

Blockchain Technology and Digital Assets For Lawyers

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Agenda

- Blockchain Technology Review
- State Regulation
- Federal Regulation
- ISBA Digital Asset Transactions and Blockchain Study Committee

Blockchain Technology

Blockchain: A Secure, Ordered, Trusted Digital Ledger or Record of Transactions

Key Characteristics:

- Peer to Peer Network of Nodes
- Public Access to Distributed Ledger
- Public/Private Key Cryptography
- Decentralized Consensus Protocol
- Ordered Blocks of Valid Transactions
- Common Set of Programmed Rules
 - Transaction and Digital Signature Rules
 - Network Rules
 - Consensus Rules

Bitcoin Protocol

Bitcoin Transaction Life Cycle

- Transaction Origination and Digital Signature: Sender/Recipient
- Decentralized Consensus Mechanism
 - Verification of Transactions
 - Candidate Blocks and Proof of Work
 - Verification of Candidate Blocks and Proof of Work
 - Issuance of New Bitcoin

Truly Immutable and Irreversible?

Digital Gold?

Ethereum Protocol

Ethereum Network – “World” Computer

- Built on Bitcoin Protocol
- Ether: Ethereum Protocol Native Token
- Decentralized Applications (“DApps”): Replace centralized servers with decentralized applications
- Smart Contracts
- Blockchain of Choice for Cryptocurrency Innovation

Recent Developments, Innovation, and Use Cases

NFTs: Non-tangible tokens

Stablecoins

Decentralized Finance (DeFi)

Decentralized Exchanges (DeX)

New Applications and Industry Use Cases

- Payment System
- Healthcare
- Musicians, Artists, and Professional Athletes
- Real Estate
- Online Gaming
- Fintech/DeFi
- Cybersecurity
- Anti-Money Laundering
- Supply Chain/Logistics

Blockchain and Digital Asset Regulation

STATE REGULATION

- Money Transmission License
 - Iowa Code Chapter 533C. Uniform Money Services Act
 - Iowa Code Section 533C.102(15) – Definition of “money transmission”
- Blue Sky Securities Laws
 - Iowa Code Chapter 502. Uniform Securities Act (Blue Sky Law) Section
 - 502.28 – Definition of “security” includes “investment contract”
 - Commissioner of Insurance Rule-Making
- Iowa Department of Revenue
 - State Income Tax: Cryptocurrency is property and subject to capital gains tax

FEDERAL REGULATION

- Commodities Futures Trading Commission (CFTC) – Oversight of commodity futures, options and swaps markets
 - Cryptocurrency is a commodity = Contracts for future delivery if futures contracts are in place
 - Regulatory Goals: Prevent Manipulation and Fraud; Ensure Market Transparency and Integrity
- Internal Revenue Service
 - Cryptocurrency is treated as property and sale/exchange is subject to capital gains tax
- Financial Crimes Enforcement Network (FinCen)
 - “Convertible” Cryptocurrency is money FIN-2013 – 9001 March 2013
 - Money Transmitter: Person that accepts currency, funds or other value substitutes for currency from one person and transmits such currency, fund or other value to another person or location
 - Virtual currency miners are not money transmitters but “users” of currency

- Financial Crimes Enforcement Network (FinCen) (con't)
 - Administrators and exchangers are money transmitters
 - Hosted wallet providers are money transmitters
 - DApps may be money transmitters if DApp accepts and transmits value between parties
 - Money Transmitters are subject to substantial criminal and civil sanctions for failing to comply with registration and reporting requirements (SARs) and violation of KYC and AML
 - Decentralized Exchanges (DEX) that only match buyers and sellers but do not control exchange of Cryptocurrency or fiat currency should not be money transmitters
 - Anti-Money Laundering Act (AMLA) – enacted January 1, 2021 as part of the National Defense Authorization Act. IP FinCen rulemaking that would impose new obligations on money transmitters is currently pending

- Department of Treasury's Office of Foreign Assets Control (OFAC)
 - Administers economic and terrorist sanctions laws
 - Maintains Specially Designated Nationals (SDN) list and blocked countries list
 - Identifies specific digital currency addresses associated with SDNs

- Securities and Exchange Commission

- Federal Securities Laws

 - Securities Act of 1933

 - Securities Exchange Act of 1934

 - Investments Advisors Act of 1940

 - Investment Company Act of 1940

- Key Issue: Is Cryptocurrency Token an investment contract under SEC v. W. J. Howey, 329 US 293 (1946)

- SEC Framework for “Investment Contract” Analysis of Digital Assets (2019)

 - Investment of money and common enterprise?

 - Reasonable expectation of profits derived from the efforts of others

 - Active promoter?

 - Share of profits?

 - Consumptive vs speculative nature of digital asset?

 - Marketed widely or to expected users of goods or services or functionality?

- Stable coins pegged to fiat currency or other asset: Not a security
- Bitcoin and Ether: Not a security
- ICO's: Whether a security depends largely on actions of active promoter and consumptive vs speculative nature of token
- Degree of network decentralization: What degree of decentralization is sufficient?

ISBA DIGITAL ASSETS TRANSACTION AND BLOCKCHAIN STUDY COMMITTEE

- Authorize Iowa political subdivisions to issue bonds and notes as digital securities?
- Authorize Iowa insurance components to invest (a limited amount?) legal reserves in digital assets?
- Authorize Iowa banks to take custody of or hold digital assets?
- Recognize and regulate digital assets as a distinct asset/property class?
- New collateral classification of digital assets for purposes of Iowa Code Chapter 554, Article 9, including perfection and priority of security interests in digital assets?
- Amendments to Iowa Code Chapter 554D, Uniform Electronic Transmission Act, to specifically address digital asset characteristics?
- Allow for real property digital assets/tokens?