Good afternoon. I would like to call this meeting of the Maryland Financial Consumer Protection Commission to order.

First, I want to thank each of my fellow Commissioners for their service. Your efforts have ensured that this has been a productive and relevant commission advising our Governor, the General Assembly and Maryland’s Congressional delegation.

After hearing testimony last year and publishing our unanimous report in January, the General Assembly considered the legislative recommendations as sponsored by four of our fellow commissioners – Senators Rosapepe, Senator Benson, Majority Leader Frick and Delegate Aumann. Attorney General Frosh and Commissioner of Financial Regulation Salazar played important roles and a number of you individually participated, along with excellent support of Tami Burt, Sally Guy and Eric Pierce staff from the Maryland Department of Legislative Services.

Marylanders now directly benefit from a number of the commission’s recommendations having been adopted into law. Tami, Sally and Eric will give us a full briefing this afternoon.

I thank each of you for the collaborative effort of this commission on behalf of all Marylanders.

I want to thank Senate President Mike Miller, Speaker Mike Busch, Chairman Middleton, and Chairman Davis for guiding and supporting the legislative initiatives through to passage and Governor Hogan for signing them into law.

Our work, though, is not complete as we’ve been tasked as Maryland’s watchdog on matters of financial services and consumer protection. The worlds of finance and Washington are fast paced and ever changing.

I want to welcome the public and members of the press who are here with us today or watching live on the internet.

As part of the recently passed legislation we were specifically asked to study cryptocurrencies, initial coin offerings, crypto exchanges and other blockchain technologies. We’re pleased to be joined today by an excellent panel of five experts in this field, including two Marylanders.

I want to take a moment to share my perspective on these technologies as since we last met I have taken on new roles at MIT as a Senior Advisor to the Director of the MIT Media Lab and as a Senior Lecturer at the MIT Sloan School of Management. One of my primary areas of teaching and research is now blockchain technology and is its role in the financial sector.
Blockchain Technology Potential

Though there are many technical and commercial challenges yet to overcome, I’m an optimist and believe that blockchain technology has the potential to transform the world of finance.

It is an innovative means of verifiably moving value and applying computer code around a distributed network. That ties it directly to the essential plumbing of the financial sector, which at its core performs the role of efficiently moving and allocating money and risk within the economy.

Either as a catalyst for change by incumbents or as an opportunity for entrepreneurial start-ups, blockchain technology could lower costs, risks and economic rents in the financial system.

To reach its potential, though, blockchain technology and the world of crypto finance it has birthed, must come fully within public policy frameworks.

Crypto Finance

As things currently are there is significant non-compliance in the over $330 billion crypto world, particularly by the new means of crowdfunding, initial coin offerings (ICOs) and crypto-exchanges.

To date, over 3400 ICOs have launched and 200 crypto-exchanges are operating with tens of millions of customers worldwide. Over 60 percent of the crypto market value is now in tokens other than Bitcoin.

Tokens and Initial Coin Offerings

By their very nature and design, ICOs and similar token offerings mix economic attributes of both investment and possible consumption.

ICO investors bear risk related to the success of a network. Typically marketed online with the release of a whitepaper prior to the launch of a new blockchain-based decentralized application, ICOs are quite different from tokens for a neighborhood laundromat or tickets to the theatre.

ICO tokens are structured with attributes to promote marketability and potential appreciation. They usually include a so called ‘monetary policy’ which is encoded in the software, limiting the future supply of tokens and introducing an element of scarcity. They are fungible or interchangeable which enhances liquidity. They are often listed on crypto-exchanges, boosting marketability and transferability. The selling company, related foundation and founders usually retain a meaningful portion of premined tokens and are motivated to increase the value of the tokens.

The token’s economic realities – its risks, expectation of profits, monetary policies, manner of marketing, and capital formation - are all attributes of investment schemes.
Issuance ballooned in the last 12 months, with nearly $24 billion reported as raised through the first quarter of 2018. With significant valuation differences versus traditional venture capital funding, many start-ups are turning to this market to raise capital. Simply put, cheap money is displacing dear money.

There is a high failure rate for ICOs. One study in February of 2018 found that 59% of a sample of 2017 ICOs had already failed or semi-failed. There also is a considerable amount of fraud and scams in this field, with numerous ICOs targeting retail investors, using celebrity endorsers, and promising short-term gains. Estimates vary considerably with 25 percent to 81 percent as scams.

**Crypto Exchanges**

Once Bitcoin developed as the first cryptocurrency, it was only natural that exchange trading would develop. There are now approximately 200 crypto-exchanges and many more have failed.

Exchanges also have tens of millions of customers worldwide. Coinbase has over 13 million active accounts opened, more than brokerage firm Charles Schwab.

To date, however, this trading activity has largely taken place outside of investor protection and market integrity regimes.

These exchanges also have some significant differences from traditional exchanges. Crypto-exchanges offer direct access to customers rather than access through regulated intermediaries. Crypto-exchanges have significant challenges protecting customers’ funds held in custody, usually in digital wallets rather than at a bank, broker dealer, or future commission merchants. Numerous hacks have led to significant losses of customer funds. Mt. Gox lost $473 million in Bitcoin in 2014. Coincheck lost $530 million in NEM tokens in 2018.

**Public Policy Frameworks & the ‘Howey’ Test**

As with the emergence of new technologies in the past, from railroads in the 19th century to the internet in the late 20th century, there have been debates on how blockchain technology and crypto finance might best fit within existing public policy and legal frameworks.

Living within these frameworks, though, has helped foster traditional capital markets for decades and are just as important for crypto finance, even if the details for achieving these goals may change. The public broadly benefits when we:

- Ensure for tax compliance.
- Guard against money laundering or terrorism financing.
- Promote financial stability.
- Protect investors and consumers.
- Promote efficient capital markets.
- Foster economic inclusion and growth.
U.S. securities laws ensure that the core principles of investor protection apply broadly, regardless of the form of investment.

An important early test of this statutory construct related to the Florida orange groves of William Howey, whose company sold land with an option to lease the land to an affiliated service company and participate in the profits of the crop. Even though not stocks or bonds, the U.S. Supreme Court in 1946 ruled that Howey’s land sale agreements satisfied the definition of ‘investment contracts’ under the 1933 Securities Act and thus should be regulated as securities.

The so-called ‘Howey Test’ from this case states that: “an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.” SEC v. W. J. Howey Co., 328 U. S. 293, 299 (1946).

In the U.S., it is now clear that ICOs, many other tokens, and crypto-exchanges, must comply with securities, commodities, and derivatives laws.

Otherwise, a growing and potentially significant portion of the capital markets would not benefit from basic investor protections. We’ve already seen high levels of fraud and loss of funds in these markets.

Maryland Action

We’ve been asked by the Governor and General Assembly to report back on what changes to Maryland law might be in order given these new developments. In specific, we are looking forward to hearing from our panel on what Maryland should do with regard to its consumer protection laws, securities laws, money transmission laws and data security laws with regard to cryptocurrencies, ICOs, crypto exchanges, and other blockchain applications.

We also will hear more today about “Operation Cryptosweep” where Provincial regulators from Canada joined with State regulators in the U.S. last month, including Maryland, in a coordinated action against ICOs with nearly 70 open investigations and 35 enforcement actions.xi

Crypto Panel Introductions

I would now like to introduce our expert witnesses:

Melanie Lubin: Securities Commissioner, Office of the Attorney General, Securities Division

Jerry Brito: Executive Director of Coin Center.

John Collins: Affiliate Berkman Klein Center for Internet and Society at Harvard University, Previously Head of Policy for Coinbase, and former Senior Advisor to the U.S. Senate Homeland Security and Governmental Affairs Committee.
**Jonah Crane:** Regulator in Residence at the FinTech Innovation Lab in New York; advisor to several FinTech companies; and Executive Director of the FinTech Lab in Washington, DC having previously served as the Deputy Assistant Secretary for the Financial Stability Oversight Council at the U.S. Treasury Department.

**Andrew Wichmann:** Associate at Gordon Feinblatt, LLC in Baltimore, focusing on technology law, intellectual property, and privacy and data security.

**Commissioner Introductions**

I also want to now give each of my fellow Commissioners a brief opportunity to introduce themselves.

**Administrative Matters**

Our meeting is being live streamed and can be viewed on the Maryland General Assembly website during or after the meeting. All Commission information from this hearing will be available on the Commission’s webpage including the agenda and testimony for the meeting.

Members of the public are encouraged to submit written testimony for the record at the following email address: FCPC@mlis.state.md.us

We hope to have a number of hearing in the fall to further explore topics as outlined by the General Assembly, including standard of care for broker dealers, the CFPB arbitration rule and lending by manufactured home retailers.

Lastly, with regard to your microphones, please push the button to talk, wait a second until a light turns on. Please also remember to push the button to turn it off as only 3 microphones can be on at any time.

Thank you.

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i Stats and Facts; ICO Bench (as of June 4, 2018) [https://icobench.com/stats](https://icobench.com/stats)

ii 24 Hour Volume Rankings (Exchange); CoinMarketCap (as of June 4, 2018) [https://coinmarketcap.com/exchanges/volume/24-hour/](https://coinmarketcap.com/exchanges/volume/24-hour/)

iii Market Cap by Cryptocurrency (as of June 3. 2018); Coin Dance; [https://coin.dance/stats](https://coin.dance/stats)

iv Token Sales: Q1 2018; Elementus (April 2018) [https://elementus.io/tokens-q1-2018](https://elementus.io/tokens-q1-2018)


