There Must Be Some Kinda Way Out of Here[1] Part II -- Security Status[2]

Scoping Out. The Commission may be able to provide greater clarity to investors and other market participants by identifying categories of ~~crypto~~ digital assets (and transactions) that do not fall within its authority. In some cases, these types of crypto assets may be within another regulator's authority. In determining what falls outside the Commission's authority, the Commission should look to the economic reality of what is being offered or sold. Simply saying something is not a security does not mean it is not a security.

5. Should the security status of certain categories of crypto assets be addressed, such as stablecoins, wrapped tokens, and NFTs?

It is a mistake to get caught up in trying to classify digital assets that can have more than one use case at a time. The analysis should be whether the asset in context of how it is offered for sale (or resale) requires the protections applicable to capital raising vehicles. Note that a fungible token sold for utility purposes would not be a security, but the same token sold in a capital raise would be. There is no way out of this conundrum if you lock in on categorizing different tokens as being "securities" or not.

Stablecoins are designed to be "stable". By definition, the issuer is telling a purchaser that they will not have a positive return on investment from purchasing the stable coin (at least in normal circumstances). That said, if an issuer sells stable coins in exchange for the capital required to back the stable coins, it is a capital raise. The Issuer should have to make disclosures to allow investigation into whether that stable coin will actually hold its value. Note that does not mean that the stable coin itself is a "security". In most circumstances, under the '34 Act, you would not want the issuer to have to report periodically (presumably stable coin legislation requiring complete backing in regulated custody should eliminate the need for periodic reports).

The issuing of a wrapped token in most scenarios is not a capital raise and does not have the investment risks that require regulation under the '33 Act. Certainly, the wrapped token should not require periodic reports under the '34 Act (unless the wrapper is of a tokenized traditional financial product, in which case the wrapper should be ignored and the financial product regulated as a security). As stated in a previous section, there may be an investment contract to regulate implicit in the action that generates the wrapped token, and that might require appropriate disclosure if the smart contract on which the wrapped token is based would allow for risk of loss of the asset provided in exchange for the wrapped asset. I recognize that the action of locking a token into a smart contract for liquidity provision, for example, is not a capital raise in the classic sense. That said, it may fall into the definition of capital raise for '33 Act purposes if we consider providing liquidity for a token on a decentralized exchange to be a use of raised capital. A risk of loss element to the analysis may prove helpful.

---

[1] With a tip of the hat to Jimi, Josh Lawler is neither a joker or a thief, but he is a seasoned securities attorney who applies a keen understanding of the technology underpinning distributed ledger use cases to navigate legal grey spaces. Accordingly, he has lots of opinions. Thanks for asking.

[2] As I start this (unpaid) odyssey, staring down Commissioner Peirce's 48 information requests, I can't really know how many I'll get to, but hopefully at least a decent group. Of course, happy to discuss in person (in fact, try to stop me).

NFTs should not be considered as a class or type of anything. NFT's, like paper, are media on which information is recorded. How one regulates a particular NFT is entirely dependent on what that NFT represents and the intent of an issuer in offering and selling it. If an NFT is not representing a traditional financial product, and is not issued in a capital raise, it should not be regulated under the '33 Act. The example of NBA Top Shots as NFTs offered by Dapper Labs is instructive. Whether implicitly or otherwise, sales communications encouraged an expectation that the NBA TopShot NFTs would go up in value. This is common with sports memorabilia and collectibles. The fact that the fiscal value of NBA TopShots was reliant on Dapper Labs is no different than the fact that my X-Men #1 comic book relies (somewhat) on Marvel comics to continue pumping out content. Dapper Labs was not selling NBA Top Shots in a capital raise transaction. The types of disclosures usually made for sales of securities would just not make any sense in that context. Special rules for consumer protection should be created, but not for the SEC to enforce.

6. How can the Commission establish a workable taxonomy while remaining merit- and technology-neutral?

Recognize that the form of media on which an asset is recorded is not relevant. If the tokens really were tokens (like poker chips), the same principals would apply. If everything were tokenized (which in this case really just means recorded on a distributed ledger), we would still have all of the instruments considered in the definition of "security" ~~in~~ under the '33 Act. Regulation of those items does not need to change just because they are tokenized. The deciding factor is that the currently required information for disclosure, including financial information~~,~~ can logically apply and provide investors with the information they need to make informed decisions.

Digital a~~A~~ssets that do not derive their value from profit~~s~~ and loss or balance sheet data of an entity may still be issued in a capital raise deserving of regulation under the '33 Act. Digital a~~A~~ssets issued in that context require appropriate disclosure. That disclosure will typically be driven by the token use case. Certainly for "utility" tokens that derive their value based on supply and demand, information about total and circulating supply, token utility demand statistics, project road~~-~~map, team, competitive landscape, and many other easily described and often quantifiable items would be appropriate to guide an investor to make a decision. It is w~~W~~orth noting that there are many reputable services that already collect this type of information and publish it. In other words, this type of disclosure is not that heavy of a lift.

Recognize that because tokens can have multiple use cases, disclosure might be appropriate for the same token in more than one value paradigm. For instance, many token projects would like to distribute revenue to holders of tokens that also derive value based on supply and demand. If an issuer designs a project in this way, then they should have to provide complete disclosure for both value propositions.

This framework does not require any merit based or technology based determinations (though a description of what technology a token relies on in performing its function will likely be a meaningful disclosure).