



DC Deep Dive: The Future of Cryptocurrency

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FTX? SBF? The whole world of crypto seems in free fall. In this month's CivicPoint DC Deep Dive, CivicPoint DC Principal Jonathan Miller interviews John Wagster, a cryptocurrency expert and Frost Brown Todd LLP Partner. Check out this quick break down on the latest happenings and gain important insight on the future of the crypto industry.

Sam Bankman Fried, FTX, and What you Should Know:

Sam Bankman-Fried, also known as SBF for short, has been well-respected in Washington, D.C. as an expert on cryptocurrency. He earned this regard through various testimonies before regulators and is known to be open, vocal about the future of the crypto industry, and relatively government friendly. SBF initially made a name for himself by creating a large hedge fund and lending platform named Alameda which later led to the creation of FTX, one of the top 5 cryptocurrency exchanges in the world. Recently, there has been a down crypto market, or what experts call a "crypto winter". As the prices of cryptocurrencies dropped, high profile bankruptcies shook the industry, causing it to fall into disarray and leading to prices dropping even further. As the bankruptcies occurred, FTX and Alameda were rapidly acquiring the companies that were going out of business, and in the process of doing so, got

overextended. There have been allegations that FTX and Alameda were improperly sharing customer funds and company resources and otherwise colluding inappropriately. SBF is claiming that he knew there was collaboration, but he didn't realize the extent of the inappropriate behavior or he would have taken more security measures. He is now facing potential criminal charges for mismanagement of investor funds.

Crypto Criticism, Conspiracy Theories, and Celebrity Endorsements:

For many people, this is still a new technology and concept, and there's a learning curve, so traders are hiring people to do it for them. That's where the exchanges, hedge funds, and lending platforms are coming in to help and making money. While we're currently too far in the weeds to see the net effects of the FTX scandal, for the most part, this is inexperienced operators making investments they shouldn't make and bad actors doing things they shouldn't do. While it looks bad on the surface for the industry, there is a distinction to make. The essence of cryptocurrency is that it operates via trustless transactions, meaning that those participating don't have to rely on a centralized party, bank, or government to transact their funds. Every bankruptcy we have seen in the industry has occurred when the entity is centralized, meaning it has a board of directors and is subject to regulation in the jurisdictions where they operate. Interestingly, decentralized entities aren't declaring bankruptcy and are pretty much operating as normal, albeit with smaller volumes.

Crypto and the New Congress:

Regulation for cryptocurrency is on the horizon, and many players in the market welcome regulation. The Biden Administration is working with various agencies and departments to build a plan while members of congress are simultaneously proposing their own solutions. As it stands, many members on the left think cryptocurrencies should be fully and tightly regulated, while on the right, some members are pushing for no regulation at all. If congress can't ultimately agree, the crypto market is used to living on the edge and will continue to do so without a decision by government.

Much of the legislation being introduced would decide who governs the industry. Currently, the SEC, CFTC, FinCEN, and OCC all have legitimate domain. Additionally, clarity is needed for stable coins (tokens backed by a particular asset or collateral such as the U.S. dollar) regarding what type of assets can back those coins as well as if they will need a full audit and attestation. For the public, determining how stablecoins need to show the collateral they have and what they are allowed to do with that collateral will be helpful. Beyond that, it would be helpful for the U.S. government to signal that it's okay to be involved in the crypto industry in the U.S. under certain parameters. Currently, many big actors aren't establishing and settling in the U.S. because there is no regulatory clarity, and if the major players aren't operating in the U.S., our government will have less say in how they operate.

As these regulations are developed, companies in the crypto space would benefit from hiring regulatory experts to help determine whether or not a token is a security or commodity under U.S. law as they are subject to different financial regulation. If a company is coming into the industry now, this is a very gray area and working with counsel can help you understand the range of what has been accepted. Importantly, no law firm can tell you with 100% certainty that a coin is not a commodity or security, but they can tell you how long they've been working in the space and what they've seen regarding enforcement action and SEC inquiries. Many companies often disregard the financial regulations, but they do so at their peril since many can result in criminal penalties. Working with counsel at Frost Brown Todd can help make sure your company is compliant and will help avoid any civil or criminal penalties.

Economic and Investment Considerations:

Investing in crypto is not free money. Though constantly fluctuating, the markets have gone up dramatically over the last few years, and it's important to know what you're doing and when to get out and get in. The same due diligence done for a stock purchase should be done for crypto investments. Read a lot and understand if the protocol you are investing in is fully decentralized or run by a handful of people. Understand ownership and control as well as centralization vs. decentralization. Importantly, centralized

exchanges like Coinbase or other popular exchanges are required to withhold taxes just like brokers. If you're a regular taxpayer and you're trading out of your own digital wallet, you will need to take meticulous notes regarding your investments to avoid any future potential trouble with the IRS.

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