

MEMORANDUM

To: Crypto Task Force Meeting Log
From: Crypto Task Force Staff
Re: Meeting with Representatives of AH Capital Management, LLC (A16z)

On February 5, 2025, Crypto Task Force Staff met with representatives from AH Capital Management, LLC (A16z).

The topic discussed was approaches to addressing issues related to regulation of crypto assets. AH Capital Management, LLC representatives provided the attached documents dated February 13, 2025, describing the issues discussed at the meeting.

February 13, 2025

Agenda:

I. Token Classification & Issuance Framework

- The need for a token taxonomy.
- The importance of clarity concerning decentralization.
 - Decentralization is a key innovation of blockchain systems because it enables these computational networks and their underlying tokens to operate and function absent unilateral control. Guidance and any applicable rulemaking should recognize this.
 - Greater clarity on token taxonomy and related disclosure requirements will facilitate the establishment of more objective and reasonably achievable decentralization criteria.
 - Benefits of guidance to enable programmatic economic models for tokens.
- Pathways for greater retail participation in innovative projects.
 - The critical need for guidance providing an exemption for airdrops & incentives-based rewards.
 - The benefits of developing specially tailored crowdfunding pathways like token safe harbor proposal 2.0.
- Investor/consumer harm in the absence of resale restrictions for insiders.
 - Appropriately tailored disclosures.
 - The importance of a reporting regime that acknowledges unique attributes.
 - The importance of resale restrictions to prevent tokens being dumped on the market and potentially undermining the protocol/network/application.

II. Market Intermediaries and Other Participants

- The importance of intermediaries and bolstering secondary transactions with DeFi.
 - Custodians, self-custody, and the importance of guidance for RIAs.
- Brokers & ATS - certifications & disclosures.
 - Revocation of the SPBD designation.
 - Guidance on B/Ds facilitating trading and custody of crypto.
 - 15c2-11 Equivalent for listing and trading crypto assets in which no controlling party is positioned to provide disclosures/reporting.
- Recommendations for bringing real world assets onchain.
 - Opportunities for traditional finance: equity onchain, derivatives, etc.
 - Modifications of the approach to ETPs, including the allowance of physical settlement on the primary market and staking the trust's holdings.

For more on these topics see a16zcrypto.com, as well as our [podcast](#) and [newsletter](#).



A new (digital) age at the SEC

By Scott Walker, Chief Compliance Officer at Andreessen Horowitz, and Bill Hinman, Advisory Partner at a16z crypto

Editor's note: This op-ed is part of a bigger package of crypto policy views. Find the rest here: "[U.S. as the crypto capital: What it would take.](#)"

As technology evolves, the U.S. Securities and Exchange Commission (SEC) must evolve with it. Nowhere is this truer than in crypto. New leadership — plus the formation of a new crypto task force — gives the agency an opportunity to take meaningful action and adapt.

The time for that action is now: The market for crypto assets has grown in size and sophistication such that the SEC's recent harmful approach of enforcement and abdication of regulation needs urgent updating. There is no other way to promote efficient markets, encourage innovation, and ensure investor protections are adopted as professional investment services begin to operate within this new industry. The principles underpinning the relevant securities laws — disclosure, fraud prevention, and market integrity — should remain sacrosanct. However, applying these principles in a way that reflects the distinct characteristics of crypto assets requires targeted regulatory changes.

This piece proposes immediate, easily adopted adjustments the SEC should take to create fit-for-purpose regulations without sacrificing innovation or critical investor protections. While legislation is necessary to provide sufficient regulatory clarity regarding crypto asset classification and secondary market oversight, these steps would provide immediate benefit to the market.

1. Provide interpretive guidance on 'airdrops' and other incentive-based rewards

The SEC should provide interpretive guidance for how blockchain projects can distribute crypto assets to participants without being characterized as securities offerings. These distributions are often called "airdrops" or "incentive-based rewards," and blockchain projects typically conduct them for free, or in exchange for de minimis value, often as a reward for prior usage of the particular network or ecosystem. Such distributions are a critical tool for enabling blockchain projects to build community and progressively decentralize, as they disseminate ownership and control of a project to its users.

This process of decentralization has multiple benefits. Decentralization can guard investors against risks commonly associated with securities and centralized control and to facilitate the expansion of the network, thereby increasing its value. If the SEC were to provide guidance on distributions, it would stem the tide of airdrops and incentive-based rewards only being issued to non-U.S. persons — a trend that is effectively offshoring ownership of blockchain technologies developed in the U.S., and effectively creating windfall gains for non-U.S. persons at the expense of U.S. investors and developers.

What to do:

- **Establish eligibility criteria:** Set baseline criteria for crypto assets that are eligible for exclusion from treatment of investment contracts under securities laws in airdrop and incentive-based reward distributions. For example, crypto assets whose market value is substantially derived from (or reasonably expected to be substantially derived from) the programmatic functioning of any distributed ledger or similar technology, or any executable software deployed to a distributed ledger or similar technology, that are not otherwise securities should be eligible for such distributions.

2. Modify crowdfunding rules for exempt offerings

The SEC should revise Regulation Crowdfunding rules to more effectively regulate exempt offerings for crypto assets.

The current limits on capital raising and investor participation in crowdfunding campaigns are ill-suited for crypto startups, which often need a broader distribution of crypto assets to develop a critical mass and network effects for their platforms, applications, or protocols.

What to do:

- **Expand offering limits:** Increase the maximum amount that can be raised through crowdfunding to a level consistent with the needs of ventures (e.g., up to \$75 million or a percentage of the overall network, depending on the depth of disclosures).
- **Exempt offerings:** Allow crypto projects to rely on exemptions similar to Regulation D while leveraging the crowdfunding platform's accessibility to reach more broadly beyond accredited investors.
- **Protect investors:** Adopt appropriate safeguards such as caps on the amounts any one individual may invest (as Reg A+ currently does) and robust disclosure requirements that encompass the material information relevant to the crypto venture — something present regulations do not address. (For example, while offering disclosures may often address matters such as directors, their compensation, and shareholding details, disclosures around the underlying blockchain, its governance, and consensus mechanisms may be more important for investors in crypto assets.) Tailoring these requirements to digital asset investors can ensure they are well-informed and protected from fraud.

These changes would empower early-stage crypto projects to access a wide pool of investors, democratizing access to promising investment opportunities while preserving transparency.

3. Enable broker-dealers to operate in crypto assets and securities

The current regulatory environment restricts traditional broker-dealers from engaging meaningfully in the crypto space — primarily because it requires brokers to obtain separate approvals to transact in crypto assets, and imposes even more onerous regulations around broker-dealers who wish to custody crypto assets.

These restrictions create unnecessary barriers to market participation and liquidity. Allowing broker-dealers to facilitate transactions in both crypto assets that are securities, as well as those that are not, would enhance market functionality, investor access, and investor protection. It would also recognize that on crypto platforms today, crypto assets that are clearly not securities (such as bitcoin, ether, or fiat-based

stablecoins) trade seamlessly against crypto assets that the SEC may consider to be subject to securities laws.

What to do:

- **Enable registration:** Develop a clear path for broker-dealers to register for dealing in (and custodying) crypto assets (securities and nonsecurities), with tailored requirements reflecting the nature of these assets.
- **Enhance supervisory framework:** Establish oversight mechanisms to ensure compliance with anti-money laundering (AML) and know-your-customer (KYC) regulations, safeguarding market integrity.
- **Collaborate with industry:** Work with the Financial Industry Regulatory Authority (FINRA) to issue joint guidance that addresses operational risks unique to crypto assets.

This approach would promote a safer and more efficient marketplace, enabling broker-dealers to bring their expertise in best execution, compliance, and custody to crypto markets.

4. Provide guidance on custody and settlement

Custody and settlement remain critical barriers to institutional adoption of crypto assets. Ambiguity concerning regulatory treatment and accounting rules has deterred traditional financial institutions from entering the custody market. This means that many investors are not getting the benefit of fiduciary asset management for their investments, and instead are left investing on their own and arranging their own custody alternatives.

What to do:

- **Tailor custody guidance:** Provide guidance concerning the custody rule under the Investment Advisers Act to clarify how investment advisers can custody crypto assets, ensuring adequate safeguards such as multi-signature wallets and secure offchain storage. This should also include guidance on staking idle assets and voting on governance decisions for crypto assets in the custody of investment advisers.
- **Set settlement standards:** Develop specific guidance on settlement for crypto transactions, including timelines, validation processes, and error resolution mechanisms.

- **Establish a technology-neutral framework:** Allow flexibility for innovative custody solutions that meet regulatory standards without imposing prescriptive technological mandates.
- **Rectify accounting treatment:** Repeal SEC Staff Accounting Bulletin 121 and allow the accounting for custodied digital assets to reflect the nature of the custody arrangements rather than a presumption of liability. By background, SAB 121 states, among other things, that, “as long as [a firm] is responsible for safeguarding the crypto-assets held for its platform...the firm should present a liability on its balance sheet to reflect its obligation to safeguard the crypto-assets held for its platform users” with a corresponding asset. The general effect of SAB 121 moves custodied crypto assets onto the custodian’s balance sheet — a practice that is at odds with the traditional accounting treatment of custodied assets. As a result, and unlike in a typical custodial arrangement, this accounting treatment may have the effect of dragging custodied crypto assets into the custodian’s bankruptcy estate, if the custodian were to go bankrupt. Perhaps worst of all, SAB 121 lacks legitimacy. The Government Accountability Office has found that it was effectively a rule that should have been submitted for Congressional review under the Congressional Review Act, and in May of 2024, the House and the Senate issued a joint resolution disapproving SAB 121, only to have the resolution vetoed by President Biden.

This clarity would provide the foundation for institutional confidence, enabling larger players to enter the market while also increasing market stability and competition among service providers. Furthermore, crypto investors, both retail and institutional, would receive the protections associated with professional, regulated asset management services.

5. Reform ETP standards

The SEC should adopt reform measures for exchange-traded products (ETPs) that will foster financial innovation. The proposals promote broader market access to investors and fiduciaries used to managing portfolios of ETPs.

What to do:

- **Restore market-size test:** The SEC’s reliance on the “Winklevoss Test” for market surveillance agreements has delayed approval of bitcoin and other crypto-based ETPs. The test requires that for a national securities exchange, such as NYSE or NASDAQ to trade a commodity-based ETP, the listing exchange must have a surveillance agreement with a “regulated market of significant size” in either the commodity or a derivative thereof. Given that the SEC does not consider crypto trading platforms to be “regulated markets,” this functionally means that ETPs can only exist for those crypto assets that have futures markets

(regulated by the Commodity Futures Trading Commission) which have demonstratively high predictive price discovery of the underlying commodity. This approach overlooks the significant size and transparency of current crypto markets. More importantly, it creates an arbitrary distinction in the standards applicable to crypto-based ETP listing applications and all other commodity-based listing applications. Therefore, we suggest reverting to the historical test for markets of significant size: requiring only that sufficient liquidity and price integrity for the commodity futures market exists to support an ETP product. This adjustment would align crypto ETP approvals with standards applied to other asset ETPs.

- **Enable physical settlement:** Permit crypto ETPs to settle directly in the underlying asset. This will result in better fund tracking, reduce costs, provide greater price transparency, and reduce reliance on derivatives.
- **Apply custody standards:** Mandate robust custody standards for physically settled transactions to mitigate risks of theft or loss. Additionally, provide for the option of staking idle assets of the ETP.

6. Implement a 15c2-11 certification for ATS listings

In a decentralized environment where the issuer of a crypto asset may play no significant continuing role, a question arises as to who bears responsibility for providing accurate disclosures around the asset. Fortunately, there exists a helpful analog from the traditional securities markets in the form of [Exchange Act Rule 15c2-11](#), which permits broker-dealers to trade a security so long as there is, among other things, current information for the security available to investors.

Extending that principle into the crypto asset markets, the SEC could permit regulated crypto trading platforms (both exchanges and brokerages) to trade any asset for which the platform can provide investors with accurate, current information. The result would be greater liquidity for such assets across SEC-regulated markets, while simultaneously ensuring that investors are equipped to make informed decisions. Two obvious benefits from this are the trading of digital asset pairs (in which one asset is a security against an asset that is not a security) on SEC-regulated markets, and a disincentive for trading platforms to operate offshore.

What to do:

- **Streamline certification process:** Establish a streamlined 15c2-11 certification process for crypto assets listed on alternative trading system (ATS) platforms, providing mandatory disclosures about the assets' design, purpose, functionality, and risks.

- **Employ due diligence standards:** Require exchanges or ATS operators to perform due diligence on crypto assets, including verifying issuer identity as well as important feature and functionality information.
- **Clarify disclosure requirements:** Mandate periodic updates to ensure investors receive timely and accurate information. Also, clarify when reporting by an issuer is no longer necessary as it is not informative to a prospective purchaser due to decentralization.

This framework would promote transparency and market integrity while allowing innovation to flourish within a regulated environment.

Conclusion

The SEC stands at a pivotal moment in determining the future of crypto asset regulation. The creation of a new crypto task force signals the Commission's intention to change course from the previous administration. By taking the above crucial steps now, the Commission can begin to rotate away from its historic and heavily contested focus on enforcement efforts and add the much needed regulatory dimension of guidance and practical solutions for investors, fiduciaries, and financial intermediaries. This will better balance protecting investors with fostering capital formation and innovation.

The changes proposed above — ranging from modernizing crowdfunding rules to creating clear standards for custody and ETPs — would reduce ambiguity and support financial innovation in this area. With these adjustments, the SEC can reclaim its purpose and reposition itself as a forward-thinking regulator, ensuring that U.S. markets remain competitive while also safeguarding the public. The long-term future of the U.S. crypto industry will likely require Congress to provide a comprehensive, fit-for-purpose regulatory framework. Until that framework is in place, however, the steps outlined here serve as a way toward appropriate regulation.

Why decentralization matters, and needs incentives

By Miles Jennings, General Counsel at a16z crypto

Editor's note: *This op-ed is part of a bigger package of crypto policy views. Find the rest here: ["U.S. as the crypto capital: What it would take."](#)*

"Decentralization" sounds like an ideology that only some kinds of people care about, but it actually impacts every one of us every day. Decentralization is actually at the heart of many issues dominating our conversations — whether it's about who controls social media networks that influence our public discourse; who financial institutions choose to bank; who controls the AI tools that help us, but that can also generate bots and deepfakes; and other concerns.

How does "decentralization" come in? Because a handful of big corporations and platforms — all centralized — have monopoly-like power over the digital products and services we use. And despite contributing to the very value those platforms provide to all their users (aka "network effects"), those users don't have a vote, choice, or other ways to control their destiny. This is especially concerning for the creators and small businesses whose livelihoods depend on those platforms. All the value is extracted by big corporations; little value is left for users. Arbitrary decisions those corporate leaders unilaterally make impact lives, and livelihoods.

The fact is that centralization, the opposite of decentralization, *works*: It allows companies to coordinate resources efficiently. It allows a single leader — or a couple of visionaries inside the same organization (like Steve Jobs and Jony Ive at Apple) — to more efficiently make decisions, sometimes resulting in better products. When an organization is centralized, it can move fast, take unilateral action, and reap the rewards. The same can be said of governments. This is why centralization and consolidation are the norm today: See Big Government, Big Banks, Big Tech, and so on.

Much like gravity, centralization is a force that's hard to resist. By comparison, decentralization — transferring control and power to distributed groups — is inefficient. It's like a rocketship: Decentralization requires immense energy, effort, and engineering to overcome the natural order.

So why fight this force of gravity?

Because centralization has led us to countless services that leave users in the clutches of monopolies, capricious gatekeepers, unreliable platforms and extractive rent-seekers. But breaking up Big Everything through traditional regulations like anti-trust alone is just as fraught an approach. Those methods often stifle innovation — going after the wrong actors or leading to regulations that actually *favor* the incumbents who can afford to comply — and squashing the smaller players in the process.

The best approach is decentralization; it's the opposite force to centralization.

But people have been talking about decentralizing companies, governments, schools, and other organizations for decades. It's been hard to pull off in practice, however, because the technologies to coordinate at scale haven't been possible (or available to all). Decentralization has therefore cost more, produced less, moved slower — not to mention also adding more complexity, redundancy, and messiness.

When going up against the well-established efficiency and stability of centralized systems, decentralized options didn't stand a chance... Until now.

Today, we have over a decade of proven technologies and techniques for decentralization to work at scale, through blockchains/ crypto — and we've already seen the results. The total crypto market cap is more than \$3 trillion. There are an estimated 30-60 million real (non-bot) users, transacting monthly. Thousands of protocols — not just one or two — hold billions of dollars, while decentralized blockchains like Bitcoin, Ethereum, and Solana (to name a few) have provided platforms for services, applications, businesses, and users to build on — much like the early internet once did.

More importantly, blockchain users and communities — enabled by decentralized blockchain networks and digital assets to defy gravity — have been able to *own* and *operate* all those services, generating that value in a decentralized manner. Ethereum (just to name one example) has pulled off a number of massive engineering feats, with its distributed community coordinating to change the tracks on the railroad while the trains were running — without interrupting the trillions of dollars value flowing through it.

Even if you're not interested in crypto, or are tired of hearing about blockchains, decentralization matters: Whether it's these specific technologies or some different form in the future, we are clearly starting to defy the gravity of centralization. We know how to build the rockets. Decentralized systems can achieve unprecedented levels of coordination and operational functionality. It is now possible to have new forms of governance and organizations; community-owned-and-operated networks and services; robust, decentralized economies; and countless other innovations. We now know how to decentralize at scale.

This doesn't mean that centralized businesses will go away. Centralized businesses can also build on top of decentralized networks. That means more choice, more voice, more competition... all of which benefit consumers.

Decentralization inherently embraces all these qualities, the same ones that have historically been the source of U.S. innovation. It's also the force behind the United States itself; "federation" is just decentralization by another name. Yes, we have a centralized government, but each state also has power to make decisions democratically — unlike in dictatorships. Decentralization is responsible not only for the greatness of our country, but for the greatness of our cities too. Just think of the dynamism and opportunity of New York City as compared to the centrally-planned, entirely closed, experience of Disneyland.

Decentralization is necessary for our society and economy, because it:

- **Fosters competition**, by leveling the playing field between incumbents and upstarts;
- **Promotes creativity**, offering a platform to build with or on top of (as though with Lego bricks, or "composability" in software terms), in a way that entices builders and offers more options to users;
- **Secures freedom**, in a "credibly neutral" way — because there is no central authority to infringe on individual liberties, discriminate against any individual, or suddenly and unilaterally change terms and rights suddenly;
- **Rewards participation**, because there are fewer middlemen who can extract value without offering much in return;
- **Shares value**, providing ways for participants to be rewarded more equitably (in proportion to their contributions, for instance), rather than having all the value accrue to just a few.

We have reached a point where decentralization *works*, and can be applied to many areas of digital life. The challenge now? It's *incentivizing decentralization*.

Incentivizing decentralization

As with gravity, the natural order "pushes down" against newer, more distributed ways of building a business. Decentralization means asking entrepreneurs and developers to give up control of their projects and proceed by consensus, rather than by singular command-and-control. Decentralization means builders, creators, and investors distribute ownership to other network participants, thereby diluting their own

economic interest. Decentralization means actively inviting third-parties to build out a given network, thereby reducing the founders' own importance, standing, and singular vision. All of these forces push against decentralization.

Unfortunately, the easiest and cheapest path to building with blockchain technology is to take shortcuts — or skip decentralization altogether. This is understandable — with regulatory uncertainty pervasive, projects are incentivized to remain centralized while pretending to be decentralized, exposing users to significant risks, but giving projects a competitive advantage over those that pursue decentralization in good faith. Ultimately, just because something uses a blockchain doesn't mean it's automatically tapping into the value of decentralization.

So how do we give people — businesses, users, builders, creators, community leaders — more incentives, pathways, and frameworks to decentralize? Decentralization isn't a light switch that can be flipped on or off; it is a process, which takes place in steps. A project often starts centralized (or somewhat centralized), before decentralizing. The trick is to lower regulatory burdens for projects as they decentralize. And to do it in a way that's a powerful enough incentive for projects to undertake the work required to decentralize.

So, we need laws that not only promote, preserve, and protect decentralization (just as we need to do for privacy) — but that also *incentivize* it. For example:

- For decentralized finance (DeFi) applications, we shouldn't apply regulations designed for intermediaries to DeFi systems that *don't* have intermediaries. Instead, we need tailored regulations that target intermediary-related risks where they appear, and that address other risks unique to DeFi (like code audit requirements).
- For digital assets, "fit-for-purpose" regulations should apply lighter-touch disclosure obligations, fewer selling restrictions, and greater access to secondary markets where projects broadly disseminate ownership and control. These recommendations would essentially treat these systems' digital assets more like commodities, and less like securities.
- Tax reporting and other compliance regimes should similarly be clarified to remove intermediary-based obligations where there are no intermediaries to exert control over the system.

Not only would this approach lead to the benefits of decentralization outlined above, but it also aligns with existing regulatory models: Decentralization removes the risks to users that result from *centralization* — the extractive and capricious gatekeeping intermediaries that regulations aim to guard against — thereby eliminating the need to apply such regulations. Furthermore, decentralization can remove these risks far more

effectively than any regulation ever could; systems that depend on a regulated intermediary are inherently more risky than systems that don't require an intermediary at all.

The U.S. Securities and Exchange Commission acknowledged this in their 2019 framework, as did the recent FIT21 bill passed by the House of Representatives last year: If a project legitimately removes intermediaries and gives up control, then it doesn't make sense to subject it to the same responsibilities, disclosure rules, and other requirements that centralized entities and securities must abide by. But these frameworks also led to unintended consequences, and must be improved.

The bottom line: We don't need loopholes making exceptions for anything labeled "crypto"; we just need good guiderails. Because decentralization matters. Control matters. If we value freedom, fairness, and resilience, then we should *all* care about the topic.

We finally know how to make decentralization work at scale, and many are already doing so — despite the many obstacles in the way — these builders and community leaders just need a clearer path forward and a level playing field on which to compete. The first wave has gone through the American frontier opening up the paths; let's now pave those paths and make a better road for future builders to travel.

Defining decentralization: It comes down to control

By Miles Jennings, General Counsel at a16z crypto

Many have made the case for decentralization, including us on several occasions — decentralization is a key benefit of blockchain technology, and has the potential to address many current social challenges online. But blockchains only make decentralization possible, they do not make it inevitable.

Regulatory approaches to decentralization will therefore play a significant role in determining whether decentralization succeeds or fails, either outright prohibiting it or incentivizing it. And the role decentralization should play in the regulatory frameworks for crypto continues to be hotly contested. Bad actors have a number of reasons to rally against it — decentralization guards against entrenched interests, regulatory capture, value extraction, and get-rich-quick schemes. Even the best industry actors have legitimate doubts — is decentralization too amorphous of a concept, and one that can be too easily manipulated by overzealous regulators, as we saw the past few years?

But abandoning decentralization would miss the unique technological characteristics that make blockchains, blockchains — the very features that distinguish them from proprietary software. Those characteristics of blockchain technology — autonomy, transparency, and trustlessness — can mitigate risks to investors and consumers (in addition to offering other benefits like ownership, choice, etc. to users). As a result, blockchains justify new regulatory approaches. Not accounting for these core principles would leave the industry unmoored from any unifying and consistent principle under the law, leaving decisions to whim and not logic.

Decentralization must be incentivized, not ignored. So I argue in this piece that we must start with a better definition of decentralization — one that moves us beyond the ambiguities that have caused unintended consequences, and that could simplify things for both policymakers and builders.

Defining decentralization

Defining decentralization can't be an amorphous, blurry Rorschach test that anyone can interpret any way they like based on what they want to see in it. We know where that path leads — enforcement agencies like the SEC, CFTC, FinCEN, and DOJ have weaponized expansive and ambiguous definitions of decentralization to go after good actors and bad actors alike. Perverse incentives abound, nowhere more so than at the

SEC, which focused the past few years on persecuting the founders who continue to build and benefit tokenholders, over those that take the money and run.

A better, simpler, and less amorphous approach is possible. Within a given regulatory framework, **the meaning of decentralization should be constrained to the unique and objectively measurable characteristics of blockchain technology that mitigate the risks a regulatory scheme is intended to address.** This core principle can be used to define decentralization for legal regimes that apply to money transmission, custody, securities laws, commodities laws, and beyond. In this post, I apply the principle to digital assets — exploring the relationship between decentralization and the risks arising from digital assets, and then proposing a constrained approach to decentralization.

My argument is simple: **For digital assets, decentralization should focus on the absence of control, not on curtailing ongoing developer efforts.** Such an approach could be used to protect investors, while still fostering innovation; limit digital assets being used to issue ordinary securities that circumvent securities laws; and provide a framework that's easier for regulators to apply and for builders to follow.

Mapping token risks to decentralization under securities laws

The relationship between decentralization, and risks arising from digital assets, is complex. Holders of digital assets are subject to a variety of risks; there are a myriad of decentralization factors that interplay with such risks; and such factors are often subjective (and their importance relative to one another varies by project).

Nevertheless, these token risks are primarily a function of a digital asset's: (1) token characteristics, and (2) trust dependencies.

Token characteristics

The risks inherent to a digital asset are a function of its characteristics. **Digital assets** are software and can be programmed to represent anything — a digital store of value like Bitcoin, a consumptive asset like Ethereum, a stablecoin like USDC, and even a share of stock.

Decentralization is most relevant to the risk profile of digital assets that have securities-like features, but are not securities. These digital assets are commonly referred to as "**network tokens**" — digital assets that are speculative in nature and whose value is substantially derived from the operation of any blockchain or smart contract protocol (e.g., BTC, ETH, SOL, UNI, etc.).

Network tokens do not provide the owner with any financial interest in another person, or enforceable contractual rights with respect to the ongoing efforts of another person — but their value is often tied to a blockchain-based network. This relationship can be as simple as the token price being driven by market demand for the blockchain network, or be as complicated as the token price being directly tied to the revenue-generating activity of the network. In all such cases, this relationship introduces risks that implicate securities laws.

Network tokens also often have **utility** — as they can easily be designed to function as a currency in connection within a blockchain-based product or service — such as to pay for gas fees, to acquire other assets, or to stake as collateral. But “utility” alone does not meaningfully change the risk profile of network tokens. For example, a share of Amazon stock would not be exempt from securities laws simply because Amazon began accepting such shares as payment for Amazon Web Services (AWS). Similarly, digital assets should not be exempted merely due to the presence of utility.

Trust dependencies

Trust is a hallmark of most types of securities: Owners of shares trust a company’s management team to drive share value or return profits. Owners of notes trust the borrower to return their funds with interest. Commodities, on the other hand, are inherently trustless — the holder of a commodity is not dependent on any single actor to drive value.

This difference in trust dependencies leads to the different treatment of offers and sales of securities and commodities under U.S. law, because the presence of trust dependencies influences the relative risk of information asymmetries arising with respect to each asset.

But securities laws are not designed to alter the risk profile of securities to turn them into commodities. Rather, they are designed to protect investors investing in securities — primarily by requiring disclosures to limit risks of information asymmetries that arise due to the trust dependencies of securities. Per the SEC’s 2019 Framework, absent disclosures, “...significant informational asymmetries may exist between the management and promoters of the enterprise on the one hand, and investors and prospective investors on the other hand. The reduction of these information asymmetries through required disclosures protects investors and is one of the primary purposes of the federal securities laws.”

Commodities trading does not require such disclosures, as the risk of information asymmetries is low.

Digital assets are different from other assets, because they can have trust dependencies comparable to both securities *and* commodities. Here are two examples to help demonstrate this:

- If Amazon were to issue a digital asset that derived value from the continued operation of AWS, such an offering would be indistinguishable from a securitization subject to *securities* laws.
- Bitcoin derives its value from the ongoing operation of the Bitcoin network, but because the operation of that network is not dependent on any actor, its trust dependencies are similar to a *commodity*.

The critical difference between these two extremes is **the relative risk of information asymmetries arising**:

- In the Amazon example, the risk is significant. Even if Amazon made no promises regarding the continued operation of AWS, and the AWS token provided no rights, title, or interest in Amazon itself — the AWS token would have similar trust dependencies and corresponding information asymmetry risks as many securities. Applying securities laws could help reduce such risks.
- In the Bitcoin example, no such trust dependencies exist; the risk of information asymmetries is minimal. Applying securities laws here would *not* meaningfully change the risk profile of the asset.

To sum up: **The trust dependencies of an asset dictate the potential risk of information asymmetries arising, which informs whether or not securities laws would be helpful to apply.**

Blockchain-based networks are different from proprietary software here, because they are uniquely positioned to eliminate trust dependencies and reduce the risk of information asymmetries. Transparent, verifiable, and publicly accessible blockchain data mean that all transactions and value accrual occur onchain — visible for anyone to audit and verify. This is the functional equivalent of audited and unassailable financial statements.

However, there are two other primary trust dependencies that are not inherently eliminated by blockchains:

- **Control.** Whoever exerts control over a system (a company, a network, etc.) or its underlying asset, controls the risks associated with that asset — exposing holders to several risks, including information asymmetries, market manipulation, conflicts of interest, and value extraction.

- **Ongoing Efforts.** Being dependent on the ongoing efforts of a small number of actors to maintain and develop a system exposes holders of the system’s underlying asset to several risks, including information asymmetries.

Across network tokens, securities and commodities, the role “control” and “ongoing efforts” differ as follows:

	Control	Ongoing Efforts
Network Token	The value of a network token is dependent on the characteristics of the token; and on the performance of the underlying network — both of which can function with or without human control .	Network tokenholders have no rights to ongoing efforts , but may nevertheless derive benefits from ongoing efforts.
Securities	The value of a share in a company is dependent on the characteristics of the share, and the company’s performance — which can only function with human control .	Shareholders have rights to ongoing efforts , and derive benefit from those ongoing efforts.
Commodities	The value of a commodity is dependent on market forces like supply and demand — which function without human control .	Commodity holders have no rights to ongoing efforts ; but may nevertheless derive benefits from ongoing efforts.

Network tokens, like commodities, derive their value from systems that can operate without human intervention. This means they are capable of operating in a manner that precludes any party from unilaterally affecting or structuring the risk associated with the network’s token. The elimination of this trust dependency again distinguishes network tokens from securities.

Returning to the Amazon example: The presence of control means Amazon can simply stop operating AWS, unilaterally changing the risk profile of the hypothetical AWS token. Applying securities laws is warranted here, to guard against the risk of information asymmetries that may arise as a result of that control.

But in the case of Bitcoin: No such controlling party exists, so applying securities laws here is unwarranted.

The SEC's 2019 framework sought to reduce the risk of information asymmetries arising from both control-based and ongoing efforts-based trust dependencies. It reasoned that:

- where a network and its token are **controlled** and being actively developed through **ongoing efforts**, the risk of information asymmetries may be comparable to a share of stock;
- but where a network and its token are **not controlled** and there is no reliance on **ongoing efforts**, the risk of information asymmetries is more similar to an ordinary commodity.

With the substantial legal benefit of avoiding securities laws now being tied to the SEC's 2019 definition of decentralization, many developers responded by reducing elements of control over their projects **and** by decentralizing their ongoing efforts. However, in the hands of the previous administration, this approach resulted in several unintended consequences:

1. The use of an expansive and subjective definition of decentralization has made the 2019 framework incredibly difficult to enforce effectively, but very easy to weaponize by overzealous regulators against good actors.
2. The incorporation of "ongoing efforts" into the definition of decentralization created a paradox: It incentivized builders to forestall or obfuscate ongoing development efforts post-token launch, thereby introducing greater operational and execution risks to token holders rather than reducing such risks.

Both of these problems can be solved with a new, simpler approach — one that pairs a more constrained definition of decentralization with a light-touch disclosure regime.

A new path forward: A simpler, and easier to apply, definition of decentralization

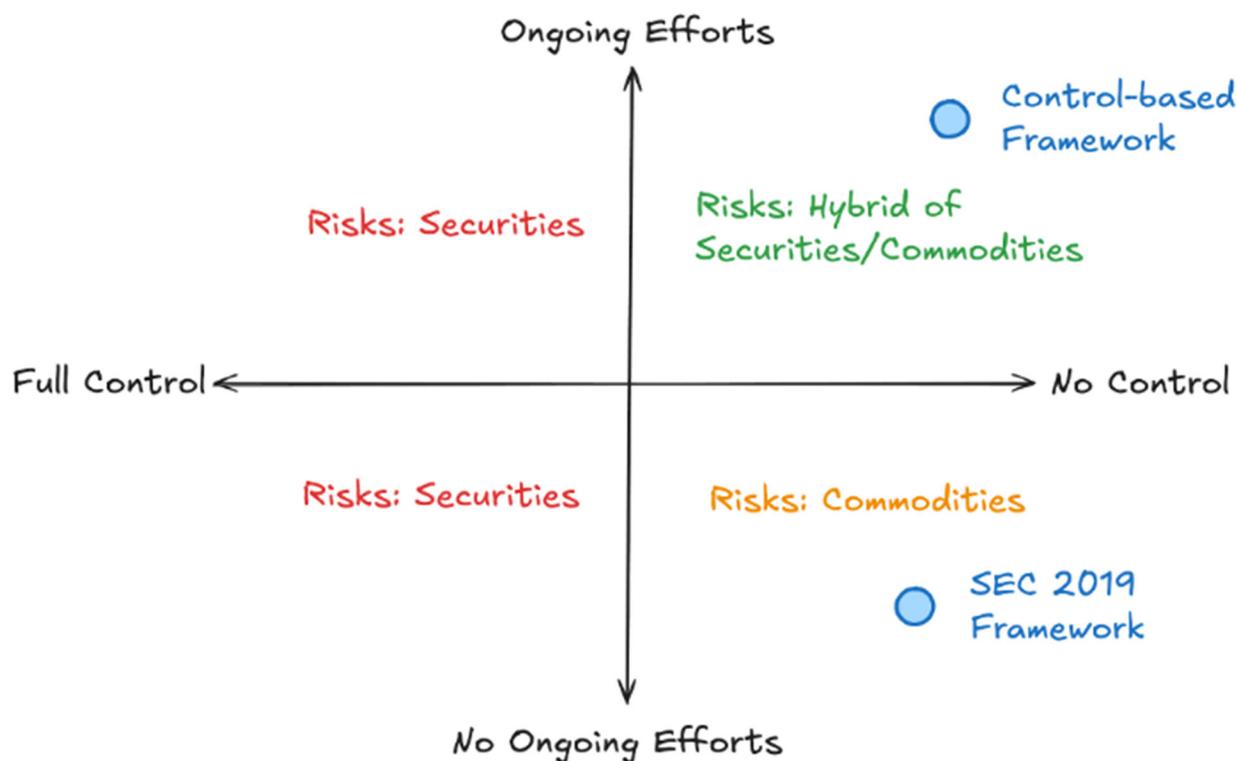
First, the definition of **decentralization should be constrained to mean the absence of control**, thereby addressing risks arising from control-related trust dependencies.

Using a rules-based approach, legislation or regulators could establish objective criteria capable of being easily evaluated — determined by anyone at any time, based on a review of a project's codebase and ledger. Among the criteria that should be considered are whether the network is: open source, functional, verifiable, autonomous, permissionless, non-custodial, credibly neutral, distributed, economically independent, and immutable.

Collectively, these characteristics are not possible for closed and proprietary networks controlled by corporations. But they are fundamental to blockchains.

Second, a fit-for-purpose **disclosure regime** could build on the transparency inherent with blockchains to mitigate risks of information asymmetries arising from **ongoing development efforts**. Such disclosure criteria should focus on information most relevant to blockchain projects, as identified in Token Safe Harbor Proposal 2.0 and FIT21, to name a few examples.

While simple, the use of a two-pronged approach is a significant improvement. The 2019 framework sought to subject projects to securities laws if they operated anywhere other than the **lower right quadrant** below (no control/no ongoing effort) — which is what led to abuse by regulators and perverse incentives for developers. But this new two-pronged approach would more appropriately provide projects with a pathway to operate in the **upper right quadrant** (no control/with ongoing effort) — where those network tokens have a risk profile that reflects a hybrid of commodities and securities.



Critically, both strategies — constrained definition of decentralization, and light disclosure — are necessary to achieve a better way. Relying on decentralization alone has failed. And while relying on disclosure obligations alone could eliminate risks of information asymmetries, disclosure obligations do not change the inherent risks of network tokens — in other words: Without decentralization, the economic reality, and

risk, of many network tokens may be comparable to securities, thereby making it difficult to credibly argue that special treatment under securities laws is justified.

Instead, pairing decentralization *and* disclosure leads to the optimal outcome: Network tokens are differentiated from securities with objective and easily measurable criteria; builders are empowered to build out in the open; and participants are provided with transparent disclosures.

This approach also provides a much more practical and tangible “decentralization” target for regulators to focus on, one that is also more consistent with other regulatory regimes:

- For decentralized finance (DeFi) applications, decentralization should focus on the absence of intermediaries.
- For tax reporting and compliance, decentralization should focus on the absence of dominion and control.
- For money transmission, decentralization should focus on the absence of third-party custody.
- And for digital assets, decentralization should focus on the **absence of control**.

Further, having more clarity and certainty around the meaning of decentralization will enable policymakers to design mechanisms that effectively incentivize decentralization; facilitate progressive decentralization; guard against bifurcated markets; and most importantly, **encourage builders to build** — rather than engage in “decentralization theater” (or worse, abandon projects). Better yet, the use of objective and easily measurable criteria means all of this can be achieved at scale.

* * *

Decentralization should be defined and used as a tool that maximizes the benefits that blockchains deliver, while reducing risks to users — across every intersection of law and blockchains/ crypto. The definition of decentralization should not be a tool for persecuting developers. While decentralization is hard, defining it doesn’t have to be. We should start with control. From there, we can rely on builders and others in the trenches to define objective criteria for “control” based on their experience and learnings from the battle-hardened blockchain systems in the space.

This isn’t an academic or wonky debate. The ambiguities of decentralization have encumbered the blockchain industry and slowed the pace of innovation to date. Clear and objective approaches would enable the industry to overcome these obstacles,

creating an environment where builders can thrive, participants can engage with confidence, and the power of decentralization is unleashed to the benefit of all.

For digital assets, that starts with redefining decentralization as the absence of control.

For more on these topics see a16zcrypto.com, as well as our [podcast](#) and [newsletter](#).

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