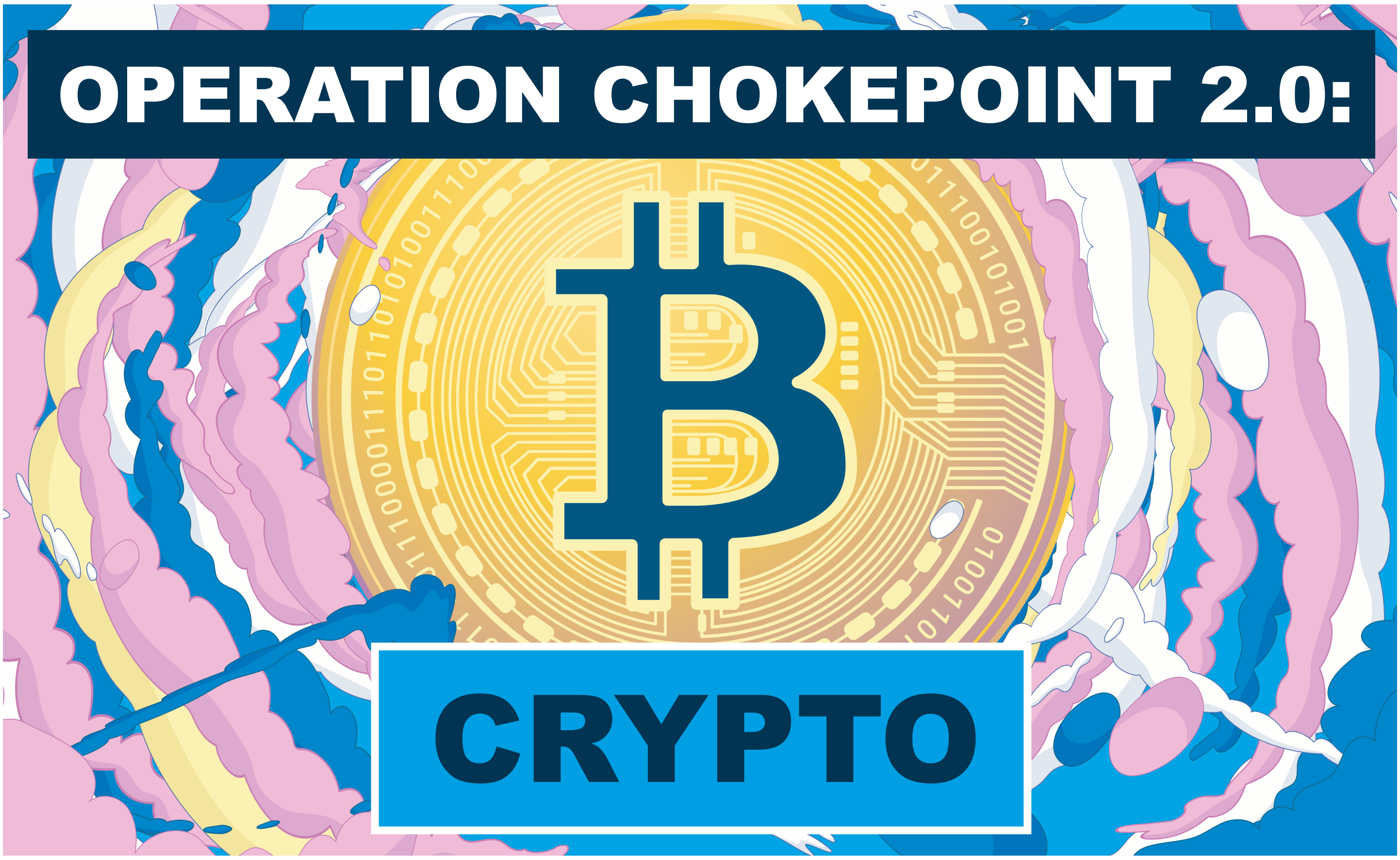

OPERATION CHOKEPOINT 2.0: CRYPTO

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A co-ordinated campaign by US bank regulators to drive crypto business out of the financial system is underway, according to US law firm Cooper & Kirk. Businesses and personal account holders are losing their bank accounts, suddenly, and with no explanation from their bankers. This crypto cleanse is allegedly a result of informal guidance documents published by bank regulators that single out cryptocurrency customers and businesses as a risk to the banking system. This is coupled with the Securities and Exchange Commission's (SEC) refusal to issue actual rules to guide crypto participants, preferring a strategy of issuing enforcement actions.

The bank regulators' campaign came to the fore with the flight of deposits from US regional banks in March 2023 when federal regulators shut down a solvent bank known to be serving the crypto industry, Signature Bank, in the third-largest bank failure in US history. After intervening, the Federal Deposit Insurance Corporation (FDIC) put Signature Bank up for sale on the condition that any buyer divest entirely from crypto and digital asset banking.

The FDIC's purpose is to maintain stability and public confidence in the US financial system, however, its actions have been labelled as an illegal regulator overreach against the crypto industry and Congress is being called to perform its oversight role and hold the federal agencies to account.

The SEC is also being accused of regulatory overreach and fostering an uninhabitable environment for crypto companies in the US. The chair of the SEC, Gary Gensler, was called before the House Financial Services committee on 18 April 2023 and was rebuked by US Congressman, Patrick McHenry:

Congress must provide clear rules of the road to the digital asset ecosystem because the regulators cannot agree. Regulation by enforcement is not sufficient nor sustainable. [The SEC's] approach is driving innovation overseas and endangering American competitiveness.

The opaque approach by the SEC was highlighted when McHenry asked Gensler to give a definitive answer on whether Ether, the second most popular cryptocurrency, qualified as a security under the SEC's oversight or a commodity under the Commodity Future Trading Commission's (CFTC) purview. CFTC's chair believes that Ether is a commodity and McHenry stressed that an asset cannot both be a commodity and a security. In spite of being pressed to confirm the SEC's position, Gensler refused to comment on whether the SEC classifies Ether as a security.

In Cooper & Kirk's view, the pattern of events is not random as this has been seen before. Federal bank regulators, working with their state-level counterparts, have used their supervisory authority to label businesses unworthy of having a bank account and working in secret to purge lines of undesirable, but legal, businesses from the banking system in Operation Chokepoint 1.0: gun stores, pawn shops, tobacco stores, payday lenders all being de-banked. Cooper & Kirk successfully challenged Operation Chokepoint 1.0 after bringing a lawsuit against three federal regulators – the Federal Reserve, the FDIC and the OCC (Options Clearing Corporation).

US officials have so far uniformly denied the existence of any coordinated agenda, whilst critical observers see the Biden administration and federal regulators as using whatever means necessary to cut the crypto industry off from banking services.

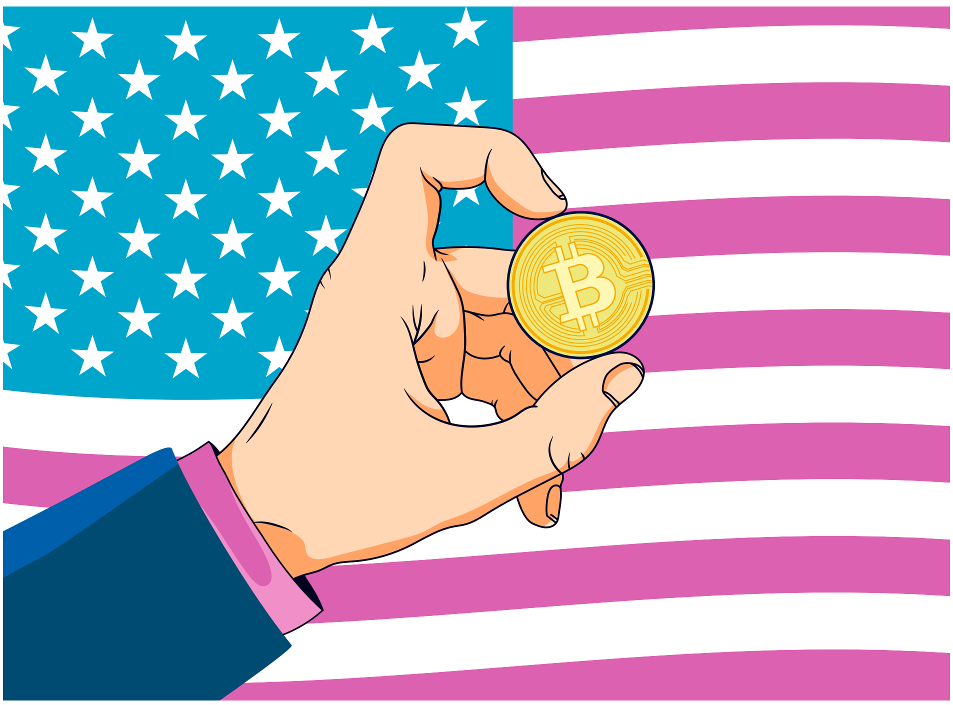
In July 2022, Coinbase (a US registered crypto exchange) filed a petition with the SEC requesting that the SEC "propose and adopt rules to govern the regulation of securities that are offered and traded via digitally native methods, including potential rules to identify which digital assets are securities". According to Coinbase, the SEC did not provide a response or comment on that petition. Instead, the SEC issued a Wells Notice against Coinbase in March 2023, which precedes an enforcement action, reinforcing its reputation for regulating by enforcement rather than providing guidance to the crypto community.

The lack of regulatory certainty and an oppressive Biden regime is driving US crypto companies offshore with two flagship crypto brands, Coinbase and Gemini, opening up exchanges in Bermuda and Singapore respectively.

As the US flounders in its regulatory positioning, the rivals to the US as centres of global financial markets are waiting in the wings to take advance to the opportunities and innovation the USD $1trn presents.

The UK has an excellent record of capturing the regulatory arbitrage opportunities. London became the centre of all FX trading after the US left the gold standard due to currency restrictions, and succeeded again in later capturing the Eurodollar and derivative markets.

Early signs indicate that the UK government is acutely aware of the opportunities with the Treasury stating its objective is to "establish a proportionate, clear and regulatory framework, which enables firms to innovate at pace, while maintaining financial stability and clear regulatory standards". If that is successful, the UK has the potential to become the epicentre for crypto and blockchain technology companies, having already tabled the Financial Services and Markets bill which will regulate issuers, custodians and service providers for fiat backed stable coins.



Whilst may still consider the crypto world as the wild west, and the collapse of FTX (the second largest exchange) only served to exacerbate this view, Bitcoin was conceived as a result of the 2008 financial crisis and 15 years later depositors still face systemic risks which were thought to have been eradicated by tightening of bank regulations. The introduction to the Bitcoin Whitepaper by Satoshi Nakamoto serves as a reminder of the underlying vision and solution:

Commerce on the Internet has come to rely almost exclusively on financial institutions serving as trusted third parties to process electronic payments….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.

What began as a concept in a whitepaper released on 31 October 2008 has grown into a USD $1.17 trn industry in 15 years. A key aspect to the pace of growth in the cryptospace is that open source is a fundamental principle with development taking place in a transparent manner by independent entities. With the correct application, and provided there are no more bad actors at the helm, there may well be an opportunity for the UK and European markets to foster crypto innovation in the face of the US regulatory crackdown.