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Mr. Bitcoin Goes to Washington

Client Alerts

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Few industries experienced a more drastic reversal of fortune on Election Day than the cryptocurrency sector. On November 4, several of its largest companies were locked in a seemingly interminable battle with the Securities and Exchange Commission and its Chair, Gary Gensler, in federal court, while legislative relief was stalled by a skeptical and sometimes openly intransigent Democratic Senate and White House. By the time the dust had settled on November 6, crypto's political prospects had reversed: Gensler's days were numbered and opponents in both Congress and the White House had been taken off the board. Even the industry's immediate financial fortunes skyrocketed: in the past week, the price of one Bitcoin passed the previously unthought summit of $100,000.

In this client alert, we will walk you through how the cryptocurrency industry helped engineer its own remarkable reversal of fortune, how it is likely to fare under a new administration and a closely divided congress, and how all of this could lead to the establishment of a crypto market outside the control of the SEC, even while other regulatory aspects such as the Bank Secrecy Act continue to operate.

Election Muscle and an Emerging Crypto Center

It was only a matter of time before cryptocurrency was converted into political action cash. The crypto industry emerged as one of the highest spenders of the 2024 cycle, raising nearly $245 million to distribute across the 2024 battlegrounds. All told, according to nonprofit watchdog Public Citizen, crypto accounted for nearly half of all money flowing into corporate PACs, outpacing private sector mainstays like the oil and pharmaceutical industries.

On November 6, the crypto-political headlines naturally focused on the biggest expenditure of the night: Republican businessman and blockchain entrepreneur Bernie Moreno defeated Senate Banking Chairman Sherrod Brown of Ohio, spurred on by nearly $40 million in donations from the industry. Brown, who famously once criticized the number of cryptocurrency advertisements during the Super Bowl, used his position at Senate Banking to slow industry-backed legislation that would limit the role of the SEC and highlight the perceived links between cryptocurrency and terrorist financing. His defeat, along with the incoming administration's promises to the industry, have led many to point to the election as a solidification of an emerging alliance between the industry and the GOP.

Here, at least, the headlines might obscure a more nuanced strategy and an emerging bipartisan consensus on the Hill. The industry proactively sought out friends amongst the Democratic caucus. Industry-aligned PACs spent $10 million to elect Elissa Slotkin (D-MI) and Reuben Gallego (D-AZ) to the Senate, and all told, donations in the House favored Democrats by a healthy margin.

All of this points to a longer-term effort to win over the youth wing of a Democratic Party which has, until now, been highly skeptical if not hostile to the industry's expansion. These gains will blunt crypto's exposure to a Democratic takeover of the House in 2026, or the damage that can be inflicted by a Senator Warren chairmanship on Senate Banking should Democrats retake the Senate in the next four years.

The industry also targeted voters on the issues that mattered to them, not just crypto issues, indicating a strong desire to build a political power base beyond digital wallet issues. In Nevada, the industry ran ads about unions and inflation. In Ohio, it ran ads about the perils of immigration. While 17% of Americans have traded a cryptocurrency, the industry ensured that its effect on the election went far beyond its economic footprint. These advertisements not only paid political dividends in the short term but sent a strong message to lawmakers that any part of their record would be fair game for a Super Bowl commercial level of cash, should they run afoul of industry. According to Stand With Crypto, nearly 300 pro-crypto lawmakers will take seats in Congress come January, and even skeptical lawmakers will likely question the advisability of voting against the industry's initiatives on the Hill.

New Appointments and a Weak or Strong SEC

While crypto will have political muscle, it is uncertain exactly how this will be used. It is almost certain however, that the agenda will be intertwined with the Trump Administration's new appointments to the SEC and a White House "crypto-czar."

Since the election, Democrats have been increasingly willing to cut a deal on the various pieces of crypto legislation that have percolated during the 118th Congress. Retiring Senator Debbie Stabenow (D-MI), in particular, has attempted to work with Republicans on the Senate Agriculture Committee to pass legislation to bring certainty to the market, including by increasing the Commodity Futures Trading Commission's (CFTC) rulemaking authority. It is highly unlikely any of these bills will be advanced during the lame duck session leading up to January 20, as it is impossible to imagine Donald Trump endorsing any bipartisan attempt to bring major financial legislation to President Biden's desk rather than his own. Any new legislation will wait until the 119th Congress and the incoming Republican trifecta in the House, Senate, and White House.

These Executive Branch changes will be accompanied by a number of changes to key congressional committees of jurisdiction. Senator Tim Scott (R-SC), a noted supporter of the industry and close ally of the President-elect, will take over at Senate Banking. In the House, Andy Barr (R-KY) and French Hill (R-AR) are the current front-runners to take over as the Chairman of House Financial Services. Both are viewed as pro-cryptocurrency lawmakers, although Hill has closer ties to the industry, based on his leadership of the Subcommittee on Digital Assets, Financial Technology, and Inclusion. Barr has promised to advance legislation which would "foster innovation in fintech and digital assets," while Hill has vowed to eliminate the "political targeting" of digital assets by bank regulators. Regardless of who wins, we expect either to favor an affirmative, pro-cryptocurrency legislative agenda.

SEC Chair and White House Crypto Czar

In a rare moment of campaign applause lines and Article II independent agency appointments converging, Donald Trump received a standing ovation on the campaign trail when he promised to remove Gensler on his first day in power. That reaction, and the First Family's professed fondness for cryptocurrency, all but guarantees favorable nominees at key agencies and posts, even if President Trump will no longer need to navigate the tricky situation of removing Gensler.

On December 4, President-elect Trump announced that he would be nominating Paul Atkins, the CEO of consulting firm Patomak Partners and a former SEC commissioner, to lead the SEC. Atkins is a staunch advocate for digital assets, in part due to his role as co-chair of the Token Alliance, an initiative of the Digital Chamber of Commerce developed to advocate for best practices and promote the industry. Atkins has also publicly criticized Gensler's crackdown on the industry, arguing that the SEC's hostility has driven innovation and market value overseas. He has also questioned the legal soundness of the SEC's enforcement authority—most notably, its invocation of the 1946 Supreme Court decision in *SEC v. Howey* to regulate the vast majority of cryptocurrencies as securities. Unsurprisingly, for a nominee who once appeared on the podcast "Get Your Government Hands Off My Crypto," Atkins's nomination has been greeted with enthusiasm by the industry. His nomination is not expected to meet with significant resistance in the Senate, although Democrats are likely to sharply question a number of his deregulatory positions surrounding *Dodd-Frank* and financial markets generally.

Atkins's likely tenure and its effect on the cryptocurrency market, however, extends beyond his familiarity with the industry. Although he is a highly respected former SEC Commissioner and a fixture of financial services circles in Washington, Atkins trends ideologically Libertarian and is viewed as a skeptic of increased regulation and of the need for SEC enforcement as a form of consumer protection in many cases. Reports were that Atkins was hesitant to take the job due to his concern that the SEC had become far too bloated under Gensler's tenure. It is possible that Atkins, more so even than other Republican regulators, will be willing to allow a permissive framework for digital assets to flourish—even one that marginalizes or excludes the SEC from areas in which it has previously been the primary or sole regulator. It was always likely that a Trump SEC would end the high-profile enforcement actions against cryptocurrency companies and set down more favorable rules of the road for industry. As will be discussed further below, an Atkins-led SEC may go one step further in creating a framework that enshrines a separation between the crypto market and the SEC.

Atkins will be expected to work hand-in-hand with a White House that emphasized cryptocurrency policy throughout the campaign. Last week, the President-elect announced on Truth Social that he would be appointing experienced venture capitalist and close Elon Musk-associate David Sacks as the "White House A.I. & Crypto Czar." As of yet, it is unclear exactly what form this role will take; whether it will have a significant budget or staff; whether Sacks will drive industry, legislative, or regulatory collaboration; or whether he will play more of a coordinator role. Early reports are that Sacks will be a "Special Government Employee" and thus will remain involved in his other ventures. It does appear that Sacks will likely oversee a crypto-advisory panel (another campaign promise) staffed in part with industry representatives, which will reportedly sit under the White House's National Economic Council. Other Trump advisors on crypto, such as former CFTC Chair Chris Giancarlo and Coinbase CEO Brian Armstrong, could sit on that panel but may prefer to advise the White House in a more unofficial capacity.

The relationship between government veterans such as Atkins and Giancarlo on one hand, and investor-advisors like Sacks and Armstrong on the other, will be key to determining how cryptocurrency will fare in Washington over the coming years. There will undoubtedly be some tension in management styles between Northern California and Washington as well as differences in opinion over how industry should be regulated moving forward.

Flooding the Market: How a New Regulatory Framework Could Quickly Become Optional

Despite the inevitable, attention-grabbing appointments to these posts, we expect the industry to continue to push a legislative-first strategy. While Atkins's appointment at the SEC will relieve regulatory pressures, a Republican trifecta, along with a significant number of friendly Democratic lawmakers on the Hill, presents a potential, unique opportunity to cement a favorable regulatory framework for the next decade.

We also expect this legislative strategy to assign primary jurisdiction for digital currencies, wherever possible, to the CFTC for at least two reasons. First, the CFTC possesses roughly 10% of the SEC's enforcement budget—relying in large part on whistleblowers to initiate cases. Assigning primary jurisdiction to the CFTC will inevitably mean an easing in the regulatory and enforcement pressures that the industry has faced, regardless of whether there is a Democratic or Republican administration—providing insurance against a reincarnation of a crypto-skeptic SEC chair with an expansive view of the term "security." Second, assigning primary jurisdiction to the CFTC aligns with industry, and perhaps even the SEC's newly installed leadership's strong intellectual belief about how most digital assets should be regulated in the first place: that these are decentralized, revolutionary assets which break, rather than reinforce, the traditional Wall Street mold of a security. [1]

For those reasons, we expect that the House will likely move to repass a version of the Financial Innovation and Technology for the 21st Century (FIT21) Act, which passed in May on a bipartisan 279–136 vote. The FIT21 Act splits supervision of digital assets between the CFTC for digital commodities and the SEC for restricted digital assets. The bill was strongly opposed by the SEC, the Biden White House, and notable Democrats on the Hill, including Financial Services Ranking Member Maxine Waters. If the bill passes the Senate, it would almost certainly be signed by President Trump.

Herein, however, lies the key: the FIT21 Act is more of a blueprint for a cryptocurrency regulatory infrastructure than the infrastructure itself. Substantial details are left to the discretion of the SEC and the CFTC, which are required to issue rules to define such key terms as "digital asset," "restricted digital asset," and "digital commodity" and to determine how to exempt registered persons from "duplicative, conflicting, or unduly burdensome provisions" of the act.

FIT 21 also affords the SEC and CFTC significant discretion in the registration process for digital assets, creating an opportunity for the Trump Administration to build a framework largely outside the bounds of the SEC's authority. FIT21 outlines a process by which a company will file a rebuttable presumption of decentralization of a blockchain system (i.e., a commodity subject to the CFTC's jurisdiction), which then becomes automatically effective in 60 days unless the SEC rejects or stays the filing based on its belief that the digital asset is a security. After a digital asset's blockchain system is certified as a decentralized system, the bill provides that the digital asset becomes a "digital commodity" that is exempt from the SEC-style regime.

The Trump Administration could therefore cement an enduring era of deregulation for crypto assets by exercising its discretion and concluding that most systems are exempt from the SEC's light-touch regime laid out in the bill, creating a crypto market largely outside the scope of the securities laws and the SEC's purview. Even under the best of circumstances, the SEC would find it difficult to assert jurisdiction over digital assets under the act: Chair Gensler argued the SEC could not adequately challenge the presumption of decentralization under FIT21's procedures, stating it was "implausible that the SEC could review and challenge more than a fraction" of the more than 16,000 crypto assets that currently exist. Chair Atkins could ensure that the SEC took a backseat role during this process, allowing the presumption of decentralization to go unchallenged and imprinting a decentralized view of the market. This approach would cede substantial amounts of authority to the CFTC in a manner that would be difficult for a future administration to reclaim. It is unclear if any Democrats will rethink their support for FIT21 now that they no longer have the backstop of Gensler at the SEC, or whether a softening in Democratic support will have any effect on the bill's prospects.

Other guidance and change will almost assuredly come from within the SEC, even if longer term legislative changes are possible. In May, President Biden vetoed a bipartisan bill that sought to repeal SEC Staff Accounting Bulletin 121 (SAB 121), a controversial instance of SEC guidance that required financial institutions holding digital assets to treat them as liabilities. While this guidance will likely be weakened or repealed by Chair Atkins, we would not rule out a longer-term legislative fix to prevent such guidance from becoming effective in the future.

Sanctions, Bank Secrecy Act, and Other Regulatory Changes

While the ongoing fights regarding the SEC's jurisdiction and rulemaking will take the spotlight, relatively settled and extensive economic sanctions and anti-money laundering (AML) regulatory requirements and oversight under the Bank Secrecy Act (BSA) will continue to present more day-to-day concerns for the industry. Nonetheless, the industry is likely to also try to exert its influence in the realm of de-banking and de-risking trends that have impacted the ability of digital asset businesses to obtain banking services, as well as against regulatory requirements such as the Financial Crimes Enforcement Network's (FinCEN's) Beneficial Owner registry, which is seen as a privacy intrusion by some.

President Trump's nominee for Treasury Secretary, Scott Bessent, has been a vocal supporter of blockchain's potential and invested in cryptocurrency through his hedge fund. Both the Office of Foreign Assets Control (OFAC) and FinCEN, in coordination with the Department of Justice (DOJ), have increased enforcement actions involving cryptocurrencies in recent years, focusing particularly on the failure of companies under 18 U.S.C. 1960 to obtain required money transmitter licenses and implement formal sanctions screening and anti-money laundering programs required by law for regulated financial institutions. Of particular concern has been the potential for digital assets flowing to Russia and Hamas, with the government warning in the first year of the Biden Administration that digital currencies posed a threat to America's sanctions program. Since then, OFAC and DOJ have brought a number of enforcement actions against crypto companies or exchanges, including one resulting in a nearly billion-dollar settlement with Binance alleging that it permitted the presence of both US- and foreign-sanctioned jurisdiction users on its platform.

Industry has generally disagreed that the risk of criminal transactions, money laundering, terrorist financing, and sanctions evasion remains higher with digital assets, suggesting that the features of the blockchain—including permanent records—increases transparency and traceability and arguing that the Biden Administration has unfairly singled out the industry.

The Treasury Department has sought increased authority from Congress to regulate digital assets under existing anti-money laundering and counter-terrorism legislation, and has been in the process of developing extensive new regulations implementing provisions of the Anti-Money Laundering Act of 2020. It is not expected that significant new legislation will be implemented in the next several years in this arena, but it remains to be seen whether the second Trump Administration will slow the current trend of enforcement against crypto platforms in this space given its plans to implement a restrictive economic agenda and potentially implement revised sanctions against Cuba and Iran. An early indication of how the administration will approach enforcement might be its decision whether to sanction the cryptocurrency Tether, which Treasury has warned has facilitated transactions for illegal criminal groups. The Trump Administration's transition chair, Cantor Fitzgerald CEO, and Commerce Secretary-nominee Howard Lutnick manages most of Tether's assets.

Finally, many Republicans in Congress have recently been highly critical of the BSA's extensive reporting requirements, arguing that suspicious activity reports and banks' informal communications with law enforcement constitute warrantless searches of Americans' financial records; the Judiciary Committee has signaled, in particular, that it might support amending the BSA to limit regulators' access to financial records given how these authorities were used post-January 6. It is unclear how any broader proposed changes would interact with financial regulators' authority to regulate cryptocurrency, which is currently broadly exercised on both the state and federal level.

Footnotes

[1] The CFTC budget for enforcement staff in fiscal year 2024 was $66 million for 172 staff. The SEC's was ten times larger: $676 million for 1420 full-time staff.

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