complete ban (China) to innovation hub (Singapore).

Singapore: Innovation Hub with Clear Rules

Monetary Authority of Singapore (MAS) Approach

Regulatory Framework:

- Payment Services Act (PSA) 2019
- Digital Payment Token (DPT) license
- Clear licensing categories
- Risk-based supervision
- Regulatory sandbox available

Requirements:

- AML/CFT (Combating the Financing of Terrorism) compliance
- Technology risk management
- User protection measures
- Capital requirements
- Fit and proper management (meaning directors and key staff must demonstrate honesty, competence, and financial soundness)

Singapore's Strategy

Attract compliant crypto businesses with clear rules, strict enforcement, and innovation support—while banning retail crypto advertising.

China: Complete Ban + CBDC

What's Banned:

- Cryptocurrency trading
- Crypto mining (since 2021)
- ICOs (token fundraising)
- Crypto exchanges
- Providing crypto services

Penalties:

- Criminal prosecution possible
- Businesses shut down
- Mining operations seized

Digital Yuan (e-CNY):

- Central Bank Digital Currency
- Controlled by PBoC
- Two-tier distribution
- Programmable money
- Pilot programs in major cities

The Strategy

Ban decentralized crypto, promote centralized CBDC. Maximum control, full surveillance.

Japan and South Korea: Regulated Markets

Japan (FSA):

- First major country to license exchanges (2017)
- Crypto as "payment method"
- Strict exchange requirements
- Cold wallet mandate (cold wallet = offline storage, not connected to the internet, harder for hackers to reach)
- Self-regulatory organization: JVCEA (Japan Virtual and Crypto Assets Exchange Association)
- Response to Mt. Gox collapse

South Korea:

- Real-name trading accounts (every crypto trader must link their exchange account to a bank account in their real, verified name — no anonymous trading)
- Bank partnerships required
- Strict Travel Rule enforcement
- Tax on crypto gains
- Major exchange oversight
- High retail participation

Common Thread

Both markets experienced major hacks/scandals that drove stricter regulation. Compliance-focused but open to innovation.

Regulatory Comparison Matrix

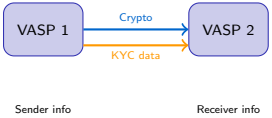
Aspect	US	EU (MiCA)	Singapore	China
Crypto trading	Varies	Licensed	Licensed	Banned
Token issuance	Case-by-case	Whitepaper	Licensed	Banned
Stablecoins	Unclear	Regulated	Licensed	Banned
DeFi	Unclear	Unclear	Evolving	Banned
NFTs	Unclear	Mostly exempt	Evolving	Gray area
CBDC	Researching	Exploring	Exploring	Live
Clarity	Low	High	Medium	High (ban)

Key Insight

Regulatory arbitrage is real. Projects choose jurisdictions strategically. Clear rules (even strict ones) often preferred over uncertainty.

The Travel Rule (FATF Recommendation 16)

What is it?
FATF requirement: Virtual Asset Service Providers (VASPs) must share sender/receiver information for transfers above thresholds.
Analogy: Like registered mail — both sender and receiver must be identified.



Information Required:

- Sender name
- Sender account number
- Sender address or ID
- Beneficiary name
- Beneficiary account number

Thresholds:

- US: $3,000+
- EU: 0 euros (all transfers!)
- FATF guidance: $1,000

DeFi Challenge

How do you apply Travel Rule to non-custodial wallets and DEXs with no central operator?

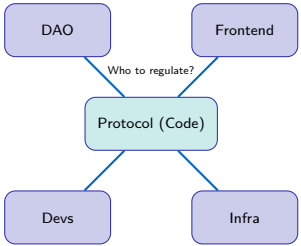
DeFi Regulatory Challenges

The Fundamental Problem:

- Who is the "operator"?
- Where is it located?
- Who do you regulate?
- How do you enforce?

Potential Targets:

- Frontend interfaces
- Token holders with governance power
- Core developers
- Infrastructure providers



Emerging Approach

Target the **chokepoints** (the few places where regulators can exert control): fiat on/off ramps (where crypto meets traditional money), centralized frontends (the websites users interact with), and infrastructure providers (the companies running the servers).

Regulatory Sandboxes

A controlled environment for innovation under regulatory supervision

How Sandboxes Work:

1. Company applies with innovative product
2. Regulator grants limited authorization
3. Testing with real users, limited scale
4. Relaxed rules during trial period
5. Evaluation and exit to full compliance

Countries with Crypto Sandboxes:

- UK (FCA)
- Singapore (MAS)
- Switzerland (FINMA)
- UAE (ADGM, DIFC)
- Bermuda
- Australia (ASIC)

Benefits

Regulators learn about new technologies. Innovators get clarity. Both sides reduce risk.

Case Study: Tornado Cash Sanctions

What Happened (Aug 2022):

- US Treasury sanctioned Tornado Cash via OFAC (Office of Foreign Assets Control — the agency that enforces economic sanctions)
- Smart contract addresses added to sanctions list
- Developer arrested in Netherlands
- First time: CODE itself sanctioned

Consequences:

- GitHub removed repository
- Circle froze USDC in flagged addresses
- Exchanges blocked deposits
- Alchemy and Infura (companies providing blockchain access services) blocked RPC access (RPC = the technical connection applications use to communicate with the blockchain)

Legal Questions

- Can you sanction open-source code?
- Is running a mixer illegal?
- What about privacy rights?
- First Amendment implications? (The First Amendment to the US Constitution protects free speech — some argue that code is speech)

Outcome:
Court ruled some sanctions overreach (2024). Case ongoing.

Case Study: SEC vs. Ripple (XRP)

The landmark case defining token classification

SEC's Position:

- XRP is a security
- Ripple raised $1.3B through unregistered sales
- Investors expected profits from Ripple's efforts
- Howey Test clearly applies

Timeline:

- Dec 2020: SEC files lawsuit
- July 2023: Summary judgment
- 2024: Ongoing appeals

July 2023 Ruling:

- Institutional sales = Securities
- Exchange sales = NOT securities
- Programmatic sales to anonymous buyers don't meet Howey

Implications

Secondary market trading may not create securities liability. Context matters more than the token itself.

Case Study: Terra/Luna Regulatory Aftermath

How regulators respond to a $40B+ collapse

Recall from Day 4 (Topic 4.3): We studied how algorithmic stablecoins like UST tried to maintain their dollar peg through automatic mechanisms. Here is what happened when that mechanism failed:

What Happened (May 2022):

- UST stablecoin de-pegged
- Algorithmic mechanism failed
- LUNA dropped 99.99%
- $40B+ market cap destroyed
- Cascading failures across DeFi

Regulatory Response:

- SEC: Securities fraud charges
- South Korea: Arrest warrants
- Do Kwon: Arrested in Montenegro
- MiCA: Influenced stablecoin rules
- Accelerated global regulation

Lesson

Systemic failures trigger regulatory action. Terra accelerated stablecoin regulation globally, especially in EU (MiCA) and proposed US legislation.

Case Study: FTX Collapse and Exchange Oversight

The case that changed crypto regulation permanently

What Failed (Nov 2022):

- Customer funds mixed with Alameda Research (the trading firm secretly run by FTX's founder, Sam Bankman-Fried)
- No segregation of assets
- Fraudulent accounting
- $8B+ customer funds missing
- Major contagion effects

Regulatory Implications:

- Proof of reserves demanded
- Customer asset segregation
- Enhanced disclosure requirements
- Congressional hearings
- Accelerated legislation efforts

Key Takeaway

FTX showed that offshore exchanges serving US customers remain enforcement targets. "Regulatory arbitrage" has limits when fraud is involved.

Case Study Synthesis: What Do These Cases Teach Us?

Case	Core Issue	Regulatory Response	Lesson
Tornado Cash	Can code be sanctioned?	OFAC sanctions on smart contracts	Privacy vs. compliance tension
Ripple (XRP)	Is XRP a security?	SEC lawsuit, partial loss	Context matters, not just token
Terra/Luna	Algorithmic stablecoin failure	Global stablecoin rules (MiCA)	Systemic risk drives regulation
FTX	Exchange fraud	Proof of reserves, segregation	Offshore is not beyond reach

Pattern

Every major crypto disaster follows the same cycle: **Innovation** $\rightarrow$ **Growth** $\rightarrow$ **Failure** $\rightarrow$ **Public outrage** $\rightarrow$ **New regulation.** Understanding this cycle helps you predict what regulators will do next.

Discussion: Regulatory Philosophy

Argument for Strict Regulation:

- Protect consumers from fraud
- Prevent money laundering
- Ensure financial stability
- Level playing field with TradFi (Traditional Finance — crypto community's term for conventional banks, stock exchanges, and financial institutions)
- Accountability for failures

Argument for Light Touch:

- Enable innovation
- Avoid regulatory arbitrage
- Code is speech (First Amendment — US constitutional protection of free expression)
- Self-sovereignty rights
- Over-regulation pushes activity offshore

Note: We have spent more time on the US because it is the largest crypto market and its regulatory approach is the most complex. Other jurisdictions often follow or react to US decisions.

Discussion Questions

- Should DeFi protocols be regulated like banks?
- Is "code is law" compatible with rule of law?
- What is the right balance for stablecoins?
- Where would you launch a crypto startup, and why?

Application: Building a Regulatory Strategy

For any digital finance project, consider:

1. **Token Classification:** Is your token a security, commodity, utility, or payment token?
2. **Jurisdiction Selection:** Where will you incorporate, operate, and serve users?
3. **License Requirements:** What licenses needed in each target market?
4. **AML/KYC Design:** How will you comply with identity and monitoring rules?
5. **Consumer Protection:** What disclosures, safeguards, and recourse mechanisms?
6. **Future-Proofing:** How might regulations evolve? Build flexibility.

Reality Check

Compliance is expensive. Budget 15–30% of early-stage costs for legal and regulatory work.

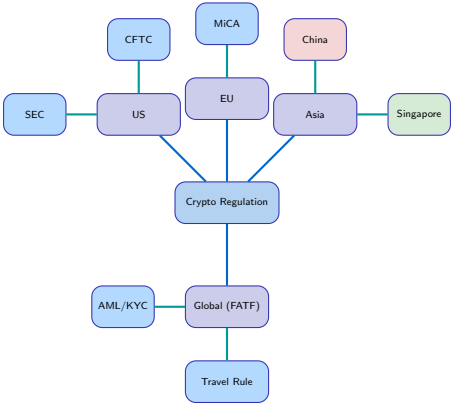
Executive Summary

Key Takeaways

1. **US:** Fragmented regulation, enforcement-driven approach, Howey Test determines security status
2. **EU (MiCA):** First comprehensive framework, clear categories, passportable licenses
3. **Asia:** Full spectrum from ban (China) to innovation hub (Singapore)
4. **Global trend:** Moving toward regulation, focus on stablecoins and consumer protection
5. **DeFi:** Fundamental challenge—who/what to regulate when there is no central operator
6. **Strategy:** Regulatory clarity (even if strict) often preferred over uncertainty

The Bottom Line: Regulation is not optional. Understanding regulatory logic helps you build compliant products and predict market evolution.

Concept Map: Regulatory Landscape



Key Terms (Part 1)

Howey Test	US legal test to determine if an asset is a security: investment of money in common enterprise with expectation of profits from others' efforts
MiCA	Markets in Crypto-Assets—EU's comprehensive crypto regulatory framework effective 2024–2025
CASP	Crypto-Asset Service Provider—licensed entity under MiCA
ART	Asset-Referenced Token—stablecoin backed by multiple assets
EMT	E-Money Token—stablecoin pegged 1:1 to single fiat currency
VASP	Virtual Asset Service Provider—FATF term for crypto businesses
Travel Rule	FATF requirement to share sender/receiver information for crypto transfers
ICO	Initial Coin Offering—a way for crypto projects to raise money by selling tokens to the public

Key Terms (Part 2)

Regulatory Arbitrage Strategically choosing jurisdictions with favorable regulations

Regulatory Sandbox Controlled environment for testing innovations with relaxed rules

BitLicense New York State's comprehensive crypto business license

FinCEN Financial Crimes Enforcement Network—US AML/KYC enforcer

FATF Financial Action Task Force—sets global AML standards

BSA Bank Secrecy Act—US law requiring financial institutions to report suspicious activity

MSB Money Services Business—FinCEN registration category for crypto businesses

Regulation by Enforcement Establishing rules through lawsuits rather than clear legislation

TradFi Traditional Finance—conventional banks, stock exchanges, and financial institutions

OFAC Office of Foreign Assets Control—US agency enforcing economic sanctions

Common Misconceptions

Misconception 1: "Crypto is unregulated"

Reality: Crypto faces extensive regulation—AML/KYC, securities laws, money transmission rules. The issue is regulatory fragmentation and unclear jurisdiction.

Misconception 2: "Decentralization means no regulation applies"

Reality: Regulators can target frontends, developers, governance token holders, and infrastructure providers. Enforcement actions against DeFi are increasing.

Misconception 3: "Operating offshore avoids US rules"

Reality: If you serve US customers, US law applies. Binance's $4.3B settlement proves offshore incorporation offers limited protection.

Misconception 4: "All tokens are either securities or commodities"

Reality: Classification depends on context. The same token can be a security in one sale (institutional) and not in another (exchange trading), as the Ripple case showed.

Self-Assessment Questions (1/2)

Test your understanding:

Question 1: What is the main jurisdictional difference between the SEC and CFTC in US crypto regulation?

A) SEC regulates all cryptocurrencies while CFTC regulates only stablecoins

B) SEC has jurisdiction over securities while CFTC oversees commodities like Bitcoin

C) CFTC regulates exchanges while SEC regulates token issuers

D) There is no difference; they share identical jurisdictions

Question 2: What are the core components of AML/KYC requirements for crypto exchanges?

A) Only requiring email addresses for all users

B) Customer identification, verification, transaction monitoring, and suspicious activity reporting

C) Collecting passport information but no ongoing monitoring

D) Anonymous trading with voluntary disclosure

Self-Assessment Questions (2/2)

Question 3 (Recall): Which approach best describes the EU's MiCA framework compared to the US?

A) Both use enforcement-driven, case-by-case regulation

B) MiCA provides clear categories and rules upfront; the US relies on enforcement

C) MiCA bans all crypto; the US permits it

D) Both use identical regulatory frameworks

Question 4 (Analytical): A startup creates a token that gives holders a share of platform revenue. The team manages all development. Using the Howey Test, is this likely a security? Why or why not?

Question 5 (Analytical): If you were launching a crypto exchange, which jurisdiction would you choose and why? Consider: licensing costs, regulatory clarity, market access, and consumer trust.

Answers (Q1–Q3)

1. **B** – SEC regulates securities, CFTC oversees commodities (BTC, ETH)
2. **B** – Full AML/KYC includes ID verification, monitoring, and SARs
3. **B** – MiCA is rules-based upfront; the US is enforcement-driven

What's Next: Topic 5.3 – DAO Governance

Preview of upcoming topic:

We will explore:

- What are DAOs?
- Token-based governance models
- Voting mechanisms (1-token-1-vote, quadratic, conviction)
- Governance attacks and defenses
- Legal status of DAOs
- Real-world DAO case studies

Key Questions:

- How do decentralized organizations make decisions?
- Can DAOs be legally recognized?
- What happens when governance fails?
- How do DAOs interact with regulation?

Connection to This Topic

DAOs raise fundamental regulatory questions: If a DAO controls a protocol, who is liable? Can governance token holders be regulated? These questions build directly on our regulatory analysis.

Resources for Further Learning

Primary Sources:

- MiCA Regulation: `eur-lex.europa.eu` (search "MiCA")
- SEC Crypto Guidance: `sec.gov/spotlight/cybersecurity`
- FATF Virtual Assets: `fatf-gafi.org/en/topics/virtual-assets.html`
- FinCEN Guidance: `fincen.gov/resources/statutes-and-regulations`

Recommended Reading:

- "Cryptoassets: Legal, Regulatory, and Monetary Perspectives" – Chris Brummer
- SEC DAO Report (2017) – The DAO investigation report
- Howey Test Case: SEC v. W.J. Howey Co., 328 U.S. 293 (1946)

Tools:

- Chainalysis regulatory compliance reports
- Elliptic compliance resources

Questions?

Topic 5.2: Regulatory Landscapes

Global Approaches to Digital Finance Regulation

Joerg Osterrieder
Digital Finance
2025

Next: Topic 5.3 – DAO Governance