



THE FUTURE OF WEB3 DEPENDS ON CAREFUL REGULATORY APPROACHES



BY
DUANE POZZA



&
LAUREN JOHNSON

Duane Pozza is a Partner at Wiley Rein LLP, focusing on regulation of emerging technologies including digital assets, and previously served as an Assistant Director for Financial Practices at the Federal Trade Commission. Lauren Johnson is an Associate at Wiley Rein LLP, and formerly worked as a project specialist assisting in the launch and operation of the Arizona Fintech Sandbox at the Arizona Attorney General's Office.

THE FUTURE OF WEB3 DEPENDS ON CAREFUL REGULATORY APPROACHES

By Duane Pozza & Lauren Johnson



HOLD YOUR HORSES

By Carol Van Cleef



WEB3 IS COMING FAST, AND REGULATION NEEDS TO KEEP PACE

By Sean Stein Smith



WEB3 IN TRANSITION AND PARTICIPATORY REGULATION

By Fabio Bassan



INSURANCE'S ROLE IN THE REGULATION OF WEB3 THROUGH DE-RISKING

By Jessica Chapman



THE TOKENIZATION OF CONSUMER SURPLUS: NEW ANTITRUST TOOLS IN WEB3 MARKETS

By Kelly Fayne & Elise Nelson



INFUSE DIGITAL ASSETS TO JUMPSTART FINANCIAL LITERACY IN AMERICA'S EDUCATION SYSTEM

By Cleve Mesidor & Mali Smith



THE FUTURE OF WEB3 DEPENDS ON CAREFUL REGULATORY APPROACHES

By Duane Pozza & Lauren Johnson

Blockchain and digital token technologies have achieved prominence in terms of crypto and digital asset transactions, but these technologies also are the foundation for a new iteration of internet technology known as Web3. Web3 technology is more decentralized and depends on development and implementation of blockchains and digital tokens to succeed. This paper broadly defines Web3 and discusses the current legislative and regulatory approaches to digital asset markets, which are merely a subset of how Web3 could be deployed. Additionally, it identifies potential issues policymakers and regulators will face if their regulation of financial digital assets broadly impacts Web3 development, and cautions against an overly expansive regulatory approach.

Visit www.competitionpolicyinternational.com for access to these articles and more!

Scan to Stay Connected!

Scan here to subscribe to CPI's **FREE** daily newsletter.



01

INTRODUCTION

The decentralized technology behind Web3 holds enormous promise, and has developed quickly over the last decade-plus. The technology may allow both new market entrants and current “Web2” internet incumbents to better compete to provide online services in areas as disparate as identity management, financial transactions, intellectual property distribution, and personal data ownership, among others yet to come. As with other technological innovations, legislation and regulation can be slow to keep pace – and focusing on regulating the technology in specific use cases, can be misguided.

Because Web3 technology is evolving, the ultimate design, development, and use of Web3 might be drastically different from the current trajectory or many predictions by those outside or even within the Web3 industry.² Web3 is being built on technologies that currently are known primarily for facilitating digital asset and cryptocurrency transactions. Government entities are currently focused on those transactions, and signaling some movement toward a regulatory framework in the digital asset space. However, the approach toward a digital asset framework could potentially impact the development of Web3 as a whole.

This paper first discusses the existing technologies underlying the foundation of Web3. Next, the paper summarizes the current regulatory landscape for digital assets by reviewing the statements and actions of regulators and legislators in the past few years. Finally, this paper zooms out to identify broader impacts on Web3 if legislators and regula-

tors are focused merely on blockchain and digital tokens as financial tools, rather than fundamental technologies that can usher in new possibilities for the internet.

02

DEFINING WEB3

Web3 technology is based on decentralized technology that gives individuals tools to innovate and execute quickly.³ Three fundamentals are blockchains, smart contracts, and digital tokens.⁴ Web3 proponents generally aim to make the internet more accessible without overly centralized control, as Web3 takes “blockchain disintermediation to a next level by making it ubiquitous, encompassing not only payments and financial services but also digital identities, data and business models.”⁵ In particular, blockchains, or distributed ledgers, permit a shift from reliance on a Web2 middleman to a more decentralized system, that still incorporates trust mechanisms. Web3 advocates often frame the technology in competition terms, hoping to “create new economies, new classes of products, and new services online.”⁶ Using a blockchain to underlie digital infrastructure can provide “decentralization, cryptographic security, transparency, and immutability,” allowing “information to be verified and value to be exchanged without having to rely on a third-party authority.”⁷

Smart contracts “represent application logic and can execute specific tasks independently” and allow more dynamic transactions on the blockchain to operate without a middleman.⁸ These autonomized transactions “allow for new mar-

2 For the purpose of this paper, the Web3 industry generally refers to entities working on blockchain, digital asset, and cryptocurrency technologies and the policy advocates for the growth of these products and services.

3 “[Web3] is a convenient shorthand for the project of rewiring how the web works, using blockchain to change how information is stored, shared, and owned.” Thomas Stackpole, *What Is Web3*, Harvard Business Review (May 10, 2022), <https://hbr.org/2022/05/what-is-web3>.

4 See Brant Carson et al., *Blockchain beyond the hype: What is the strategic business value?*, McKinsey & Company, at 3 (June 2018), <https://www.caba.org/wp-content/uploads/2020/04/IS-2018-209.pdf> (“Blockchain is a distributed ledger, or database, shared across a public or private computing network. Each computer node in the network holds a copy of the ledger, so there is no single point of failure. Every piece of information is mathematically encrypted and added as a new ‘block’ to the chain of historical records.”); Primavera De Filippi et al. *Smart contracts*, 10 *Internet Policy Review* 2 (2021), <https://doi.org/10.14763/2021.2.1549>, (“A smart contract is code deployed in a blockchain environment, or the source code from which such code was compiled.”); *Digital Token*, Westlaw Practical Law Glossary, w-024-0323 (“A digital representation of value or rights that is offered and sold for the purpose of [f]acilitating access to, participation in, or development of a distributed ledger, blockchain, or other digital data structure [and] [r]aising capital for the development of the network or platform.”).

5 Ahto Buldas et al., *Towards a Foundation of Web3*, *Future Data and Security Engineering: Big Data, Security and Privacy, Smart City and Industry 4.0 Applications*, 1688 *Communications in Computer and Information Science* 3 (Nov. 2022), https://doi.org/10.1007/978-981-19-8069-5_1.

6 Stackpole, *supra* note 3.

7 Carson, *supra* note 4.

8 Anutosh Banerjee et al., *Web3 beyond the hype*, McKinsey & Company (Sept. 26, 2022), <https://www.mckinsey.com/industries/financial-services/our-insights/web3-beyond-the-hype>.

kets to develop: disintermediated contract markets in which parties do not have concern for counterparty risk.”⁹ In a completely decentralized blockchain, smart contract applications can be governed by decentralized autonomous organizations (“DAO”), and if “set up correctly, no company can unilaterally decide to change the parameters of the application.”¹⁰

A critical component for smart contracts to operate are digital tokens, which “can represent anything of value and engage with smart contracts to become ‘programmable.’”¹¹ Similar to how website addresses allow for navigation between webpages in Web2, digital tokens will allow users to interact with Web3 interfaces.¹² Digital tokens provide a mechanism for transmitting information on a blockchain, which can be used to validate transactions, represent real estate, and even act as a voting mechanism.¹³ From serving as the medium for smart contracts to providing validation to blockchain transactions, digital tokens are necessary for basic Web3 operation.

03

CURRENT APPROACHES TO WEB3 LEGISLATION AND REGULATION

Legislators and regulators have primarily focused on regulating the use of blockchain and tokenization technologies in digital asset and cryptocurrency contexts, rather than Web3 generally. Even in those areas, guidance from government entities has been far from cohesive or concrete,

creating regulatory uncertainty in a number of areas, even as new legislative and regulatory proposals are introduced and debated.

A. White House Response

The White House has discussed digital assets regulation at a very high level, requesting federal agencies and departments conduct analyses and reports recommending action that can mitigate risks presented by digital assets, stablecoins, and central bank digital currencies (“CBDC”). In March 2022, Executive Order 14067 (“EO 14067”) outlined broad priorities for regulation of digital assets including protecting consumers and the financial industry from negative effects and fallouts from digital assets, encouraging United States (“U.S.”) competitiveness in the space, and exploring the practicality of CBDCs.¹⁴ After the White House reviewed the requested agency reports, it released a framework for digital assets, which broadly reinforced the same guiding principles from EO 14067.¹⁵ Based on these actions, the White House seems focused on mitigating downside risk from digital assets, deferring to agencies’ judgment on the best course for monitoring and enforcing existing laws and regulations.¹⁶

B. Regulatory Response

1. Securities and Exchange Commission

Many regulatory agencies are involved in the extensive regulatory landscape that digital asset companies are trying to navigate. The Securities and Exchange Commission (“SEC”) has been one of the most active regulators of digital assets. While not issuing any rulemakings on digital assets, the agency has provided informal guidance for application of the “Howey” test – which governs whether an asset is a

9 Trevor I. Kiviat, *Beyond Bitcoin: Issues in Regulating Blockchain Transactions*, 65 Duke Law Journal 569, 606 (2015), <https://scholarship.law.duke.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=3827&context=dlj>.

10 Banerjee, *supra* note 8.

11 *Id.* For the purpose of this paper, digital tokens encompass all types of tokens that operate on the blockchain. In contrast, digital assets are tokens use to facilitate a financial transaction of some sort. Digital assets are a subset of digital tokens under this framework.

12 SHERMIN VOSHM GIR, *TOKEN ECONOMY: HOW THE WEB3 REINVENTS THE INTERNET* (2d. ed. 2020).

13 Token Alliance, *Understanding Digital Tokens: Market Overviews and Proposed Guidelines for Policymakers and Practitioners*, Chamber of Digital Commerce at 9, <https://lowellmilkeninstitute.law.ucla.edu/wp-content/uploads/2018/08/Understanding-Digital-Tokens.pdf>.

14 Exec. Order No. 14067, 3 C.F.R. 14143 (2022).

15 *Fact Sheet: White House Releases First-Ever Comprehensive Framework for Responsible Development of Digital Assets*, The White House (Sept. 16, 2022), <https://www.whitehouse.gov/briefing-room/statements-releases/2022/09/16/fact-sheet-white-house-releases-first-ever-comprehensive-framework-for-responsible-development-of-digital-assets/>.

16 See *id.* (The White House also suggests the Bank Secrecy Act be amended to include apply it to crypto exchanges and NFT platforms.).

security – to digital assets.¹⁷ Further, SEC Chairman Gary Gensler has made it clear that he believes most digital assets and crypto exchanges fall under SEC jurisdiction and should be regulated according to existing rules.¹⁸ In general, Chairman Gensler intends to “continue to take [the SEC’s] authorities as far as they go” and favors even more regulatory authority from Congress to “prevent transactions, products, and platforms from falling between regulatory cracks.”¹⁹ Indeed, in the recent case of *SEC v. LBRY*, the SEC successfully argued that certain tokens with utility functions related to the overall blockchain-based projects were still securities under the *Howey* test.²⁰ The application of securities laws to utility tokens would further expand SEC jurisdiction and securities registration and reporting requirements for many projects.²¹

“Many regulatory agencies are involved in the extensive regulatory landscape that digital asset companies are trying to navigate

2. Commodity Futures Trading Commission

The Commodity Futures Trading Commission (“CFTC”) has taken a more limited approach to the regulation of digital assets. Similar to the SEC, the CFTC has not issued formal rulemakings related to digital assets, but the CFTC has used its authority over fraud and market manipulation to extend to conduct involving digital assets.²² The agency has stated that it believes that its regulatory oversight is limited, but it retains “general anti-fraud and manipulation enforcement authority over virtual currency cash markets as a commodity in interstate commerce.”²³ In a 2015 enforcement action, the CFTC stated that all virtual currencies are commodities.²⁴ Former CFTC Chairman Tarbert specified in 2019 that Ether, one of the largest digital assets by market capitalization and the currency for the Ethereum platform, was a commodity that fell under the CFTC’s jurisdiction, which came not long after the CFTC determined that Bitcoin was a commodity.²⁵ CFTC Commissioner Stump recently explained that “the CFTC regulates futures on Bitcoin because Bitcoin is a commodity – but the CFTC does not regulate Bitcoin itself.”²⁶ She reiterated the CFTC’s focus on using its “anti-fraud and anti-manipulation enforcement authority (as opposed to day-to-day regulatory oversight) ... as a tool to assist in its primary function of regulating derivatives products, such as futures.”²⁷ While the CFTC is not “in the business of regulating Bitcoin transactions or the

17 Framework for “Investment Contract” Analysis of Digital Assets, SEC, <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets> (last updated Apr. 3, 2019). The Supreme Court determined that an investment contract was “a contract or scheme for ‘the placing of capital or laying out of money in a way intended to secure income or profit from its employment.’” *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 298 (1946).

18 Gary Gensler, Chairman, Securities Exchange Commission, Penn Law Capital Markets Association Annual Conference (April 4, 2022).

19 Gary Gensler, Chairman, Securities Exchange Commission, Remarks Before the Aspen Security Forum (Aug. 3, 2021).

20 *U.S. Securities and Exchange Commission v. Lbry, Inc.*, No. 21-cv-00260, Complaint ¶ 24, (D. N.H. Mar. 29, 2021).

21 SEC Chairman Gensler and Commissioner Crenshaw, though not speaking on behalf of the agency when offering remarks, have indicated strong personal beliefs that the SEC should be regulating decentralized finance (DeFi) products to the extent possible. Commissioner Crenshaw stated in the *International Journal of Blockchain Law*, “...for non-compliant projects within our jurisdiction, we do have an effective enforcement mechanism. For example, the SEC recently settled an enforcement action with a purported DeFi platform and its individual promoters. The SEC alleged they failed to register their offering, which raised \$30 million, and misled their investors while improperly spending investor money on themselves. To the extent other offerings, projects, or platforms are operating in violation of securities laws, I expect we will continue to bring enforcement actions.” Commissioner Caroline Crenshaw, *Statement on DeFi Risks, Regulations, and Opportunities*, 1 Int’l J. of Blockchain L. 2021. See *supra* note 18. See also *U.S. Securities and Exchange Commission v. Lbry, Inc.*, No. 21-cv-00260 (D. N.H. Mar. 29, 2021); *U.S. Securities and Exchange Commission v. Ripple Labs Inc.*, No. 20-cv-108032 (S.D. N.Y. Dec. 12, 2020).

22 CFTC’s Role in Monitoring Virtual Currencies, CFTC (2020), <https://www.cftc.gov/media/4636/VirtualCurrencyMonitoringReportFY2020/download>.

23 *Id.*

24 *In the Matter of: Coinflip, Inc.*, CFTC Dkt. No. 15-29, 3 (Sept. 17, 2015) (“Bitcoin and other virtual currencies are encompassed in the definition and properly defined as commodities.”).

25 Heath Tarbert, Former Chairman, Commodity Futures Trading Commission, Comments on Cryptocurrency Regulation at Yahoo! Finance All Markets Summit (Oct. 10, 2019).

26 Dawn Stump, Commissioner, Commodity Futures Trading Commission, Regarding Enforcement Action Relating to Bitcoin Fraud (March 8, 2022).

27 *Id.*

individuals or entities that buy, sell, trade, transfer, or store Bitcoin,” Congress has explored options giving the CFTC greater authority in the space.²⁸

Many in the Web3 industry would prefer to fall under CFTC jurisdiction given the agency’s transparent position, and that digital assets would be subject to less disclosure and reporting requirements than are required by the SEC.²⁹ CFTC Chairman Rostin Behnam has testified before the Senate Committee for Agriculture, Nutrition, and Forestry that he supports “bills that contemplate shared responsibility for the CFTC and the Securities and Exchange Commission, where the SEC would utilize its existing authority and reporting regime requirements for all security tokens, while the CFTC would apply its market-based rules for the more limited subset of commodity tokens, which do not have the same characteristics as security tokens.”³⁰ This division of authority would provide less onerous compliance for digital tokens that are not designed to raise capital.

“The Commodity Futures Trading Commission (“CFTC”) has taken a more limited approach to the regulation of digital assets

3. Other Regulatory Bodies

Other agencies with authority over digital assets in certain capacities include the Consumer Financial Protection Bureau (“CFPB”), Federal Trade Commission (“FTC”), Financial

Crimes Enforcement Network (“FinCEN”), and the Federal Reserve Board (“the Fed”). As a regulator of financial products or services, the CFPB has authority over certain digital assets in some circumstances. Director Rohit Chopra has stated that he is committed to “working to promote competition and innovation, while also reducing the risks that digital assets could pose to our safety and security.”³¹ As with other agencies, no official rulemakings have been proposed or released, but the CFPB issued a report publicizing the rise in crypto-related consumer complaints.³² Chopra has noted that the CFPB is keeping tabs on use of digital assets and blockchain technologies for payment services, but in his view, “right now, cryptocurrency, including stablecoins, are not primarily used in consumer payments. They’re really used for speculative trading purposes.”³³ The CFPB’s focus, as expressed by Director Chopra, is around how digital assets are marketed and what representations companies make about the security of customer funds.³⁴

Exercising its broad jurisdiction over potential unfair and deceptive practices, the FTC has taken similar positions as the CFPB. The FTC released a report in June 2022 outlining the rise in scams that utilize digital assets.³⁵ The FTC maintains that it will take action to prevent crypto-related fraud or scams using its regulatory authority under Section 5 of the FTC Act, and has provided warnings to consumers about types of crypto-fraud.³⁶

The Fed, as an institutional regulator, provides guidance to banks and other financial institutions about their involvement with digital assets. At the end of 2021, the Fed and other banking regulators released a joint statement indicating their plan to “provide greater clarity on whether certain activities related to crypto-assets conducted by banking organizations are legally permissible, and expectations for safety and soundness, consumer protection, and compli-

28 *Id.* See also *Digital Commodities Consumer Protection Act of 2022*, S. 4760, 117th Cong. (2022).

29 See Dawn Stump, Commissioner, Commodity Futures Trading Commission, CFTC’s Regulatory Authority Applicable to Digital Assets (Aug. 23, 2021) (“The CFTC’s regulatory oversight authority, as well as the application of our enforcement authority, must be well understood by the public.”).

30 Rostin Behnam, Chairman, Commodity Futures Trading Commission, Testimony Before U.S. Senate Committee on Agriculture, Nutrition, and Forestry (Dec. 1, 2022).

31 Rohit Chopra, Director, Consumer Financial Protection Bureau, CFPB Director Chopra Statement on President Biden’s Digital Assets Executive Order (Mar. 9, 2022).

32 CFPB Publishes New Bulletin Analyzing Rise in Crypto-Asset Complaints, CFPB (Nov. 10, 2022), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-publishes-new-bulletin-analyzing-rise-in-crypto-asset-complaints/>.

33 Jon Hill, *From Crypto To Apps, CFPB’s Chopra Has Payments In Focus*, Law 360 (Jul. 27, 2022), <https://www.law360.com/articles/1515319/from-crypto-to-apps-cfpb-s-chopra-has-payments-in-focus>.

34 *Id.*

35 Emma Fletcher, *Reports show scammers cashing in on crypto craze*, FTC (Jun. 3, 2022), <https://www.ftc.gov/news-events/data-visualizations/data-spotlight/2022/06/reports-show-scammers-cashing-crypto-craze>.

36 Lina Khan, Chairwoman, Federal Trade Commission, Financial Literacy and Education Commission Public Meeting (Nov. 17, 2022).

ance with existing laws and regulations.”³⁷ The Fed released more information as a letter in August 2022, which discussed how banks engage in crypto-asset-related activities.³⁸ The letter mostly cautions banks about the risks associated with such transactions and mandates that all financial institutions regulated by the Fed notify the agency of their intention to engage in digital-asset related activities.³⁹

C. Legislative Approach

While federal regulators navigate how to oversee digital assets under existing law, different groups of Senators have drafted two notable pieces of legislation that would provide a legal framework for digital assets. First, the Responsible Financial Innovation Act, sponsored by Senators Cynthia Lummis and Kirsten Gillibrand, would create a framework to establish which digital assets should be viewed as commodities and which as securities.⁴⁰ The bill would divide the regulatory authority between the CFTC and SEC, giving CFTC authority over all digital asset spot markets, except securities, non-fungible tokens (“NFTs”), and stablecoins.⁴¹ Additional provisions include disclosure requirements for digital asset service providers, a framework for stablecoins, a tax reporting exemption, and potential creation of a regulatory sandbox and self-regulatory organization.

The second prominent digital asset legislation, Digital Commodities Consumer Protection Act (“DCCPA”) of 2022, was proposed by Senators Debbie Stabenow, John Boozman, Cory Booker, and John Thune. This bill similarly would grant CFTC jurisdiction over digital commodity trading, authorizing the agency to develop rules governing margined, leveraged, or financed digital commodity trades.⁴² The CFTC would have the option to consult with the SEC on whether a digital commodity listing could be considered a security.⁴³ The bill contains preemption provisions for state money transmission registration requirements but would require

digital asset platforms to comply with the Bank Secrecy Act’s anti-money laundering (“AML”) rules. The definitions of “Digital Commodity Broker,” “Digital Commodity Dealer,” “Digital Commodity Trading Facility,” have specific carve-outs for software developers and publishers, but several members of the Web3 industry still see this bill as sweeping in decentralized entities that may not have the practical ability to comply with certain regulatory requirements.⁴⁴

While the passage of either of these exact bills would face legislative headwinds, they indicate the direction of many lawmakers seeking to sharpen digital asset regulation – including focusing on those digital assets that are already expected to fall under CFTC or SEC jurisdiction.

04

REGULATORY PITFALLS AND POTENTIAL SOLUTIONS

The lack of preemptive regulation of digital assets and blockchains has provided room for Web3 technologies to keep developing and changing, but the wrong legislative and regulatory provisions could hinder this development. As discussed in Section A, Web3 is primarily built with blockchain, smart contract, digital token technologies, and while these technologies are being used for cryptocurrency platforms and digital asset exchanges at the moment, that is not the only use for such decentralized, autonomous products. An understanding of the scope in the digital asset marketplace can inform a regulatory approach that will provide opportunities for Web3 to develop to its full potential.

37 *Joint Statement on Crypto-Asset Policy Sprint Initiative and Next Steps*, Board of Governors of the Federal Reserve System Federal Deposit Insurance Corporation Office of the Comptroller of the Currency (Nov. 23, 2021), <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20211123a1.pdf>.

38 Pete Schroeder, *U.S. banking regulators to clarify banks’ crypto role in 2022*, Reuters (Nov. 23, 2021), <https://www.reuters.com/business/finance/us-banking-regulators-clarify-banks-crypto-role-2022-statement-2021-11-23/>.

39 *SR 22-6 / CA 22-6: Engagement in Crypto-Asset-Related Activities by Federal Reserve-Supervised Banking Organizations*, Board of Governors of the Federal Reserve System (Aug. 16, 2022), <https://www.federalreserve.gov/supervisionreg/srletters/SR2206.htm>.

40 Lummis-Gillibrand Responsible Financial Innovation Act, S. 4356, 117th Cong. (2022).

41 *Id.*

42 Digital Commodities Consumer Protection Act of 2022, *supra* note 28.

43 *Id.*; *DCCPA Markup Latest 10.19.22*, GitHub (Oct. 19, 2022), <https://github.com/LeXpunK-Army/Crypto-CaseLaw/blob/main/DCCPA%20Markup%20Latest%2010.19.22.pdf>.

44 *Id.* See also Jennifer J. Schulp & Jack Solowey, *DeFi Must Be Defended*, CATO Institute (Oct. 26, 2022), <https://www.cato.org/commentary/defi-must-be-defended>.

05

CONCLUSION

As legislators draft new laws for digital assets and regulators try to fit digital assets into existing regulatory categories, it is important to zoom out and look at the larger impact of focusing on the highest profile use cases. In particular, blockchain and digital tokens are not merely tools for cryptocurrency transactions. Blockchains can serve as both a record-keeping and transactional system.⁴⁵ So for example, certain reporting and anti-money laundering (“AML”) requirements, if broadly applied to digital assets recorded on a blockchain, would be almost impossible to apply to certain kinds of market participants. While transactions to and from different users are recorded on the blockchain, the users’ names, addresses, and other information required for most reporting requirements are not necessarily recorded.⁴⁶ Broad reporting obligations effectively require intermediaries working on more centralized systems and platforms. While, in some contexts, regulators may view an additional layer of intermediaries as beneficial (such as in facilitating financial transactions), in others overly strict reporting requirements may remove advantages of decentralization with little benefit or without consideration of modified regulations that would still advance regulatory goals.

Additionally, the view that all blockchain-based digital tokens require classification and regulation as commodities or securities should not be reflexively applied to all digital tokens that allow blockchains to functionally operate. As explained in Section A, digital tokens are often issued as a mechanism to facilitate the operation of the blockchain. Treating all tokens as securities or commodities would raise costs and significantly limit usability of many tokens for the core functions they fulfill in blockchain operations. A similar problem arises if creators of new blockchain projects must be overly concerned with tripping SEC registration or reporting requirements, particularly if the protocol is designed in a way that the creators have little insight into or responsibility for consumer engagements on the protocol. In Web2 terms, this would be akin to requiring websites to register and report transactions on their websites. Such regulations would have discouraged people from creating websites just as overbroad regulation here would massively disincentivize development of tokens that are not meant to be speculative assets.

None of the above discussion is meant to suggest that blockchain and digital tokens must be unregulated to function, or there are no risks associated with decentralized blockchain transactions. However, policymakers and regulators should be cautious about regulating Web3 technology only based on its function in digital financial markets.

The current predominant use of blockchains and digital assets to facilitate cryptocurrency transactions has in many ways pigeonholed the developing Web3 industry from the viewpoint of legislators and regulators. A step back to understand the potential benefits of blockchains, smart contracts, and digital tokens will allow legislators and regulators to target the potential harms associated with certain use cases rather than approach the new technology with a broad brush. They should also recognize that technology evolves in unknown directions and any regulations should be flexible and technology-neutral to adapt to those changes. U.S. regulators and legislators will play a key role in determining if the U.S. is leading the charge in Web3 development. ■

“*The lack of preemptive regulation of digital assets and blockchains has provided room for Web3 technologies to keep developing and changing, but the wrong legislative and regulatory provisions could hinder this development*

⁴⁵ Reade Ryan & Mayme Donohue, *Securities on Blockchain*, 73 *The Business Lawyer* 85, 89-90 (2017).

⁴⁶ See e.g. 31 U.S.C. § 5312.

CPI SUBSCRIPTIONS

CPI reaches more than **35,000 readers** in over **150 countries** every day. Our online library houses over **23,000 papers**, articles and interviews.

Visit [competitionpolicyinternational.com](https://www.competitionpolicyinternational.com) today to see our available plans and join CPI's global community of antitrust experts.

