



Crypto Tokens, Cryptocurrencies, and Crypto Commodities

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Agenda

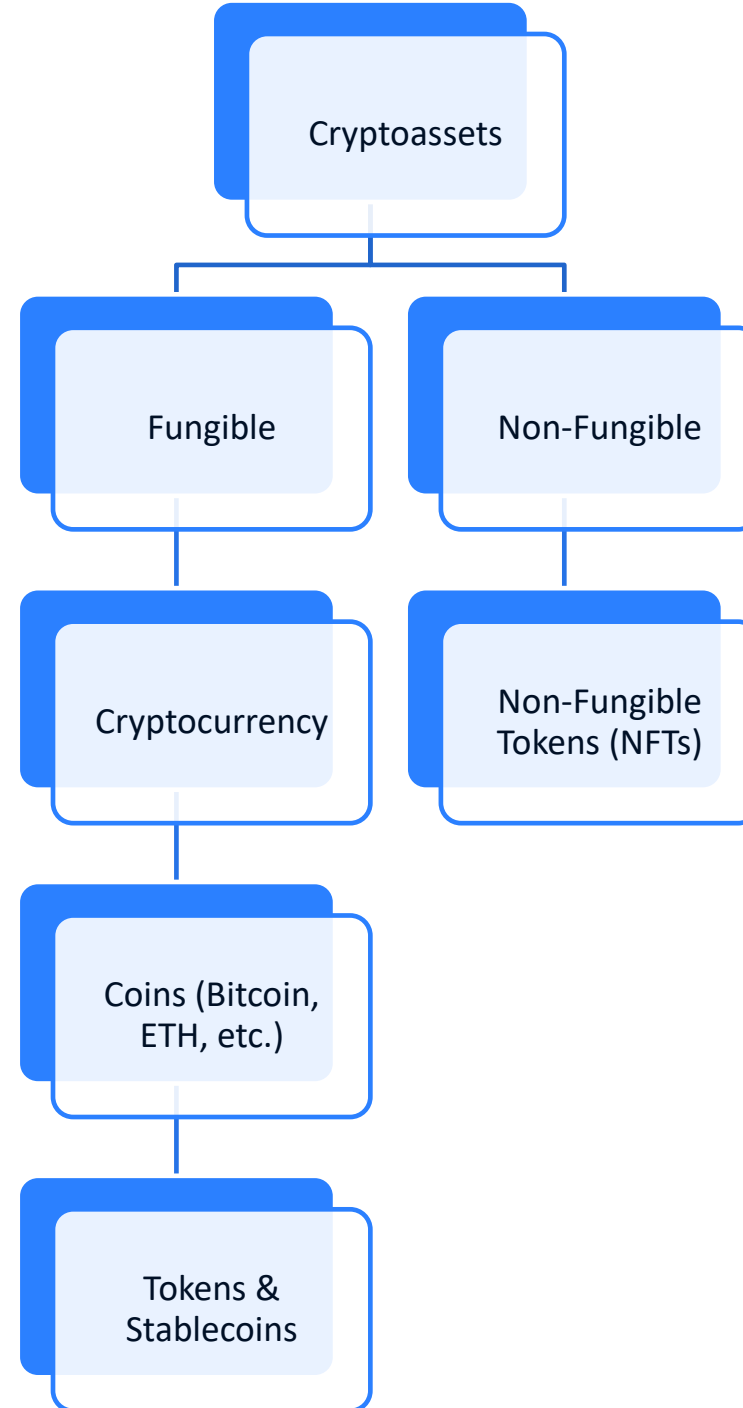
Key Concepts & Trends

Main Policy Concerns

Q & A

What is Cryptocurrency?

- [GAO](#): “Digital representations of value protected through cryptographic mechanisms (instead of a central repository or authority) and typically not government-issued legal tender”
- May serve as medium of exchange, store of value, and/or unit of account.

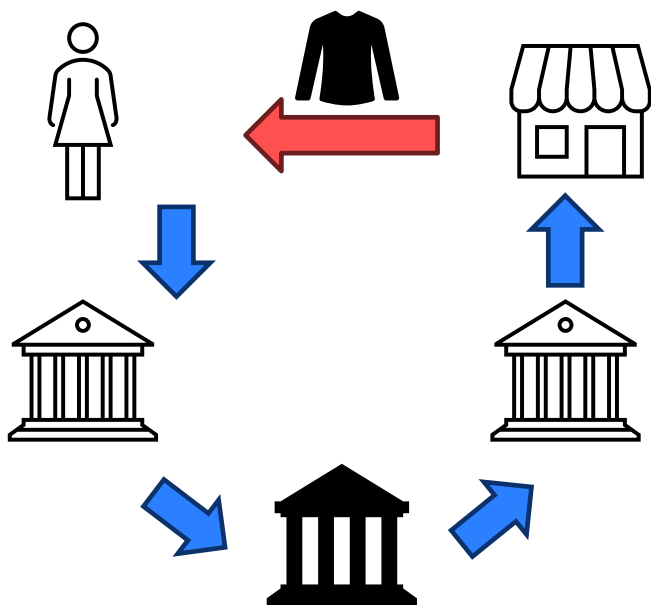


“What is needed is an electronic payment system based on cryptographic proof instead of trust, allowing any two willing parties to transact directly with each other without the need for a trusted third party.”

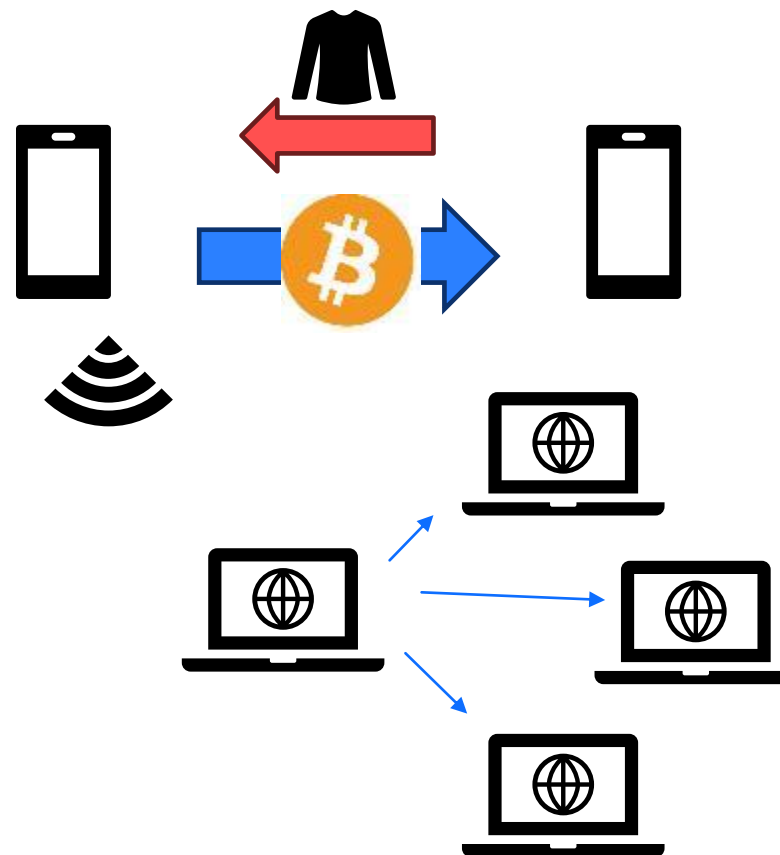
Satoshi Nakamoto, “Bitcoin: A Peer-to-Peer Electronic Cash System”



How does it work?



Typical transaction in
banking system

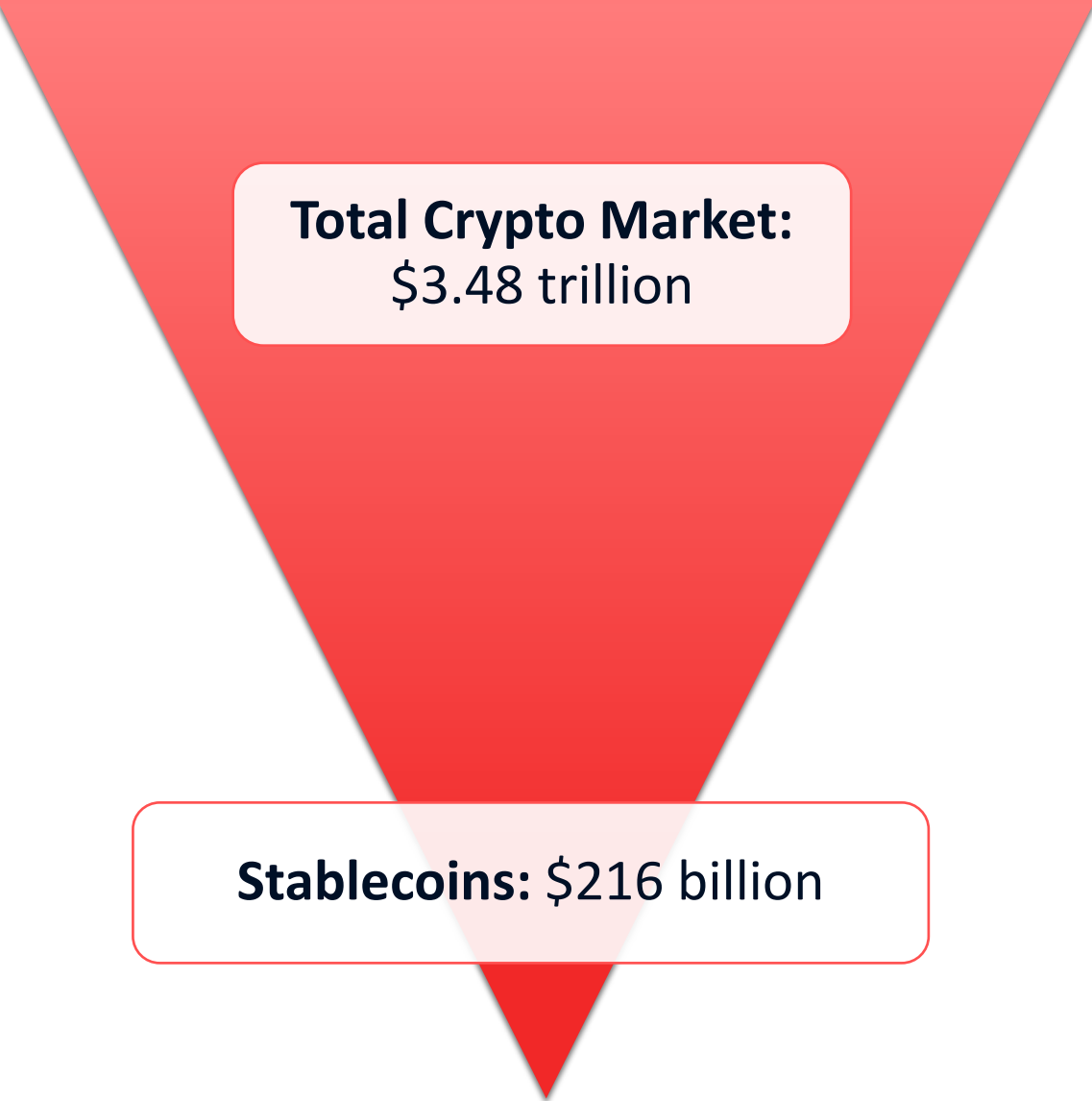


- **Bitcoin address:** Like an email address; can be shared.
- **Private key:** like a password should not be shared and must be protected.



Man says his binned Bitcoin fortune now worth £500m

[BBC News](#), November 19, 2024



Total Crypto Market:
\$3.48 trillion

Stablecoins: \$216 billion

- Bitcoin accounts for ~60% of the total market.
 - Top three cryptoassets (BTC, ETH, XRP) =75%.
 - Top 10 = 87%
- Memecoin: *a cryptocurrency based on an internet meme or pop culture phenomena.*
 - \$102B total value
 - Dog-themed: \$67B
 - Frog-themed: \$7B
 - Cat-themed: \$2.6B
- Many cryptoassets have little or no value.
- Global regulation is inconsistent:
 - Per FATF, 29% of jurisdictions have not conducted a virtual asset risk assessment; 75% were inadequate.
 - 27% have not decided if or how to regulate.

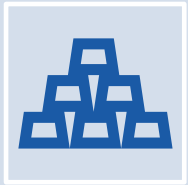
What are Stablecoins?

- [PWG Report](#): “Digital assets that are designed to maintain a stable value relative to a national currency or other reference assets.”
- Intended to be used for payments.
- Primarily used for digital assets trading but have seen some adoption in emerging economies.

Stablecoins	Amount in Circulation
Tether	\$139b
USDC	\$52b
Ethena	\$5.7b
Dai	\$4.6b
FDUSD	\$1.6b



Fiat-backed



Asset-backed (commodities/ precious metals, crypto, commercial paper, secured loans)



Algorithmic

Stablecoins Have Been Less Than Stable

- [Moody's Analytics](#): Large-cap stablecoins **depegged 609 times** between January and November 2023.
- [Bank for International Settlements](#): “[S] tablecoins in circulation today do not meet the key criteria for being a safe store of value and a trustworthy means of payment in the real economy.”



Stablecoin Risks

- If users lose confidence or reserves drop, a “bank run” could occur—how would that impact the financial system?
- Disintermediation of banks risks loss of deposits, harming credit creation.
- Disintermediation of national currencies may have severe economic consequences.
- Illicit Finance: Sanctions Evasion, Money Laundering, etc.



What is Decentralized Finance?

- Decentralized Finance = “financial products, services, activities, and arrangements that use distributed ledger or blockchain technologies (DLT), including self-executing code referred to as smart contracts...[and] **aims to operate in a disintermediated and decentralized manner, eliminating some traditional financial intermediaries and centralized institutions...**”

- Total Value Locked = \$119 billion
 - At the end of 2021, it reached an all-time high of nearly \$200 billion.
- DeFi platforms frequently experience attacks and exploits.
 - In 2022, 82.1% of all stolen assets came from DeFi protocols (\$3.1 billion)
 - North Korea stole at least \$428 million from DeFi protocols in 2023.

Sources: DeFillama, IOSCO [Final Report with Policy Recommendations for Decentralized Finance \(DeFi\)](#), [Chainalysis blog](#) (January 24, 2024)

Tokenization: the generation and recording of a digital representation of traditional assets on a programmable platform.

Potential Benefits of Tokenization



Major Tokenization Projects/Ideas

The Finternet/ “Unified Ledger”

Vision [proposed](#) by Agustin Carstens of BIS

“A ‘common venue’ [ie a shared programmable platform) where digital forms of money and other financial assets co-exist.”

Project Agorá

[Announced](#) in April 2024; Involves BIS, 7 central banks (including NY Fed), private commercial banks

Will explore how tokenized deposits and wholesale CBDC can improve cross-border payments

Regulated Settlement Network

Evolution of the [Regulated Liability Network](#); NY Fed participated in [POC](#)

Second [stage](#) explored shared ledger to allow for tokenized deposits, central bank money, US Treasury securities and other assets

Main Policy Concerns

- Cryptoasset Regulation
- Stablecoin Regulation
- Illicit Finance

Crypto & The Howey Test: How Should Crypto Be Regulated?

- Do crypto-asset transactions meet the criteria established by the Howey Test to qualify as investment contracts?
- Can something start its life as a security and become something else?
- Under what conditions and timeframe can “sufficient decentralization” occur? Who will decide and how?
- How should the spot market for non-security cryptoassets be regulated?
- How can consumers/investors be protected?

But this also points the way to when a digital asset transaction may no longer represent a security offering. If the network on which the token or coin is to function is sufficiently decentralized – where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts – the assets may not represent an investment contract. Moreover, when the efforts of the third party are no longer a key factor for determining the enterprise’s success, material information asymmetries recede. As a network becomes truly decentralized, the ability to identify an issuer or promoter to make the requisite disclosures becomes difficult, and less meaningful.

And so, when I look at Bitcoin today, I do not see a central third party whose efforts are a key determining factor in the enterprise. The network on which Bitcoin functions is operational and appears to have been decentralized for some time, perhaps from inception. Applying the disclosure regime of the federal securities laws to the offer and resale of Bitcoin would seem to add little value.^[9] And putting aside the fundraising that accompanied the creation of Ether, based on my understanding of the present state of Ether, the Ethereum network and its decentralized structure, current offers and sales of Ether are not securities transactions. And, as with Bitcoin, applying the disclosure regime of the federal securities laws to current transactions in Ether would seem to add little value. Over time, there may be other sufficiently decentralized networks and systems where regulating the tokens or coins that function on them as securities may not be required. And of course there will continue to be systems that rely on central actors whose efforts are a key to the success of the enterprise. In those cases, application of the securities laws protects the investors who purchase the tokens or coins.

I would like to emphasize that the analysis of whether something is a security is not static and does not strictly inhere to the instrument.^[10] Even digital assets with utility that function solely as a means of exchange in a decentralized network could be packaged and sold as an investment strategy that can be a security. If a promoter were to place Bitcoin in a fund or trust and sell interests, it would create a new security. Similarly, investment contracts can be made out of virtually any asset (including virtual assets), provided the investor is reasonably expecting profits from the promoter’s efforts.

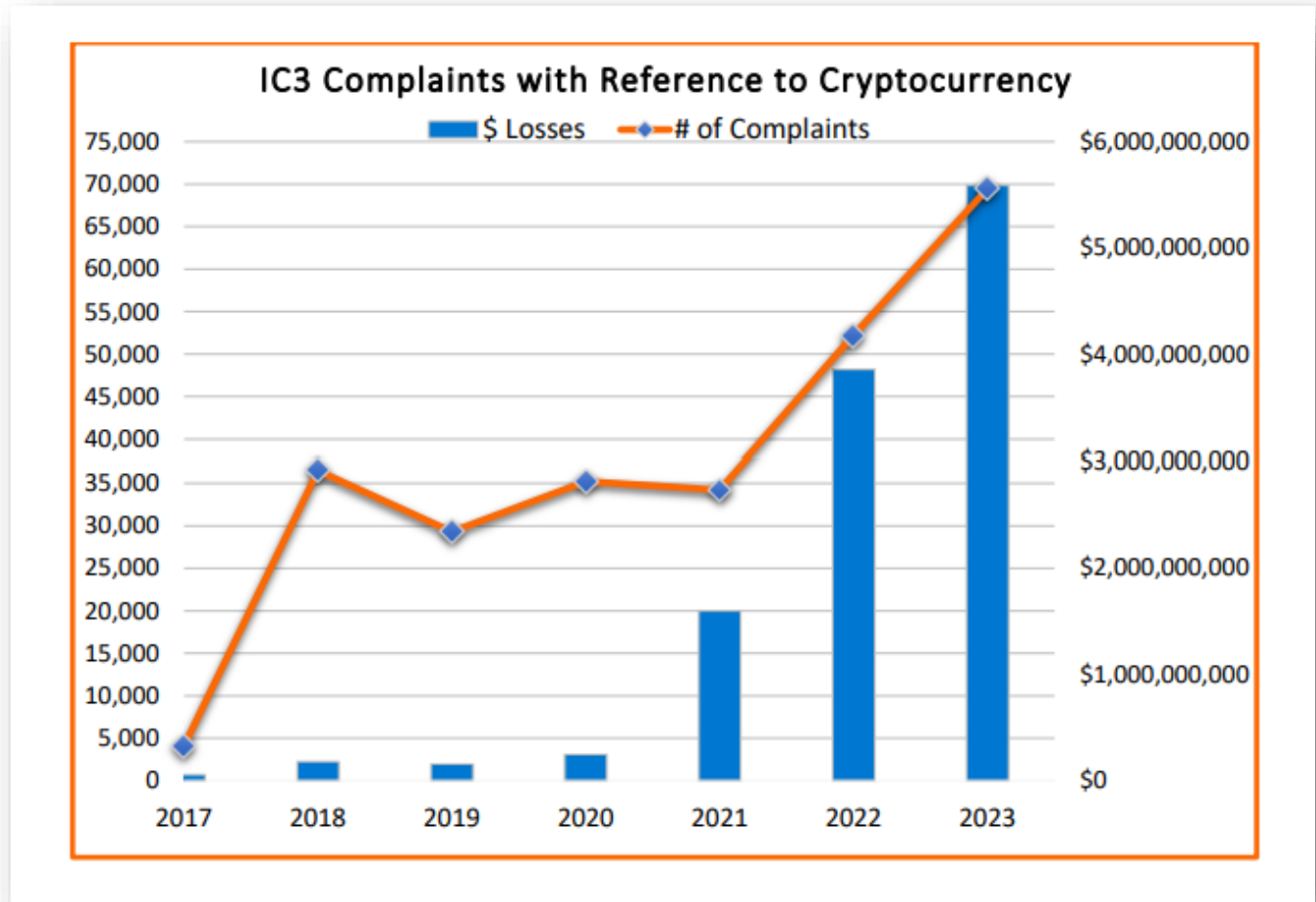
Stablecoin Regulation

- Libra/Diem Project in 2019 spurred global policymakers to consider appropriate regulatory frameworks.
- In 2021, the President's Working Group called for stablecoins to be regulated.
- Unresolved Issues:
 - Role of state regulators vs. role of federal regulators
 - Access to Federal Reserve Master Accounts
 - Reserves, capital requirements, resolution process, AML/KYC
 - Harmonization with other countries



Crypto Investment Scams Surge

- Crypto crimes jumped 45% over 2022, reaching \$5.6B in losses.
- Investment fraud/Pig butchering [losses](#) referencing crypto reached almost \$4 billion in 2023 (highest of any category)
- Crimes referencing crypto were only a tenth of reports but accounted for more than 50% of losses.



Source: [IC3 2023 Cryptocurrency Fraud Report](#)

North Korea's Threat Rises

The UN Security Council is investigating at least 58 cyberattacks on crypto entities since 2017 attributed to North Korea that netted more than \$3 billion for its WMD program.

FATF: “There are serious concerns about the threat posed by the DPRK’s illicit VA-related activities to finance the proliferation of weapons of mass destruction (WMDs), enabling an unprecedented number of recent launches of ballistic missiles (including inter-continental ballistic missiles)”

Q & A

