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Crypto-Asset Exchanges: Current Practices and Policy Issues

July 23, 2021

Crypto-asset exchanges, which include cryptocurrency exchanges and are also referred to as digital asset trading platforms, are market structures where digital asset buying and selling can occur. Some industry observers perceive digital asset trading platforms as similar to securities exchanges in functionality. However, they are generally not subject to the same regulatory regime, leading to policy debates regarding market integrity, investor protection, and the need to foster financial innovation.

Trading Platforms as Money Transmitters

Many crypto-asset exchanges are registered as money transmitters, a type of money service business licensed at the state level. Money transmitters are subject to registration and reporting requirements from the Financial Crimes Enforcement Network (FinCEN), a bureau of the Treasury Department responsible for implementing the Bank Secrecy Act (P.L. 91-508). For example, money transmitters are required to verify customer identity and record beneficiary information for transfers of $3,000 or more and are required to file "Suspicious Activity Reports" for certain transactions exceeding $2,000. In 2013, FinCEN issued interpretative guidance for crypto-asset exchanges, stating that an "administrator or exchanger that (1) accepts and transmits a convertible virtual currency or (2) buys or sells convertible virtual currency for any reason is a money transmitter under FinCEN's regulation."

Trading Platforms as Securities Exchanges

Because money transmitter regulation is focused mostly on state licensing, some argue that this framework is insufficient for large-scale interstate and international digital asset trading activities. For some observers, regulating crypto-asset exchanges as money transmitters raises investor-protection concerns, because although some view them as functional equivalents to stock exchanges, they are not subject to the same type of investor protection regulation as those exchanges.

Crypto-asset exchanges could be subject to regulation from securities and commodities regulators. Under the Commodity Exchange Act (P.L. 74-675), the Commodity Futures Trading Commission (CFTC) regulates derivatives exchanges (for example, exchanges trading Bitcoin futures rather than Bitcoins). The

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IN11708

CFTC has the authority to bring enforcement actions for fraud and market manipulation involving digital asset commodities spot and forward transactions. However, observers point out that the CFTC does not otherwise regulate these markets or market participants.

In addition, the SEC issued a statement clarifying that the online platforms for buying and selling crypto assets that qualify as securities could be unlawful. The SEC took its first enforcement action against an unregistered crypto-asset exchange in 2018. The agency stated that the platform "had both the user interface and underlying functionality of an online national securities exchange and was required to register with the SEC or qualify for an exemption" but appeared to have failed to do so.

Crypto-Asset Exchanges Versus National Securities Exchanges

The differences between crypto-asset exchange investor protections under current regulation and what they would be if most or all were regulated by the SEC as national securities exchanges could include requirements to increase transparency, fairness, and efficiency. These are guiding principles in national securities exchange regulation, yet some perceive them as lacking in crypto-asset exchanges' current practices. The downsides of heightened regulation may include increased compliance costs, hindrance of financial innovation, and competitive pressure for resources and talent internationally.

Nontransparent, Fraudulent, and Manipulative Activities

Many crypto-asset exchanges (including those that generally allow trading of digital assets that are not securities and thus not regulated by the SEC) are reportedly exaggerating their volumes to attract more participation. Many investors may not know whether the trading volume and prices reflect real activities or market manipulation. To take the more frequently studied digital asset Bitcoin, for example, one study showed that 95% of Bitcoin's trading volume displayed on digital asset price and volume aggregator CoinMarketCap.com is either fake or non-economic in nature. Another academic study illustrated the large scale of potential damage that digital asset market manipulations could create, underlining investor-protection concerns.

One observer stated that "when you go into one of these exchanges, you don't know whether the order book is accurately reporting the bids and the offers. You don't really know if there is front-running. You don't know whether some of the trading that is reported is real or fake."

Network Congestions and Market Inefficiencies

Unlike SEC-regulated exchanges, crypto-asset exchanges frequently face network congestions or trading halts, leading some to question the readiness of these exchanges to serve a growing marketplace. For example, during a rapid digital asset selloff and recovery in May 2021, multiple major crypto-asset exchanges reportedly encountered technical issues, further intensifying market stress during a volatile time of increased trading. These market disruptions could generate investor protection concerns due to investors' inability to get in and out of their investment positions in a timely manner or investors' inability to seek best execution for their trades—common features of a fair and efficient trading system.

Policy Proposals

Many observers have called for changes to the regulatory framework governing crypto-asset exchanges. Some have questioned whether digital asset trading warrants more regulatory safeguards. SEC Chair Gary Gensler has asked Congress to provide more clarity regarding authority over crypto-asset exchanges.

Gensler stated that the lack of oversight of crypto-asset exchanges represents a "gap in our system" that denies traders basic investor protection—such as the protections found in traditional securities markets. Members of Congress followed up with inquiries into the agency's authority over crypto-asset exchange regulation. Opponents of stricter regulation voice concerns that new regulation may hinder innovation and place the United States at a competitive disadvantage relative to other countries.

Additionally, the use of state and federal bank charters by crypto-asset exchanges has the potential to affect how these exchanges are regulated. The Comptroller of the Currency (OCC), which charters and regulates national banks, reportedly developed a new charter for national payments institutions, which would provide a nationwide licensing and regulation platform for money transmitters. To the extent crypto-asset exchanges obtain such a license, they would be subject to certain prudential and consumer protection regulations promulgated by the OCC and other banking regulators.

Related CRS Products

CRS Report R46208, *Digital Assets and SEC Regulation*, by Eva Su.

CRS Report R46486, *Telegraphs, Steamships, and Virtual Currency: An Analysis of Money Transmitter Regulation*, by Andrew P. Scott.

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