

# Distinguishing virtual currencies from virtual assets: a functional approach

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The blockchain economy begs the question: when are virtual (digital) assets “money”? For purposes of money transmission laws, the states have answered this question inconsistently.

Some statutes have been amended or adopted to explicitly include virtual assets within the scope of monetary transmission.<sup>1</sup> Others explicitly exclude them,<sup>2</sup> while still others are simply silent on the topic, leaving state regulators in the difficult position of assessing the potential application of state laws to technology that did not exist at the time the statutes were written.

Similarly, legislators, regulators and courts have used inconsistent rationales to determine whether to apply money transmission laws to virtual assets.

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Some policymakers have taken the position that virtual assets fall under money transmission laws because they can serve the economic functions of money.<sup>3</sup> Others have found the opposite, concluding that virtual assets, at least to date, do not perform these functions and instead fall outside of money transmission,<sup>4</sup> generally limiting the application of money transmission statutes to fiat currency.<sup>5</sup>

Even when a law is clear that virtual assets can be money, it may be unclear which types of virtual assets are money and when.<sup>6</sup> A functional approach is needed to provide a more coherent framework for both policymakers and industry participants starved for clear and consistent guidance.

Economists often define money as a medium of exchange, a unit of account, or a store of value based on the different economic functions money can perform. Different types of virtual assets can be any, all, or none of these things.

Whether such functions are legally relevant, however, is a very different kind of question. When contemplating whether a virtual

asset is money, policymakers must first identify what function of money they are attempting to regulate. Only then can they determine what types of virtual assets, if any, actually perform that function.

Some laws contemplate money as a unit of account. Strictly speaking, a unit of account is anything that can be counted, including puka shells or gallons of oil. Because the types of property that can perform this function are futilely broad, where the concept of “unit of account” is relevant, the law attempts to narrow it.

For example, the Internal Revenue Code requires taxpayers to calculate their tax liability in terms of a “functional currency,” generally the U.S. dollar or in certain cases a foreign sovereign currency.<sup>7</sup> Similarly, Regulation S-X of the Securities and Exchange Commission requires public companies to publish financial statements in a specified “currency.”<sup>8</sup>

Insofar as “currency” is generally limited to sovereign fiat money, laws contemplating money performing the function of a unit of account often default to treating money narrowly as currency to ensure a common basis for accounting.<sup>9</sup> A tax return filed in terms of puka shells is hardly useful to the IRS.

Because governments generally have not yet created blockchain versions of fiat currency, virtual assets are generally not “currency” for these purposes.<sup>10</sup> In short, where the function of “money” is to act as a unit of account, the law does not recognize virtual assets as performing that function, even if they could.

Similarly, anything that is valued by others can be a “store of value.” Accordingly, laws considering money as a store of value tend to construct “money” broadly precisely because the function that is being regulated is the ability to hold and exchange value.

For example, the *Howey* test requires an “investment of money” for an arrangement to be an investment contract and thus a security under the Securities Act of 1933.<sup>11</sup> In this regard, an “investment of money” has been read to extend far beyond currency to include any “tangible and definable consideration.”<sup>12</sup>

Accordingly, where the function of money that is being regulated is broadly its ability to represent a container of value, so much so that almost any exchange of “goods and services” would otherwise be covered, courts have begun to conclude that an investment of

virtual assets can constitute an investment of money.<sup>13</sup> (This is a different question from whether the virtual asset itself is a security.)<sup>14</sup>

Neither the function of “money” as a unit of account nor as a store of value is meaningful, however, with respect to the purposes of state money transmission regulation. As discussed above, anything can be a unit of account. The manner in which things are counted is of little concern to money transmission laws, unless the concept of the unit of account for this purpose is further defined specifically to encompass only fiat currency, as in the examples above.

Nor have state money transmitter laws historically been interpreted so broadly as to capture the wide swath of material and virtual items that can perform the function of a store of value.

Yes, at its core, money transmission involves the transmission of value, but no money transmission statute would ever claim to exhaustively capture the disparate manners in which different material and virtual items could store value. Rather, money transmission regulation has historically contemplated only the third function money — acting as a medium of exchange.

At their core, money transmission laws regulate the movement of funds that people depend upon in their day-to-day lives and that businesses depend upon to engage in commerce. They ensure that the facilitator of a payment is financially able to complete a transaction, that such an entity provides certain customer protections, and that in transferring funds, the entity complies with anti-money laundering and sanctions requirements.

In this regard, the type of value exchange that is being regulated is more narrow than was at issue in *Howey*. To the extent that value exchange beyond the transfer of fiat currency is contemplated, only value that has the same function as a medium of exchange in ordinary commerce in goods and services is an appropriate target for regulation.

For this reason, for example, money transmitter laws do not apply to transfers of securities, even though such transfers may be an effective means of moving value.

Thus, taking a functional approach towards the regulation of “money” leads inexorably to the conclusion that the application of money transmitter laws to virtual assets must assess the role of the virtual asset in providing a medium of exchange, not whether the virtual asset could store of value or act as a unit of account.

However, to avoid “medium of exchange” being treated as an unhelpful analogue to “store of value,” money transmission laws must draw a distinction between virtual assets generally, all of which are designed to be “exchanged” in some form, and “virtual currencies” subject to regulation as money transmission.

There are certain guiding principles that can inform that effort. First, a virtual currency should be generally accepted as a method of payment for goods and services in the economy writ large, or in the rubric used by the Financial Crimes Enforcement Network, act as a “substitute for currency.”<sup>15</sup> The mere fact that a virtual asset can be exchanged for other assets or services on a particular platform should not be sufficient to regulate the exchange of those tokens as money transmission.

Second, a substantial part of the utility of a virtual asset to users should be in the performance of that exchange function; if the primary function of the asset is to enable speculation or to enable the operation of a particular platform, the ancillary use of the asset for some commercial transactions should not be considered a sufficient basis for regulation as money transmission either. In both cases, the asset would not be acting as a “substitute for currency” in any meaningful way.

Applying this framework, it can be argued that there are not yet any virtual assets that satisfy the aforementioned standard to be considered true virtual currencies.

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For example, although stablecoins are generally designed for the specific purpose of being accepted as payment in certain ecosystems, they have not yet penetrated mainstream commerce in a meaningful way. As of the writing of this article, no stablecoin in the market had an outstanding market capitalization even approaching \$100 billion and most stablecoin usage to date has been to facilitate trades in other virtual assets rather than general commercial activity.

Thus, while stablecoins satisfy the second part of the above test, i.e., they are designed to be a medium of exchange by virtue of their stable pricing, they are not yet generally accepted as a method of payment for goods and services in the economy writ large and are not yet ripe for regulation as money transmission.

Similarly, even bitcoin, the most widely adopted virtual asset in the world, is not broadly accepted as payment for goods and services. Among other things, significant fluctuations in the price of bitcoin, as well as the cost to complete a transaction in bitcoin, has hindered its broad adoption in commerce.

Indeed, most regulatory attention to bitcoin has focused less on its theoretical ability to act as a means of exchange, and more on the investment risks incurred by users speculating through investment in the virtual asset. Thus, while reasonable minds might differ, even the original and largest virtual asset of them all is probably not yet an appropriate candidate to be treated as a “virtual currency.”<sup>16</sup>

Stepping further away from the leading virtual assets such as bitcoin and ether, other virtual assets, including utility tokens, security tokens, and non-fungible tokens, simply do not meet the standards above. They may serve the function of transferring value within a defined ecosystem for media, computing power or any of a myriad of other purposes, but they simply do not have a primary functionality to act as a medium of exchange in general commerce.

This is not to say that virtual assets that do not function as a virtual currency should be left entirely unregulated. Instead, that money transmission is not the appropriate regulatory regime for a class of

assets that are broadly do not function as a medium exchange in the broader economy.

This conversation is not simply academic. The inappropriate regulation of non-monetary virtual assets under money transmission statutes does a disservice to consumers and businesses and impedes the growth of the blockchain economy.

With sanctions for unlicensed money transmission including everything from civil money penalties to incarceration, law-abiding companies and individuals are hamstrung in attempting to determine whether virtual assets that do not perform the function of a medium of exchange in a meaningful way, i.e. do not truly act as a substitute for currency in the broader economy, will nonetheless be regulated as money transmission.

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Unfortunately, some policymakers have declined to engage in this functional analysis. Whether painting disparate virtual assets with the same broad brush, misunderstanding of “money” in terms of a “store of value,” “unit of account,” or legal tender status, or failing to consider how to differentiate assets that truly act as a medium of exchange for general commercial transactions, a number of states across the country have failed to contextualize the potential application of money transmission regulations based on the function those assets actually perform.

For example, proposed AB 2269 in California, modeled after a framework proposed by the Conference of State Bank Supervisors, would require a license for organizations engaged in “digital financial asset business activity.”<sup>17</sup>

The bill takes the nonfunctional approach of defining a “digital financial asset” as a “medium of exchange, unit of account, or store of value,”<sup>18</sup> broadly referencing a set of economic standards that are not useful for differentiating the types of activities money transmission laws are designed to address.

By providing a laundry list of functions rather than keying in on the one that matters, this definition captures disparate assets and paints them with the same broad brush. As indicated above, focusing more narrowly on the function of money as a true substitute for currency in the broader economy would lead to a very different approach.

If California and other states want to capture certain types of virtual assets as the functional equivalent of money, the “function” in this regard must be the role of acting as a true medium of exchange within the broader economy. Those virtual assets that perform this function — virtual currencies — can be regulated under money transmission laws. Those that are not are best regulated under another framework.

This is not a call for complete deregulation of virtual asset businesses; rather it is a call for recognition that money transmission regulation is the wrong instrument for oversight of many forms of virtual assets, and a call to relegate the definition of money as a “medium of exchange, unit of account, or store of value” to economic texts rather than the statute books.

## Notes

<sup>1</sup> See, e.g., Fla. Stat. § 560.103(24) (“Money transmitter” means [an entity] ... which receives currency, monetary value, a payment instrument, or virtual currency for the purpose of acting as an intermediary to transmit currency, monetary value, a payment instrument, or virtual currency from one person to another location or person by any means...); Fla. Stat. . § 560.103(36) (“Virtual currency” means a medium of exchange in electronic or digital format that is not currency); Wash. Rev. Code § 19.230.010(18) (Money transmission can be triggered by the handling of “money or its equivalent value (equivalent value includes virtual currency)”; see also Wash. Rev. Code § 19.230.010(30) (“‘Virtual currency’ means a digital representation of value used as a medium of exchange, a unit of account, or a store of value, but does not have legal tender status as recognized by the United States government.”).

<sup>2</sup> See Ut. Code. Ann. § 7-25-102(9)(b) (“‘Money transmission’ does not include a blockchain token.”).

<sup>3</sup> See *U.S. v. Harmon*, 474 F. Supp. 3d 76 (D.D.C. Jul. 24, 2020) (holding that Bitcoin is a form of money for the purposes of the DC Money Transmitters Act because it can function as it can function as “a medium of exchange, method of payment, and store of value”).

<sup>4</sup> See “Regulatory Treatment of Virtual Currencies Under the Kansas Money Transmitter Act,” Office of the State Bank Commissioner (May 18, 2021) (concluding that virtual currencies are neither “money” nor “monetary value” because a “medium of exchange” means “anything generally accepted as payment,” which does not include virtual currency).

<sup>5</sup> See Tex. Fin. Code. § 151.301(b)(3) (“Money” or “monetary value” means currency or a claim that can be converted into currency through a financial institution, electronic payments network, or other formal or informal payment system); Tex. Fin. Code. § 151.301(b)(1) (“Currency” means the coin and paper money of the United States or another country that is designated as legal tender and circulates and is customarily used and accepted as a medium of exchange in the country of issuance).

<sup>6</sup> See, e.g., Texas Dept. Banking, Supervisory Memorandum 1037 (providing that while decentralized cryptocurrencies “as currently implemented” cannot be considered money or monetary value under the Money Services Act, no generalized guidance is being given on the treatment of centralized virtual currencies, other than sovereign backed-stablecoins, which may, in certain circumstances, but money or monetary value).

<sup>7</sup> See 26 U.S.C. § 985.

<sup>8</sup> 17 C.F.R. § 210.3-20(a).

<sup>9</sup> See I.R.S. Notice 2014-21, 2014-16 I.R.B. 938 §§ 4A-1, 4A-2 (Apr. 14, 2014) (adopting FinCEN’s approach of defining “currency” as “the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance.”).

<sup>10</sup> We defer the El Salvador experiment in adopting bitcoin as a currency and other unique cases for another day.

<sup>11</sup> *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) (requiring, inter alia, an “investment of money” for an arrangement to constitute an investment contract).

<sup>12</sup> See *Int’l Brotherhood of Teamsters v. Daniel*, 39 U.S. 560, n.12 (1979) (rejecting the position that an investment must take the form of cash, rather than of goods and services); see also *Uelton v. Com. Lovelace Motor Freight*, 940 F.2d 564 (10th. Cir. 1991) (stating that “in spite of Howey’s reference to an ‘investment of money,’ it is well established that cash is not the only form of contribution or investment that will create an investment contract. Instead, the ‘investment’ may take the form of ‘goods and services.’”).

<sup>13</sup> See *Sec. & Exch. Comm’n v. Shavers*, No. 4:13-CV-416, 2014 WL 4652121, at \*1 (E.D. Tex. Sept. 18, 2014) (holding that an investment in the form of Bitcoin is an “investment of money” for the purposes of forming an investment contract).

<sup>14</sup> In order for a virtual asset to be an investment contract and therefore a security under the Securities Act of 1933, it must satisfy all four prongs of the Howey test,

which is an investment of money in a common enterprise with the expectation of profits solely from the efforts of others.

<sup>15</sup> See 12 C.F.R. 1010.100(ff)(5)(i)(A).

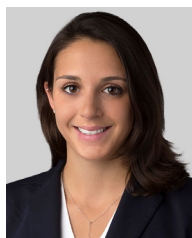
<sup>16</sup> It can fairly be noted that FinCEN has concluded that bitcoin satisfies the standard of being value that substitutes for currency. However, it is also true that FinCEN has not yet articulated a cogent basis for that conclusion. Even if concerns regarding Federal anti-money laundering policy result in the regulation of bitcoin for that purpose, that would not necessarily drive the same conclusion for state money

transmission licensing laws. Unlike state money transmission laws, the Federal Bank Secrecy Act broadly defines “financial institutions” to cover a diverse group of entities, including travel agents, real estate settlement agents, and businesses engaged in vehicle sales, thus evincing a Congressional intent to cover value transfers beyond simple movement of money.

<sup>17</sup> A.B. 2269, 2021-2022 Reg. Sess., (Ca. 2022) at 3103(a).

<sup>18</sup> *Id.* at 3102(f).

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