

INJECTIVE LABS.

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BY ELECTRONIC SUBMISSION (<https://www.sec.gov/about/crypto-task-force/submit-written-input>)

Commissioner Hester M. Peirce
Crypto Task Force
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-0213

Dear Commissioner Peirce and Members of the SEC’s Crypto Task Force:

Injective Labs Inc. (“Injective Labs”) again appreciates the opportunity to contribute its perspective to the SEC’s ongoing dialogue on digital asset regulation and respectfully submits this second comment in response to Commissioner Hester Peirce’s February 21, 2025 statement, *“There Must Be Some Way Out of Here,”* and the related inquiries posed by the SEC’s Crypto Task Force.

On July 9, 2025 Injective Labs submitted a comment to the Commission regarding the appropriate treatment of decentralized finance protocols under the Exchange Act, the benefits of a safe harbor modeled on Commissioner Peirce’s proposed Rule 195, and the importance of providing a clear exemption from broker-dealer rules for qualifying front-end interfaces that facilitate access to DeFi protocols. That comment provided background on Injective Labs and the Injective blockchain ecosystem, which in the interest of brevity, we will not repeat in this submission but respectfully encourage the Commission to consider, given that Injective Labs is a U.S. company, headquartered in New York City.

Summary of Recommendations

Issue principles-based interpretive guidance clarifying that DeFi credit protocols that are (i) non-custodial, (ii) over-collateralized with transparent, automated liquidation parameters, (iii) governed by open-source code with no ongoing centralized-actor discretion material to user returns, and (iv) not used to raise capital for an issuer or enterprise, do not involve investment contracts under *Howey* or notes under *Reves*.

COMMENTS AND ANALYSIS

A. DeFi borrowing and lending, generally, does not constitute transactions in investment contracts under Howey, or notes under Reves.

Applying the securities laws designed in the 1930s and 1940s for centralized enterprises to novel decentralized software protocols would be a category error with profound negative consequences for American innovation. DeFi lending transactions bear none of the essential hallmarks of a security as

defined by the Supreme Court in *SEC v. W.J. Howey Co.*¹ and its progeny. It is a loan, not an investment contract, and it falls outside the jurisdictional scope of the federal securities laws.

1. Alignment with the Commission's Mission to Foster Innovation

The current tone and policy direction, articulated by Chairman Atkins and Commissioners Uyeda and Peirce, signals a welcome focus on the SEC's historical tripartite mission: protecting investors, maintaining fair and orderly markets, and facilitating capital formation. A collaborative, principles-based approach is essential to achieving this mandate in the digital age.

Chairman Atkins' recent remarks at the "DeFi and the American Spirit" roundtable powerfully frame the issue. He correctly identified DeFi's alignment with "foundational American values—economic liberty, private property rights, and innovation," and cautioned that we should not "allow century-old regulatory frameworks to stifle innovation with technologies that could... improve and advance our current, traditional intermediated model."² This perspective is not a call to abandon oversight, but an invitation to apply it judiciously.

Similarly, Commissioner Uyeda's analogy of the Commission navigating a "regulatory wilderness" underscores the need to think beyond existing frameworks. He rightly asked, "In what situations should DeFi systems be deemed to fall outside the scope of the securities laws?"³ We seek to answer that question directly with respect to DeFi lending, arguing that its structure and function place it squarely outside the scope of existing securities laws. This analysis is consistent with the Commission's Staff Statement on Protocol Staking Activities, which thoughtfully distinguished between ministerial protocol functions and the kind of managerial efforts that implicate securities laws.⁴ Applying this same analytical rigor to DeFi lending will provide much-needed clarity and ensure that financial innovation can thrive in the United States.⁵

2. The Technical Reality of DeFi Lending Protocols

To properly apply the law, one must first understand the facts. DeFi lending protocols are not companies or traditional financial intermediaries; they are autonomous software systems comprised of open-source smart contracts deployed on a public blockchain. These protocols facilitate lending and borrowing through a series of automated, non-custodial functions.

Consider two of the most prominent lending protocols, Aave and Compound. While their specific features differ, their core mechanics illustrate the fundamental nature of DeFi lending:

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

² Remarks of Chairman Paul Atkins, SEC Roundtable, "DeFi and the American Spirit" (June 9, 2025).

³ Remarks of Commissioner Mark T. Uyeda, SEC Roundtable, "DeFi and the American Spirit" (June 9, 2025).

⁴ SEC Division of Corporation Finance, Statement on Protocol Staking Activities (May 29, 2025).

⁵ *See, e.g.*, Statement of Kristin Smith, CEO, Blockchain Association, Applauding Passage and Signing of Measure to Roll Back DeFi-Killing Broker Rule (Apr. 10, 2025).

- *Liquidity Pools*: Rather than matching individual lenders and borrowers directly, these protocols utilize liquidity pools. Lenders, or "liquidity providers, deposit their digital assets into a smart contract designated for a specific asset, such as ETH or the USDC stablecoin. These assets form a pool of liquidity from which borrowers can draw.
- *Algorithmic Interest Rates*: The interest rate for both lenders and borrowers is not set by a centralized or controlling board or committee. It is determined algorithmically by the protocol's code, based on the supply and demand within that specific asset's liquidity pool. This is often expressed as a "utilization rate" - as the percentage of assets being borrowed from a pool increases, the interest rate for both borrowers and lenders automatically rises to incentivize new deposits and discourage further borrowing.
- *Overcollateralization and Automated Liquidation*: To mitigate credit risk in a system without identity-based underwriting, borrowers supply collateral in an amount that exceeds the value of their loan. If the value of the borrower's collateral falls below a predetermined liquidation threshold, the protocol's smart contracts automatically permit a third-party liquidator to repay a portion of the debt and claim a corresponding portion of the collateral at a discount. This automated process protects the principal of the lenders in the pool.
- *Non-Custodial and Permissionless*: At all times, users retain control of their assets. They interact directly with the publicly-auditable smart contracts. As Rebecca Rettig, a leading legal expert in the space, testified before Congress, a key hallmark of DeFi is that "there is no identifiable entity or person who holds or otherwise can control cryptoassets on behalf of others."⁶ There are no centralized gatekeepers; access is open and permissionless.

Crucially, the developers who initially wrote the code for protocols like Aave, Compound, Maple and others are not parties to these transactions. Once the smart contracts are deployed on the blockchain, they operate autonomously. As Chairman Atkins noted, citing relevant case law, it would be "irrational to hold the developer of a self-driving car liable...for a third-party's use of the car to commit a traffic violation."⁷ The same logic applies here; developers who publish code are not managing a securities enterprise just because lending is taking place.

3. DeFi Lending Fails the *Howey* Test for an Investment Contract

The *Howey* test provides a four-part framework to identify an "investment contract": (1) an investment of money, (2) in a common enterprise, (3) with a reasonable expectation of profits, (4) to be derived from the entrepreneurial or managerial efforts of others. A failure to satisfy any single prong is dispositive. DeFi lending transactions fail to meet at least three, and arguably all four, prongs of this test.

⁶ Written Testimony of Rebecca Rettig, Chief Legal Officer, Polygon Labs, before the House Financial Services Committee, Subcommittee on Digital Assets, Financial Technology and Inclusion (Sept. 10, 2024).

⁷ *Supra*, n. 2.

a. There Is No "Common Enterprise."

The "common enterprise" prong requires a showing that the investors' fortunes are linked. Courts primarily recognize two types of commonality: horizontal and vertical. DeFi lending satisfies neither. Horizontal commonality, the most rigorous standard, requires the "pooling" of investor funds and the distribution of profits on a pro-rata basis, tying the fortunes of the investors to one another. *See, e.g., Revak v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994). While assets are "pooled" in a technical sense within a liquidity pool, this does not create the horizontal commonality contemplated by securities law. The return for a lender in the USDC pool on Aave is a function of the utilization rate of that specific pool. It is entirely unaffected by the performance of the ETH pool or any other. A catastrophic loss in one pool would not, by itself, impact the returns of lenders in other, separate pools. The fortunes of the lenders are not interwoven in a shared enterprise.

Nor is there "broad vertical commonality," which would tie the lender's fortune to the efforts of a promoter. A lender's return is determined by the autonomous code of the protocol, not the ongoing efforts of the developers who wrote it. The lender's fortune is tied to the algorithmic interest rate and the borrower's creditworthiness, not to the "success" or "failure" of the development team.

b. Any Return Is Not Derived From the "Managerial Efforts of Others."

This is the most dispositive failure of DeFi lending under the *Howey* test. The SEC's own framework states that the "efforts of others" must be "the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."⁸ Writing and publishing software code is not the same as performing ongoing, essential managerial efforts.

A distinction should be drawn between the technology and the typical business of financial institutions. The developers of DeFi protocols are software engineers, not asset managers. Their work precedes the lending transaction. The lender does not rely on them to generate a return; the lender relies on the autonomous execution of the smart contract code, which operates independently of any developer. The argument that Decentralized Autonomous Organizations (DAOs) constitute "managerial efforts" is misplaced. Lending and governance are distinct activities. A user can lend assets and earn interest without ever owning a governance token. Their return is generated by the loan, not by the governance process, which focuses on high-level parameter changes, not the day-to-day operations that generate yield.

c. The Transaction is a Loan, with an Expectation of Interest, Not "Profits."

While the *Howey* analysis often focuses on the other prongs, it is crucial to recognize that the fundamental nature of the transaction is a loan regardless of all the novelty of DeFi and digital assets. The user deposits an asset with the expectation of receiving that same asset back, plus interest. This is the classic economic reality of a debt instrument, not an equity investment. The return is not a dividend or a share in the protocol's revenue; it is interest, paid by the borrower. Case law analyzing loan participation has long distinguished between a fixed rate of return in the form of interest and the expectation of "profits" from a

⁸ SEC, Framework for "Investment Contract" Analysis of Digital Assets (Apr. 3, 2019), quoting *SEC v. Glenn W. Turner Enters., Inc.*, 474 F.2d 476, 482 (9th Cir. 1973).

capital investment.⁹ The potential for the underlying lent asset to appreciate in value is entirely external to the lending transaction itself, just as a loan of a barrel of oil does not become a security simply because the price of oil may go up.

d. The Economic Reality of DeFi Credit Protocols

*United Housing Foundation, Inc. v. Forman*¹⁰ instructs that, in considering whether a transaction involves securities, economic realities control over labels. DeFi lending is secured credit intermediation, not capital formation: the lender expects return of the same asset plus interest; the borrower seeks temporary liquidity against over-collateralized assets; no issuer is raising enterprise capital. Treating such code-mediated, collateralized loans as equity-like investment contracts would extend *Howey* far beyond its purpose.

4. DeFi Lending Fails the *Reves* Test for a Note

Whether an offer or sale constitutes a transaction in a security under *Reves*¹¹ requires a two-step process: (a) does the offering involve the “issuance” of a note or debt obligations that “does not bear a strong family resemblance to an item on the judicially crafted list of exceptions?”¹² If the answer is no, the offer or sale does not involve a security. If the answer is yes, then: (b) the analysis turns to the following four-factor test: (i) the motivation of the parties; (ii) the plan of distribution; (iii) the reasonable expectation of the public; and (iv) the presence or absence of risk-reducing factor that would make the application of the Securities Acts unnecessary.

a. There is no issuance of a note or debt obligation in DeFi lending.

With respect to transactions on each side of the lending pool/smart contract (lender and borrower):

- Transactions involve no promissory notes (or formal obligations of any kind);
- There is no “issuer” soliciting funds for capital raising purposes (as is typical in debt issuances).
- There are no identifiable obligors;
- Humans only interact with autonomous smart contracts, not human counterparties;

*b. All four *Reves* factors militate in favor of DeFi lending constituting commercial, rather than investment, activity.*

With respect to the motivations of the parties, while lenders are motivated by profit, borrowers are not seeking to raise capital in a traditional sense, but instead they collateralize their own assets to obtain temporary liquidity. The protocol itself operates pursuant to preprogrammed instructions without human

⁹ See, e.g., *Union Planters Nat'l Bank v. Commercial Credit Bus. Loans, Inc.*, 651 F.2d 1174, 1184-85 (6th Cir. 1981) (holding that a fixed rate of return in the form of interest does not satisfy the "reasonable expectation of profits" prong of the *Howey* test).

¹⁰ 421 U.S. 837 (1975)

¹¹ *Reves v. Ernst & Young*, 494 U.S. 56 (1990)

¹² *Id.* citing *Exchange Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126, 1137 (CA2 1976)

intervention and has no investment stake in the transaction. The parties' motivations are functionally those of a secured financing, not a capital investment.

With respect to the plan of distribution factor, there is no distribution. Specifically, there is no issuer, no underwriter, no promotion. Rather, transactions are always user-initiated and are limited to peer-to-pool or peer-to-smart contracts.

With respect to the reasonable expectations of the public, lender-users generally treat DeFi lending as collateralized lending, not investment. There are no promises of profit from an identifiable promoter. Reasonable users understand they are using autonomous code, not relying on managerial efforts. On the borrower side, there is no expectation of profit and no capital raise in connection with the transaction. With respect to alternative regulatory regimes/protections, loan transactions are over-collateralized with automated collateral liquidation mechanics such that funds deposited by lenders are adequately collateralized. In light of the foregoing, neither lender deposits nor borrower withdrawals, in connection with DeFi lending, are transactions in notes per *Reves*.

DeFi lending protocols represent a technological paradigm shift. They are automated, non-custodial systems that facilitate borrowing and lending through transparent, autonomous, open-source code. *The core economic function of DeFi lending is credit intermediation, not capital formation.* These protocols are far more akin to permissionless financial utilities than investment schemes. Forcing these software protocols into a regulatory framework designed for centralized entities would stifle a major field of American innovation without providing commensurate investor protection benefits. Participation in DeFi lending protocols, as described herein, does not constitute a securities transaction.

We appreciate the Crypto Task Force's effort to engage constructively and transparently on the complex legal questions surrounding decentralized finance. The issues outlined above, particularly the need for tailored guidance and frameworks that reflect the realities of decentralized protocols, are critical to fostering responsible innovation in the United States. We welcome the opportunity to serve as a resource to the Staff and look forward to continued dialogue in support of a regulatory approach that is clear, workable, and grounded in how these technologies operate in practice. With this in mind, Injective Labs will request a meeting with the Crypto Task Force, via the designated form on the Commission's site. We look forward to discussing with the Staff the topics covered in this comment, as well as those we addressed in our July 9, 2025 comment.

Respectfully,



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