

MEMORANDUM

To: Crypto Task Force Meeting Log
From: Crypto Task Force Staff
Re: Meeting with Representatives of Cumberland DRW LLC

On March 31, 2025, Crypto Task Force Staff met with representatives from Cumberland DRW LLC.

The topic discussed was approaches to addressing issues related to regulation of crypto assets. Cumberland DRW LLC representatives provided the attached documents, which were discussed during the meeting.

SEC and Cumberland DRW – Proposed Meeting Agenda

Cumberland DRW attendees: Don Wilson, Graham Harper, Chelsea Pizzola

Agenda:

1. Cumberland DRW's initial comment letter on security status (attached)
2. Secondary-market trading
 - a. Impediments to over-the-counter principal trading in certain cryptoassets in a broker-dealer
 - b. Considerations for cryptoasset trading involving both securities and non-securities within a broker-dealer
3. Tokenization
 - a. Importance of tokenization for 24/7 collateral/margining to avoid unnecessary market disruptions
 - b. New tokenization initiatives
 - c. Support for a technology-neutral approach: tokenization should not affect an asset's regulatory status

March 16, 2025

Crypto Task Force
Securities and Exchange Commission
100 F St NE, Washington, DC 20549
crypto@sec.gov

Re: Crypto Task Force Input: Security Status and Safe Harbor from Registration

Dear Crypto Task Force members,

Cumberland DRW LLC and its affiliates (collectively, “Cumberland” or “we”) commend the Securities and Exchange Commission (“SEC” or “Commission”) for forming the Crypto Task Force to develop a comprehensive and clear regulatory framework for crypto assets. We also commend Commissioner Peirce for publishing for public input some of the questions the Task Force is considering. To expedite its feedback submissions and facilitate SEC staff review, Cumberland will comment separately on distinct topics on the list. The comments in this letter address the “Security Status” and “Safe Harbor from Registration” sections of the list. Cumberland will comment on the “Trading” section in the near future and intends to comment on other sections as soon as is practicable.

Cumberland agrees with the other market participants who have expressed concern that analyzing certain cryptoassets under *Howey*¹ is extremely difficult and prone to inconsistent application given the subjective and fact-intensive nature of the test. However, we accept that until Congress, the Supreme Court, or a federal appellate court determines otherwise, the *Howey* test for investment contract status is the test most generally applicable to determine “security” status for transactions in cryptoassets that are not simply tokenized representations of another type of security.

Given the difficulties in applying this test, we would strongly support a safe harbor such as provisionally named Rule 195. If the Commission does not adopt such a safe harbor or a material set of tokens remain outside the safe harbor, we would support an SEC rulemaking,² jointly or in close consultation with the CFTC, to address the complexities that make it difficult to apply the *Howey* test consistently in the context of digital assets. In particular, it would be very helpful for a rulemaking to clarify the specific matters outlined below.

A. *Howey* is a transaction-specific test.

Multiple courts have ruled that cryptoassets are not in and of themselves “investment contracts” and that the relevant inquiry is whether the facts and circumstances of a particular cryptoasset *transaction* satisfy the “investment contract” definition.³ Under the

¹ *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

² Cumberland DRW would alternatively support the issuance of joint guidance if the public is given an opportunity to comment before the guidance is finalized.

³ See, e.g., *SEC v. Binance*, 1:23-cv-01599, at *19-21 (June 28, 2024) (collecting cases); *Salameh v. Tarsadia Hotel, Corp.*, 726 F.3d 1124, 1131–32 (9th Cir. 2013) (requiring an investment contract’s elements be satisfied at the time of the particular transaction); *Goodman v. Epstein*, 582 F.2d 388, 406 (7th Cir. 1978) (explaining that

previous Chair, the SEC seemingly resisted this interpretation in crypto-related litigations for some time, classifying certain cryptoassets as inherently “cryptoasset securities,” but appeared to concede the point in oral arguments and court filings in late 2024.⁴ However, on the same day that the SEC made one of these concessions, it published a consent order again referring to certain cryptoassets as “cryptoasset securities,” engendering widespread confusion as to the SEC’s true position on this issue.⁵ Any joint rulemaking or guidance should make clear that the SEC—like every federal court to consider the issue—will apply the *Howey* test on a transaction-by-transaction basis, rather than viewing all cryptoassets as intrinsically securities or non-securities.

B. Secondary-market cryptoasset transactions generally do not involve investment contracts.

Under this transaction-by-transaction approach, a sale of cryptoassets in the secondary market is not inherently a security transaction solely because the initial offering of the security met the “investment contract” definition.⁶ Rather, the specific facts and circumstances of that secondary-market transaction must be considered. For the reasons set forth below, among others, Cumberland DRW believes that the typical circumstances of a secondary-market cryptoasset transaction do *not* meet the *Howey* test. To facilitate regulatory certainty and uniformity of application, we would ask the SEC to confirm that it likewise views such circumstances as defeating a finding of an investment contract, absent exceptional situations or fraud or evasion.

i. Secondary-market transactions do not result in pooling of funds in a common enterprise.

Courts have held that a finding of “horizontal commonality” satisfying the “common enterprise” prong of *Howey* requires pooling of investor funds “not only between the developer or promoter and each individual investor but also among the investors.”⁷ There must be a combination of multiple investors’ funds to finance the profitmaking enterprise in

Howey requires consideration of the “actual facts and circumstances of the particular investment arrangement”).

⁴ See *SEC v. Coinbase*, 726 F. Supp. 3d 260, 280 (S.D.N.Y. 2024) (“[T]he SEC does not appear to contest that tokens, in and of themselves, are not securities.”); Tr. of Jan. 17, 2024 Oral Arg. at 21:11, *SEC v. Coinbase*, No. 23-cv-04738, ECF No. 101 (SEC Staff admitting the “token itself is not the security”); see also SEC’s Mem. of Law ISO Mot. for Leave to Am. Compl. at n.6, *Binance*, 1:23-cv-01599, ECF No. 273-1 (Sept. 12, 2024) (acknowledging that crypto assets are not inherently securities and stating that “the SEC regrets any confusion it may have invited” by using terms that indicated otherwise).

⁵ See *In re eToro USA LLC*, SEC Admin. Proc. File No. 3-22106 (Sept. 12, 2024).

⁶ See, e.g., *Binance*, 1:23-cv-01599, at *42-43 (“Insisting that an asset that was the subject of an alleged investment contract is itself a ‘security’ as it moves forward in commerce and is bought and sold by private individuals on any number of exchanges, and is used in any number of ways over an indefinite period of time, marks a departure from the *Howey* framework that leaves the Court, the industry, and future buyers and sellers with no clear differentiating principle between tokens in the marketplace that are securities and tokens that aren’t.”).

⁷ *Wals v. Fox Hills*, 24 F.3d 1016, 1018 (7th Cir. 1994) (internal quotation marks and citation omitted); see also, e.g., *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994); *Binance*, 1:23-cv-01599, at *21-24 (noting that under D.C. Circuit precedent, “a common enterprise is ordinarily met with a showing of horizontal commonality, which ‘requires that there be a pooling of investment funds, shared profits and shared losses’”) (citations omitted).

question—“in short, a wheel and not just a hub and a spoke.”⁸ This criterion of pooling of investor funds as capital funding a developer’s profitmaking efforts is critical because it is necessary to establish a “contract, transaction, or scheme” seeking “*the use of the money of others on the promise of profits,*” as *Howey* demands.⁹

While certain federal appellate circuits accept variants of “vertical commonality”¹⁰ in lieu of horizontal commonality, others have refused to do so. The U.S. Courts of Appeal for the Sixth and Seventh Circuits in particular firmly require horizontal commonality, including the pooling elements discussed above.¹¹

We would urge the SEC to require horizontal commonality, as defined above, to establish the “common enterprise” prong of *Howey*, in the context of cryptoassets if not in other investment contract analyses. In addition to the foregoing rationales espoused by courts in other cases, requiring horizontal commonality is particularly appropriate in the context of cryptoassets because it is an objective, predictable test: in a given transaction, a purchaser’s funds either are pooled with the developer to fund its profitmaking enterprise or they are not. This set of uniformly applicable criteria contrasts sharply with the SEC’s efforts under its prior Chair to contort itself into a showing of vertical commonality through inherently subjective speculation about the expected “fortunes” of the investors and promoter. How large a share of token supply must an issuer or promoter retain before its fortunes are “tied” to those of token holders? Does the answer change depending on the size of that share relative to the issuer or promoter’s overall balance sheet or its other business activities? Given the myriad other difficulties in applying *Howey* to cryptoassets, the objective criteria of the horizontal commonality approach would provide welcome simplification and objectivity.

Applying this framework, we believe that a common enterprise is not present unless a cryptoasset issuer, developer, or promoter receives funds from the relevant cryptoasset purchaser and combines those funds for use in developing the network or use cases for it, or for a similar profitmaking endeavor related to the cryptoasset. Generally, in a secondary-market transaction, the issuer / promoter does not receive the purchaser’s funds; the *seller*

⁸ *Id.*

⁹ *Howey*, 328 U.S. at 299 (emphasis added); see also *Binance*, 1:23-cv-01599, at *16 (“The case law points to whether the proceeds of the offering were ‘pooled’ as a critical aspect of analysis.”).

¹⁰ The “strict” theory of vertical commonality requires that the fortunes of investors be tied to those of the promoter. Under the “broad” theory of vertical commonality, the fortunes of investors need only be tied to the *efforts* (as opposed to the fortunes) of the promoter. The Second Circuit has held that broad vertical commonality impermissibly collapses the “common enterprise” prong of *Howey* into the “expectation of profits from the efforts of others” prong. *Revak*, 18 F.3d at 88. If the SEC continues to rely on vertical commonality in crypto-related *Howey* analyses, it should at least reject “broad” vertical commonality and accept only the “strict” variant.

¹¹ See, e.g., *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 100 (7th Cir. 1977) (declining to adopt the Fifth and Ninth Circuits’ standard of vertical commonality) (citation omitted); *Hart v. Pulte Homes of Mich. Corp.*, 735 F.2d 1001, 1004 (6th Cir. 1984) (explaining that the Sixth Circuit “has interpreted the *Howey* test as requiring a showing of horizontal commonality” and finding no investment contract because “[n]othing in the complaint intimates a pooling of risks and investments among these purchasers”); *Wals*, 24 F.3d at 1018 (“Our circuit’s position comports better, we believe, with the purpose of the 1933 Act than that of the circuits which dispense with the requirement of establishing horizontal commonality.”). *Binance*, 1:23-cv-01599, at *21-24, noted that though there is a “dearth” of circuit case law on vertical commonality, the U.S. District Court for the Southern District of New York has applied both the horizontal and “strict” vertical commonality tests. See *SEC v. Telegram Group Inc.*, 448 F. Supp. 3d 352, 369–70 (S.D.N.Y. 2020).

in the transaction does. There is no reason to suppose that the seller will pass along the buyer’s funds to the issuer / promoter, for pooling and deployment in a profitmaking endeavor or otherwise.¹² We would ask the SEC to confirm that it agrees with this view that secondary-market transactions where such pooling and deployment are absent do not involve investment contracts.

ii. *Objective commentary on secondary-market trends does not create a reasonable expectation of profits.*

As the Commission knows, market participants often comment publicly and privately on market trends and expectations. Such commentary is ubiquitous in markets for many non-security commodities, such as oil, natural gas, foreign exchange, metals, and “softs” (e.g., cocoa, coffee, etc.). However, following the ruling on a motion to dismiss in *SEC v. Kraken*,¹³ the SEC seemed to take the litigation position that even objective statements of past or expected cryptoasset price activity or market trends *by a secondary-market participant or platform*—not the issuer / promoter—create an expectation of profits in a cryptoasset purchaser.¹⁴ The SEC appeared to take this view even where such statements only “at times, imply that [an asset’s] value[] could increase.”¹⁵ Under this theory, a secondary-market commentator ostensibly could not even report that a token’s price has risen by a certain amount without fearing triggering the final prong of *Howey*, even if the commentator also reports on token price *decreases*.¹⁶

This theory has no limiting principle, creates serious First Amendment concerns, and threatens market integrity by chilling ordinary discussions of “market color” that are important to the price discovery process. We urge the Commission to disavow this position.

C. Transactions in the native token of a decentralized network should not be viewed as securities transactions.

In cases where the above secondary-market considerations may not apply, Cumberland supports a theory of the effect of decentralization on a *Howey* analysis similar to that espoused by former SEC Division of Corporation Finance Director Bill Hinman.¹⁷ In our view, in cases where many unaffiliated individuals or entities are independently engaged in developing a native token’s underlying network or use cases for the network, with none able unilaterally to implement or reject any material change in the network’s functionality, it cannot be said that any gain in the value of the underlying token is a result of the entrepreneurial and managerial efforts of the issuer or an identifiable central promoter, as

¹² See, e.g., *SEC v. Ripple Labs*, 682 F. Supp. 3d 308, 328 (S.D.N.Y. 2023). While *SEC v. Terraform Labs* declined to distinguish primary from secondary markets and found that the SEC had plausibly alleged horizontal commonality, there the court was required to credit the SEC’s allegations that the defendant, who was the issuer of the token, pooled the proceeds from the sale of its crypto assets and represented that proceeds would be used to benefit all purchasers. See 684 F. Supp. 3d 170, 195–96 (S.D.N.Y. 2023).

¹³ *SEC v. Payward, Inc.* [d/b/a Kraken], Case 3:23-cv-06003 (Aug. 23, 2024).

¹⁴ SEC Mem. of Law ISO Mot. for Leave to Am. Compl., *Binance*, 1:23-cv-01599, ECF No. 273-1, *passim* (Sept. 12, 2024); *SEC v. Cumberland DRW LLC*, Case: 1:24-cv-09842, *passim* (Oct. 10, 2024) (Compl.).

¹⁵ See *Cumberland DRW*, Case: 1:24-cv-09842, ¶ 62 (Oct. 10, 2024) (Compl.).

¹⁶ See, e.g., *Cumberland DRW*, Case: 1:24-cv-09842, ¶ 193(d) (Oct. 10, 2024) (Compl.).

¹⁷ William Hinman, Director, Division of Corporation Finance, SEC, “Digital Asset Transactions: When *Howey* Met Gary (Plastic)” (June 14, 2018).

Howey requires. Thus, the native token of a network that has reached such a state of decentralization generally should not be viewed as the basis for an investment contract.

This view applies the central logic of *Howey* but also makes good sense from a practical and a policy perspective: if a network and its use cases are developed by a centralized organization, then, assuming the other prongs of *Howey* are met, that organization can and should be made to disclose to token purchasers the material facts about its actions and plans with respect to the network. By contrast, in a truly decentralized system, there is no identifiable individual or entity that can confidently and accurately disclose all material aspects of current and planned network development efforts.¹⁸ Provisionally named Rule 195 and the Financial Innovation and Technology for the 21st Century Act (FIT21), H.R. 4763, each appear to be grounded in the above logic. It would be helpful for the Commission to recognize criteria for network decentralization that are clear and uniformly applicable but are not overly prescriptive, such as whether a broad group of unaffiliated persons is engaged in meaningful network development efforts, or whether the consensus of such a broad group is required for a material change in the network's functionality.

Thank you very much for your consideration of the above comments.

Best regards,

DocuSigned by:

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Chelsea Pizzola
Associate General Counsel
Cumberland

¹⁸ *Id.* (“If the network on which the token or coin is to function is sufficiently decentralized – where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts – the assets may not represent an investment contract. Moreover, when the efforts of the third party are no longer a key factor for determining the enterprise’s success, material information asymmetries recede. As a network becomes truly decentralized, the ability to identify an issuer or promoter to make the requisite disclosures becomes difficult, and less meaningful.”).