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The seismic collapse of cryptocurrency exchange FTX has added fresh urgency to the ongoing debate over how policymakers should respond to the complex regulatory challenges posed by crypto.

The industry itself—while only a bit more than a decade old and today valued far less than at its November 2021 peak—continues to command outsized attention in the overlapping spheres of politics, media, and finance. Still, relatively few voices can offer a cogent explanation of the technology at the industry's core; where its economic and social value lies; and what opportunities and risks it poses for consumers, the financial system, and the general economy.

Is crypto just a speculative bubble, or perhaps nothing but a toolbox for money launderers and scam artists? Is it instead the keys to a fairer, more inclusive, and more efficient financial system? Does it perhaps offer novel solutions to everyday commercial challenges like remittances? Is it a swirling mix of all of these, or is it something else entirely?

The current tug-of-war playing out in Washington, Wall Street, Silicon Valley and beyond is not going to resolve these basic questions. But the fundamental lack of consensus and clarity on just what crypto is makes the policy debate difficult to follow even for those who have the most say about US regulation.

Today's lack of clarity does not mean that a legislative response can continue to be deferred—whatever one's thoughts on the topic, millions of Americans have investment exposure to the asset class and their interests deserve protection. That is, after all, one of the basic reasons we have financial services regulation.

A couple of observations may help separate the signal from the noise.

First, let's appreciate that when we speak about crypto, there are several different types of assets, and policies that might make sense for one category may be wholly inappropriate or unnecessary for another.

Second, let's acknowledge the uselessness of asking whether cryptoassets are securities.

Crypto Is Not Monolithic

It's essential to bear in mind that all blockchain-based cryptographic assets do not fall into the same bucket. While there are endless variations within the more than 10,000 identifiable assets estimated to exist, and while no taxonomy is going to satisfy everyone, we can identify four broad categories that policymakers can use to organize their thinking: stablecoins, NFTs, and digital securities—and a catch-all category with everything else.

Stablecoins

Stablecoins are cryptoassets intended to derive their value from another asset—usually a dollar or other brand of fiat currency—but a stablecoin could just as easily be tied, or “pegged,” to the value of a barrel of crude, a troy ounce of gold, or some other recognizable asset.

Stablecoins with the broadest market adoption, and which are designed as payment tools, are usually pegged 1:1 to a unit of fiat. The juice is in how the peg is designed—what backs the stablecoin? Is it like the cryptocurrency USDC where every token in circulation is backed by high quality liquid assets like US treasuries? Or is it like TerraUS, “algorithmically” backed by another digital asset?

NFTs

NFTs, or “non-fungible tokens,” are designed to be unique, or at least issued in limited quantities. Today the NFT marketplace is dominated by collectibles like Bored Apes, Cyberpunks, and digital sports memorabilia, and NFTs are increasingly being used as marketing swag by consumer product companies.

But we've barely scratched the surface of NFT use cases. For example, every jar of baby food could be tagged with an NFT, allowing families to keep track of nutritional and safety information, product recalls and the like.

Digital Securities

Digital securities, currently more of an idea than a reality, are simply traditional securities packaged in digital form. Instead of a paper certificate representing a share of Apple common stock, one could trade Apple stock in the form of lines of computer code. Instead of holding your Apple stock through an online brokerage account (where it exists as a claim against your broker), you could hold it in your own digital wallet. Maybe that isn't the greatest idea—after all, you could lose the password, and you wouldn't be covered by the Securities Investor Protection Corporation. On the other hand, digitizing the securities markets may be a way to speed up transaction processing times and minimize operational and credit risk in the national market system.

And . . . the Catch-All

To light a path for how crypto might sensibly be regulated, one can think of the rest of the industry—a catch-all—as a category unto itself. By default this is the largest and most varied category of crypto, including everything from Bitcoin and Ether, which today account for the bulk of the market, to so-called Layer 1 tokens like Solana, Cardano, and Polygon that offer a platform on which to build diverse applications; tokens designed to be used for a specific commercial purpose like Filecoin (data storage) or Ripple (cross-border payments); assets designed for DeFi (decentralized finance) applications like Uniswap or Aave; and "meme" tokens like Dogecoin and Shiba Inu that straddle the line between whimsy and pure speculation.

Some will object to lumping this diversity of assets together. But here is the common thread: Cryptoassets in the catch-all category are those that themselves do not represent a claim on the earnings or assets of a business enterprise (as do stock and bonds), but are instead designed for a particular use, like making a payment, playing a game, or engaging in an intermediary-free lending transaction.

Some cryptoassets in this category have widely dispersed ownership and are traded on popular trading platforms such as Coinbase and Kraken, but the vast bulk of them probably never fulfilled the ambitions of their promoters—some of whom undoubtedly used the tokens as inducements in transactions fairly characterized as unregistered securities offerings. And under the elastic, decades-old judicial tests that define the term, some of these assets may themselves be "securities" under US law.

The Regulatory Solution Can't Be Monolithic Either

The overarching observation here is that terms like "cryptocurrency" and "digital asset" cover a wide and varied terrain, and before talking about how to regulate them or who should be doing the regulating, it's essential to understand what type of crypto we are talking about.

There is no reason to suppose that all crypto should be subject to the same rules or under the aegis of a single regulator.

Stablecoins, for example, can be susceptible to run risk and solvency risk depending on the nature and quality of the assets that support the peg. Federal and state banking regulators are the most experienced in supervising these kinds of risks and so perhaps should have primary responsibility for regulating these assets and their issuers.

Whether NFTs need a bespoke regulatory regime is an open question. Existing consumer-protection laws and intellectual property rights may already be sufficient for private plaintiffs and authorities like the Federal Trade Commission and state attorneys general to ensure adequate public protection.

Digital securities, which use new technology to frame familiar and already well-regulated assets, should be overseen primarily by the Securities and Exchange Commission, as it would plainly make no sense for, say, an issuer of common stock to be able to avoid the SEC's investor-protection rules simply by issuing the instrument on a blockchain. That's not to say digital securities can or should be regulated the same as their non-digital forebears; the benefits of blockchain technology (quicker settlement, perhaps) will not be realized without targeted updates to the SEC's rulebook.

The most contentious issue is, of course, who should have authority over the catch-all category. There is no obvious answer, which brings us to the next observation.

But Is It a Security?

Whether crypto is a security doesn't resolve how Congress and federal and state regulators should think about regulating the crypto industry. That's because with the exception of digital securities and some NFTs, crypto is fundamentally a new asset class.

Arguing whether crypto is a security under the existing judicial tests is nothing but a disguised debate over whether crypto should be effectively regulated out of existence under a framework that evolved for a different purpose—to support efficient capital formation—or whether it should be left virtually unregulated (maybe in the hope of scamming itself out of existence).

Neither outcome makes sense.

Congress has the opportunity to move us past this tired dialogue. Let's recognize that cryptocurrencies—in particular, those in the catch-all category—raise legitimate investor-protection concerns. Leaving that market wholly to self-regulation is not a serious solution for products whose holders number in the millions and whose backers hope to disrupt major industries like payments, tech, and finance. The FTX debacle could not make this plainer.

But—and this is the hard part—we cannot regulate crypto as if it is just another financial asset like common stock, corporate debt, or mutual fund shares. Yes, many people invest their savings in crypto and these people should have access to accurate and complete information about their investments, and they should be able to trade their holdings without fear of loss on a mismanaged trading platform. It does not necessarily follow that investors need audited financial statements, extensive financial performance disclosures and detailed information about management compensation concerning the company whose engineers wrote the software code, when use of the token—and the token's inherent value—does not depend on any company's profitability.

Nor does it follow that secondary trading markets in crypto need to be remolded and then shoehorned into the structure that has grown up organically to support securities trading, with centralized exchanges that don't do business directly with the public and clearing agencies whose functions may not be needed when asset ownership is cryptographically recorded on an immutable public ledger.

Despite the square peg/round hole fit between crypto and the existing securities regulatory regime, the SEC has so far done little to adapt its rulebook in a way that would make realistic its regular exhortations to "come in and register."

And so arguing over whether crypto is or is not a security misses the point. The point is that we need a regulatory approach that takes account of the attributes of the asset class instead of an approach that attempts to cram one asset into a regime built for another.

Congress can do this by writing laws that, first, clearly define what crypto is, and second, set forth Congress's basic expectations for how the asset class should be regulated. Whether Congress then chooses to assign regulatory responsibility to the SEC, the Commodity Futures Trading Commission or some other agency entirely is a different question. A question that is, admittedly, politically fraught given Congressional oversight lines that assign responsibility for the CFTC to the agriculture committees and responsibility for the SEC to the financial services committees.

But let that political fight take place in the open, not veiled behind arguments over whether crypto tokens are securities.