

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 93551 / November 10, 2021

ADMINISTRATIVE PROCEEDING
File No. 3-20650

In the Matter of

American CryptoFed DAO LLC,

Respondent.

RESPONDENT’S REPLY TO DIVISION OF ENFORCEMENT’S
OPPOSITION TO RESPONDENT’S MOTION FOR EXEMPTION
FROM SECTION 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934

American CryptoFed DAO LLC (“American CryptoFed” or “Respondent”), respectfully submits this reply to the Division of Enforcement (“Division”)’s Opposition (“Opposition”) to Respondent’s Motion for Exemption (“Motion for Exemption”) from Section 12(g) of the Securities Exchange Act of 1934 (“Exchange Act”).

1. American CryptoFed Is Entitled to Issue Tokens First and
File Form 10 After the Fact

Division’s Opposition states at p.8 the following:

The closest the Motion comes to providing a basis for an exemption is the statement: “Given that the Commission’s OIP, if confirmed by the Commission’s ruling, disables Respondent’s capacity to file the Form 10, the OIP will actually serve as evidence exempting Respondent from the mandatory obligation to file Form 10 pursuant to Section 12(g) of Exchange Act.” Motion at 3. **This argument—that an issuer whose registration statement has been denied by the Commission is exempted from the applicable provisions of the**

federal securities laws by virtue of that denial—is self-evidently fallacious and merits no further discussion. (Emphasis added).

However, the Division’s Opposition contradicts the operation of statute Section 12(g) of the Exchange Act, the plain text of which allows American CryptoFed to issue tokens first and file Form 10 after the fact:

(g)(1) Every issuer which is engaged in interstate commerce, or in a business affecting interstate commerce, or whose securities are traded by use of the mails or any means or instrumentality of interstate commerce shall—

(A) **within 120 days after the last day of its first fiscal year** ended on which the issuer has total assets exceeding \$10,000,000 and a class of equity security (other than an exempted security) held of record by either—

(i) 2,000 persons, or

(ii) 500 persons who are not accredited investors (as such term is defined by the Commission), and... (15 U.S. Code § 781) (Emphasis added).

If this Motion for Exemption is denied, in theory, after Respondent has more than 500 persons of token holders, just a few months after the Commission’s ruling confirms the OIP, “**within 120 days after the last day of its first fiscal year**”, Respondent will be required by the statute to file an identical or similar Form 10 again, although it has already been denied.

2. The violation of Section 5 of the Securities Act Is Impossible.

Division’s Opposition at p.8 states the following:

Finally, the Motion appears to suggest that American CryptoFed, Marian Orr, Scott Moeller, and/or Xiaomeng Zhou intend to willfully violate Section 5 of the Securities Act by asserting that “Respondent has the rights [sic] to issue restricted, untradeable, and non-transferable tokens to more than 500 persons” as long as Respondent subsequently files a Form 10.

The Division’s statement is false. The relevant text of Section 5 of Exchange Act reads as follows (emphasis added):

15 U.S. Code § 77e - Prohibitions relating to interstate commerce and the mails (a)**Sale or delivery after sale of unregistered securities**

Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

- (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or
- (2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the **purpose of sale or for delivery after sale.**

**2.1. The violation of Section 5 of the Securities Act Is Impossible,
Because There Is No Token Sale before the Securities and Exchange Commission
("Commission" or "SEC") Declares Respondent's Form S-1 Effective.**

In its Omnibus Memorandum in Opposition to Respondent's Motions for a More Definite Statement ("Omnibus Memorandum"), the Division makes the time span of all of its allegations clear, as follows (p.10-11):

2) Response to Motion #2: the Allegations of the OIP Relate
to American CryptoFed As It Presently Exists.

... American CryptoFed admits it is not presently decentralized, stating that (1) "CryptoFed will be decentralized to the extent that a CEO is no longer needed within three years," and (2) MShift's powers and rights over CryptoFed "will completely and irreversibly become delegated" only after CryptoFed's S-1 registration statement is declared effective. These are admissions that American CryptoFed is not presently operating as a decentralized autonomous organization.

Given that "the Allegations of the OIP Relate to American CryptoFed As It Presently Exists" before "CryptoFed's S-1 registration statement is declared effective", Respondent can confirm that all tokens will be distributed, *free of charge*, and there is absolutely no sale of any tokens whatsoever for the time period, before "CryptoFed's S-1 registration statement is declared effective". Also, all Locke tokens will be restricted through a proprietary wallet. No Locke tokens will be allowed to be traded in a secondary market. All detailed descriptions can be found in the Form 10 filing attached as Exhibit A to the Answer, Preamble, p.5-6, Section 2.4.1.2, p. 22, Section 2.4.1.1.6, p. 22, and Section 6, p. 32; American CryptoFed DAO's Constitution attached as Exhibit 1 to the Form 10 or Exhibit B to the Answer, Section 14.6, p. 12-13, Section 15.1, p.

13; and Ducat Economic Zone attached as Exhibit 2 to the Form 10 or Exhibit L to the Answer, Section 6).

2.2. The violation of Section 5 of the Securities Act Is Impossible, Because the Division Never Proves that Respondent's Tokens Are Securities, and Because American CryptoFed, Locke Token and Ducat Token Do Not Meet the Definition of "Investment Contract" in SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

Respondent filed Form 10 to register two tokens designed to operate in tandem issued under the names Locke and Ducat, while clearly stating in the registration statement that the two tokens are not securities:

CryptoFed is registering Locke and Ducat tokens with the SEC as utility tokens, not as securities, for the purpose of disclosure. Form 10 allows CryptoFed to voluntarily become a reporting company for ongoing disclosure purposes and becomes effective sixty (60) days after the initial filing date regardless of whether there are outstanding SEC comments. **Filing Form 10 does not mean CryptoFed concedes that Locke and Ducat tokens are securities.** Section 2.9 of Item 1: Business entitled "2.9. Locke and Ducat as Utility Tokens" explains why the Locke and Ducat tokens are utility tokens, not securities. (Emphasis added, Exhibit A to the Answer to OIP, p.5).

The reason that Respondent was forced to file the Form 10 was due to the Commission's inclusive definition of securities as expressed by the Commission's Chairman Gary Gensler in his Remarks Before the Aspen Security Forum, on August 3, 2021, and published on the SEC website, attached as Exhibit 1. Chairman Gensler stated the following:

We already live in an age of digital public monies — the dollar, euro, sterling, yen, yuan. If that wasn't obvious before the pandemic, it has become eminently clear over the last year that we increasingly transact online.

Such public fiat monies fulfill the three functions of money: a store of value, unit of account, and medium of exchange.

No single crypto asset, though, broadly fulfills all the functions of money. (Emphasis added, p.2).

The implication drawn from Chairman Gensler's perspective, is that all crypto assets can be classified as securities, not as money (currency). Under Chairman Gensler's leadership, it is highly possible that American CryptoFed would be prosecuted by the Commission if Respondent

did not file a registration statement with the Commission, giving the Commission actual notice of the American CryptoFed's monetary system, and the Locke and Ducat tokens. In its October 12, 2021 rebuttal reply to the October 8, 2021 letter of Division of Finance's staff (Exhibit G to the Answer to OIP, p.3), Respondent cited Chairman Gensler's quote above, sent to all Commissioners and emphasized:

If Ms. Purnell was guided by Chairman Gensler's statement "No single crypto asset, though, broadly fulfills all the functions of money", we understand why she would have concluded that our Form 10 and Form S-1 filing has "deficiencies".

However, if Ms. Purnell compares our Form 10 and Form S-1 filing to the "digital public monies — the dollar, euro, sterling, yen, yuan" Chairman Gensler listed above, the "deficiencies" she referred to, would disappear immediately. This is because the "deficiencies" she referred to were the lack of attributes inherent to securities. These are attributes that the two tokens (Locke and Ducat) of a decentralized blockchain-based CryptoFed monetary system will never have.

The Supreme Court provides the criteria below to determine whether a transaction qualifies as an "investment contract," and therefore would be considered a security and thus subject to disclosure and registration requirements under the Securities Act of 1933 and the Securities Exchange Act of 1934:

This definition was uniformly applied by state courts to a variety of situations where individuals were led to **invest money in a common enterprise** with the expectation that they would earn a profit solely through the efforts of the promoter or of some one other than themselves. *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) at 298. (Emphasis added)

A. No money is invested in American CryptoFed.

American CryptoFed discloses and explains in Section 2.5 of the Form 10 filing (Exhibit A to the Answer to OIP, p.23 – 24 shown below), why American CryptoFed will not receive money by investment, because all funds will be preserved for the purpose of refunding or redemption. No money belongs and goes to American CryptoFed:

2.5.1. Locke Token Proceeds in USD-Pegged Stablecoins

CryptoFed grants a percentage of Locke tokens, free of charge, to individuals or entities. For price discovery purposes, CryptoFed may conduct refundable Locke token auctions, but all the proceeds from those auctions must be preserved and used for refunding. After the refund

right of purchasers expire, the corresponding funds must be used to buy back Locke tokens on compliant exchanges, which is another method of refunding the proceeds back to the Locke token holders. **As a result, CryptoFed cannot book any funds gained from Locke auctions as revenue.**

2.5.2. Ducat Token Proceeds in USD-Pegged Stablecoins

CryptoFed sells Ducat to individuals or entities, but the proceeds must be preserved for redemption purposes. Ducat purchasers use Ducat to buy goods and services at merchants who in turn will convert the Ducat back to USD on compliant exchanges for redemption. In addition, CryptoFed pays Ducat tokens, free of charge, to individuals or entities as rewards, interest, and compensation. For each Ducat sold, CryptoFed will provide 10 % – 20% additional Ducat as rewards, interest, and compensation. CryptoFed must buy back Ducat tokens on compliant exchanges to maintain the Target Equilibrium Exchange Rate between Ducat and USD. CryptoFed uses Locke tokens to conduct the Ducat buyback via open market operations. In order to enable Locke to buy back Ducat on an ongoing basis, the USD proceeds from the Ducat sales must be used to constantly buy back Locke on compliant exchanges. **As a result, CryptoFed cannot book any funds gained from Ducat sales as revenue.** Below is the redemption flow.
 Purchaser => Ducat => Merchant => Ducat => Exchange => USD => Merchant
 CryptoFed => USD-pegged stablecoin proceeds => Locke buyback => Ducat buyback

The Section 15.4 and 15.5 of the American CryptoFed DAO Constitution shown below also clearly defines that all proceeds from Locke token auctions and Ducat token sales must be preserved for the purposes of refunding or redemption. (Exhibit B to the Answer to OIP, p.13-14).

15.4 For price discovery purposes, CryptoFed may conduct refundable auctions from time to time via compliant crypto exchanges. Proceeds from these token sales must be used for refunding purposes and must be reserved in order to allow purchasers to request full refunds at the original purchase prices via smart contracts. Purchaser refund rights expire if: a) Locke's price surpasses 5 times the original purchase price, or b) the original Locke tokens are sold, or c) 3 years passes from the original date of purchase, whichever comes first. After refund rights expire, the corresponding proceeds will be transferred to CryptoFed's USD-pegged stablecoin reserve for Locke buyback.

15.5 All proceeds either from Locke auctions after refund rights have expired or from Ducat sales, will be held in CryptoFed's USD-pegged stablecoin reserves for Locke buyback. No proceeds can be used for other purposes. Locke token buyback is not only an alternative method to refund Locke token holders for their token purchases, but also an effective tool for Ducat redemption. Ducat holders buy goods and services at merchants which in turn will convert the Ducat back to USD on compliant exchanges. CryptoFed must buy back those Ducat tokens on compliant exchanges to maintain the Target Equilibrium Exchange Rate between Ducat and USD. CryptoFed uses Locke tokens to conduct the Ducat buyback via open market operations. In order to enable Locke to buy back Ducat on an ongoing basis, the USD proceeds from the Ducat

sales must be used to constantly buy back Locke on compliant exchanges. Below is the redemption flow.

Ducat Purchaser/ Holder => Ducat => Merchant => Ducat => Exchange => USD => Merchant
CryptoFed => USD-pegged stablecoin proceeds => Locke buyback => Ducat buyback

B. American CryptoFed Does Not Generate Revenue

All proceeds from Locke auction and Ducat sales must be preserved for the purposes of refunding or redemption. Thus, these proceeds cannot be booked as revenue in accordance with generally accepted accounting principles. In addition, American CryptoFed DAO Constitution does not allow any transaction fees whatsoever.

1. Mission

To create and maintain a monetary system with zero inflation, zero deflation and zero transaction costs. Under no circumstances, should inflation or deflation in the Ducat economy be allowed.

Under no circumstances, should American CryptoFed DAO LLC (CryptoFed) charge any transaction fees in any form. A unanimous consent of all outstanding Locke token votes is required to make changes to this section. (Exhibit B to the Answer to OIP, p.2).

Zero transaction fee is also disclosed in the Form 10 filing below.

2.5.3. Transaction Fees

CryptoFed does not charge any transaction fees. (Exhibit A to the Answer to OIP, p.24).

C. No “Investment Contract” in American CryptoFed Exists

All proceeds from Locke auction sales and Ducat sales must be preserved for the purposes of refunding or redemption. As a result, these proceeds do not belong to American CryptoFed. American CryptoFed DAO Constitution prohibits American CryptoFed from using the proceeds for other purposes, such as revenue (profit) creation. By design, American CryptoFed will not have mechanisms to generate revenue (profit) and to own the proceeds from Locke token auction and Ducat sales. Instead, American CryptoFed is designed for a giveaway business model, which is the opposite of the “investment contract” definition in *SEC v. W.J.*

Howey Co., 328 U.S. 293 (1946). American CryptoFed discloses this giveaway business model in Section 2.5 of Form 10 filing as follows:

CryptoFed does not have revenue, nor does it possess any USD fiat bank accounts. CryptoFed's mission is to maintain zero inflation and deflation of Ducat with zero transaction costs by adjusting the money supply of its two native tokens, Locke and Ducat, through a **giveaway business model**. There is no revenue earning function or operation incorporated into CryptoFed. All functions, mechanisms and operations are designed to achieve CryptoFed's **giveaway business model** effectively and automatically. There is no way for CryptoFed to earn any revenue in fiat, including USD. Given that CryptoFed has no revenue forever, the only way it can survive is to ensure that it does not have any costs either. Fortunately, CryptoFed's zero cost operations can be achieved by using its own native tokens, just as the Bitcoin Blockchain and Ethereum Blockchain have both demonstrated by incentivizing their miners with their own native tokens of BTC and ETH. (Emphasis added, Exhibit A to the Answer to OIP, p.23).

D. The Division Has the Burden of Proof

The order instituting administrative proceedings ("OIP") against American CryptoFed simply presumes that Locke and Ducat tokens are securities, based on the fact that Respondent sought to register them with the Commission without substantive analysis. On December 22, 2021, the Division further asserted in the Division's Memorandum in Opposition to American CryptoFed DAO LLC's Respondent's Motion to Lift the Order That Stays the Effectiveness of Respondent's Form 10, that "The Division is not conceding that the tokens are not securities." ("Opposition Memorandum", Note 32, p.19). Again, the Division failed to provide any substantive analysis in support of its position. In accordance with 5 U.S. Code § 556 plain text below, the Division has the burden of proof that Locke token and Ducat token are securities:

5 U.S. Code § 556 - Hearings; presiding employees; powers and duties; **burden of proof**; evidence; record as basis of decision

(d)Except as otherwise provided by statute, **the proponent of a rule or order has the burden of proof**. (Emphasis added).

The Supreme Court ruling in *SEC v. W.J. Howey Co., 328 U.S. 293 (1946)* stated the following:

The term "investment contract" is undefined by the Securities Act or by relevant legislative reports. But the term was common in many state "blue sky" laws in existence prior to the adoption of the federal statute and, although the term was also undefined by the state laws, it had been broadly construed by state courts so as to afford the investing public a full measure of protection. **Form was disregarded for substance and emphasis was placed upon economic reality.** An investment contract thus came to mean a contract or scheme for "the placing of capital or laying out of money in a way intended to secure income or profit from its employment." *State v. Gopher Tire & Rubber Co.*, 146 Minn. 52, 56, 177 N.W. 937, 938. This definition was uniformly applied by state courts to a variety of situations where individuals were led **to invest money in a common enterprise** with the expectation that they would earn a profit solely through the efforts of the promoter or of some one other than themselves. *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) at 298. (Emphasis added)

The Division is aware of the Supreme Court ruling above, because on April 3, 2019, the SEC published on its website, [Framework for "Investment Contract" Analysis of Digital Assets] ("Framework for Analysis"), attached as Exhibit 2, states the following at Note 6:

Whether a contract, scheme, or transaction is an investment contract is a matter of federal, not state, law and does not turn on whether there is a formal contract between parties. Rather, under the **Howey test, "form [is] disregarded for substance and the emphasis [is] on economic reality."** *Howey*, 328 U.S. at 298. The Supreme Court has further explained that that the term security "embodies a flexible rather than a static principle" in order to meet the "variable schemes devised by those who seek the use of the money of others on the promise of profits." *Id.* at 299. (Emphasis added).

Respondent cited the Framework for Analysis not only in its October 12, 2021 rebuttal reply to the October 8, 2021 letter of Division of Finance's staff (Exhibit G to the Answer to OIP, p.7), but also in its Form 10 filing (Exhibit A to the Answer to OIP, p.28) and Amendment No. 1 to Form 10 (Exhibit E to the Answer to OIP, p.4). However, the Division has not provided a substantive analysis to meet the requirement outlined by the Supreme Court's ruling in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946): **"Form was disregarded for substance and emphasis was placed upon economic reality."** Repeatedly, American CryptoFed has welcome the Division or the Commission to provide analysis to prove that Locke token and Ducat token are securities. Here, Respondent invites the Division one more time to provide its analysis. Given that the Division has had the opportunity, but is unable or elects to abandon its obligation, to

provide proof that Locke token and Ducat token are securities, Locke token and Ducat token should not be classified as securities as the Division asserts.

For the reasons set forth above, if the OIP is confirmed by the Commission's ruling, Respondent respectfully requests that the Commission act promptly to exempt Respondent from Section 12 (g) of Exchange Act registration, even if Respondent's token holders exceed 500 persons who are not accredited investors, as long as there are no material changes to Respondent's business model disclosed in the current Form 10 filing and as long as all the tokens remain restricted, untradeable and non-transferable. Otherwise, Respondent will be required to and be able to file the Form 10, soon after the Commission's ruling confirms the OIP as there is no other form prescribed.

Dated: January 9, 2022

Respectfully submitted,

DocuSigned by:
Marian Orr
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By /s/ Marian Orr

Marian Orr

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CERTIFICATE OF SERVICE

I hereby certify that a true copy of this Motion was filed by eFAP and was served on the following on this 9th day of January 2022, in the manner indicated below:

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RESPONDENT

AMERICAN CRYPTO FED DAO LLC

EXHIBIT 1

Statement

Remarks Before the Aspen Security Forum



Chair Gary Gensler

Aug. 3, 2021

Thank you for that kind introduction. It's good to join the Aspen Security Forum.

As is customary, I'd like to note that my views are my own, and I'm not speaking on behalf of the Commission or the SEC staff.

Some might wonder: What does the SEC have to do with crypto?

Further, why did an organization like the Aspen Security Forum ask me to speak about crypto's intersection with national security?

Let me start at the beginning.

It was Halloween night 2008, in the middle of the financial crisis, when Satoshi Nakamoto published an eight-page paper^[1] on a cypherpunk mailing list that'd been run by cryptographers since 1992.^[2]

Nakamoto — we still don't know who she, he, or they were — wrote, "I've been working on a new electronic cash system that's fully peer-to-peer, with no trusted third party."^[3]

Nakamoto had solved two riddles that had dogged these cryptographers and other technology experts for a couple of decades: first, how to move something of value on the internet without a central intermediary; and relatedly, how to prevent the "double-spending" of that valuable digital token.

Subsequently, his innovation spurred the development of crypto assets and the underlying blockchain technology.

Based upon Nakamoto's innovation, about a dozen years later, the crypto asset class has ballooned. As of Monday, this asset class purportedly is worth about \$1.6 trillion, with 77 tokens worth at least \$1 billion each and 1,600 with at least a \$1 million market capitalization.^[4]

Before starting at the SEC, I had the honor of researching, writing, and teaching about the intersection of finance and technology at the Massachusetts Institute of Technology. This included courses on crypto finance, blockchain technology, and money.

In that work, I came to believe that, though there was a lot of hype masquerading as reality in the crypto field, Nakamoto's innovation is real. Further, it has been and could continue to be a catalyst for change in the fields of finance and money.^[5]

At its core, Nakamoto was trying to create a private form of money with no central intermediary, such as a central bank or commercial banks.

We already live in an age of digital public monies — the dollar, euro, sterling, yen, yuan. If that wasn't obvious before the pandemic, it has become eminently clear over the last year that we increasingly transact online.

Such public fiat monies fulfill the three functions of money: a store of value, unit of account, and medium of exchange.

No single crypto asset, though, broadly fulfills all the functions of money.

Primarily, crypto assets provide digital, scarce vehicles for speculative investment. Thus, in that sense, one can say they are highly speculative stores of value.

These assets haven't been used much as a unit of account.

We also haven't seen crypto used much as a medium of exchange. To the extent that it is used as such, it's often to skirt our laws with respect to anti-money laundering, sanctions, and tax collection. It also can enable extortion via ransomware, as we recently saw with Colonial Pipeline.

With the advent of the internet age and the movement from physical money to digital money several decades ago, nations around the globe layered various public policy goals over our digital public money system.

As a policy matter, I'm technology-neutral.

As a personal matter, I wouldn't have gone to MIT if I weren't interested in how technology can expand access to finance and contribute to economic growth.

But I am anything but public policy-neutral. As new technologies come along, we need to be sure we're achieving our core public policy goals.

In finance, that's about protecting investors and consumers, guarding against illicit activity, and ensuring financial stability.

So how does the SEC fit into all this?

The SEC has a three-part mission — to protect investors, facilitate capital formation, and maintain fair, orderly, and efficient markets in between them. We focus on financial stability as well. But at our core, we're about investor protection.

If you want to invest in a digital, scarce, speculative store of value, that's fine. Good-faith actors have been speculating on the value of gold and silver for thousands of years.

Right now, we just don't have enough investor protection in crypto. Frankly, at this time, it's more like the Wild West.

This asset class is rife with fraud, scams, and abuse in certain applications. There's a great deal of hype and spin about how crypto assets work. In many cases, investors aren't able to get rigorous, balanced, and complete information.

If we don't address these issues, I worry a lot of people will be hurt.

First, many of these tokens are offered and sold as securities.

There's actually a lot of clarity on that front. In the 1930s, Congress established the definition of a security, which included about 20 items, like stock, bonds, and notes. One of the items is an investment contract.

The following decade, the Supreme Court took up the definition of an investment contract. This case said an investment contract exists when "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."^[6] The Supreme Court has repeatedly reaffirmed this Howey Test.

Further, this is but one of many ways we determine whether tokens must comply with the federal securities laws.

I think former SEC Chairman Jay Clayton said it well when he testified in 2018: “To the extent that digital assets like [initial coin offerings, or ICOs] are securities — and I believe every ICO I have seen is a security — we have jurisdiction, and our federal securities laws apply.”^[7]

I find myself agreeing with Chairman Clayton. You see, generally, folks buying these tokens are anticipating profits, and there’s a small group of entrepreneurs and technologists standing up and nurturing the projects. I believe we have a crypto market now where many tokens may be unregistered securities, without required disclosures or market oversight.

This leaves prices open to manipulation. This leaves investors vulnerable.

Over the years, the SEC has brought dozens of actions in this area,^[8] prioritizing token-related cases involving fraud or other significant harm to investors. We haven’t yet lost a case.

Moreover, there are initiatives by a number of platforms to offer crypto tokens or other products that are priced off of the value of securities and operate like derivatives.

Make no mistake: It doesn’t matter whether it’s a stock token, a stable value token backed by securities, or any other virtual product that provides synthetic exposure to underlying securities. These products are subject to the securities laws and must work within our securities regime.

I’ve urged staff to continue to protect investors in the case of unregistered sales of securities.

Next, I’d like to discuss crypto trading platforms, lending platforms, and other “decentralized finance” (DeFi) platforms.

The world of crypto finance now has platforms where people can trade tokens and other venues where people can lend tokens. I believe these platforms not only can implicate the securities laws; some platforms also can implicate the commodities laws and the banking laws.

A typical trading platform has more than 50 tokens on it. In fact, many have well in excess of 100 tokens. While each token’s legal status depends on its own facts and circumstances, the probability is quite remote that, with 50 or 100 tokens, any given platform has zero securities.

Moreover, unlike other trading markets, where investors go through an intermediary like the New York Stock Exchange, people can trade on crypto trading platforms without a broker — 24 hours a day, 7 days a week, from around the globe.

Further, while many overseas platforms state they don’t allow U.S. investors, there are allegations that some unregulated foreign exchanges facilitate trading by U.S. traders who are using virtual private networks, or VPNs.^[9]

The American public is buying, selling, and lending crypto on these trading, lending, and DeFi platforms, and there are significant gaps in investor protection.

Make no mistake: To the extent that there are securities on these trading platforms, under our laws they have to register with the Commission unless they meet an exemption.

Make no mistake: If a lending platform is offering securities, it also falls into SEC jurisdiction.

Next, I’d like to turn to stable value coins, which are crypto tokens pegged or linked to the value of fiat currencies.

Many of you have heard about Facebook’s efforts to stand up a stablecoin called Diem (formerly known as Libra).

Due to the global reach of Facebook’s platform, this has gotten a lot of attention from central bankers and regulators. This is not only due to general policies and concerns with crypto, but also due to Diem’s potential impact on monetary policy, banking policy, and financial stability.

Maybe less well known to this audience, though, is that we already have an existing stablecoin market worth \$113 billion,^[10] including four large stablecoins — some of which have been around for seven years.

These stablecoins are embedded in crypto trading and lending platforms.

How do you trade crypto-to-crypto? Usually, somebody uses stablecoins.

In July, nearly three-quarters of trading on all crypto trading platforms occurred between a stablecoin and some other token.^[11]

Thus, the use of stablecoins on these platforms may facilitate those seeking to sidestep a host of public policy goals connected to our traditional banking and financial system: anti-money laundering, tax compliance, sanctions, and the like. This affects our national security, too.

Further, these stablecoins also may be securities and investment companies. To the extent they are, we will apply the full investor protections of the Investment Company Act and the other federal securities laws to these products.

I look forward to working with my colleagues on the President's Working Group on Financial Markets on these matters.^[12]

Next, I want to turn to investment vehicles providing exposure to crypto assets. Such investment vehicles already exist, with the largest among them having been around for eight years and worth more than \$20 billion.^[13] Also, there are a number of mutual funds that invest in Bitcoin futures on the Chicago Mercantile Exchange (CME).

I anticipate that there will be filings with regard to exchange-traded funds (ETFs) under the Investment Company Act ('40 Act). When combined with the other federal securities laws, the '40 Act provides significant investor protections.

Given these important protections, I look forward to the staff's review of such filings, particularly if those are limited to these CME-traded Bitcoin futures.

The final policy area has to do with custody of crypto assets. The SEC is seeking comment on crypto custody arrangements by broker-dealers and relating to investment advisers.^[14] Custody protections are key to preventing theft of investor assets, and we will be looking to maximize regulatory protections in this area.

Before I conclude, I'd like to note we have taken and will continue to take our authorities as far as they go.

Certain rules related to crypto assets are well-settled. The test to determine whether a crypto asset is a security is clear.

There are some gaps in this space, though: We need additional Congressional authorities to prevent transactions, products, and platforms from falling between regulatory cracks. We also need more resources to protect investors in this growing and volatile sector.

We stand ready to work closely with Congress, the Administration, our fellow regulators, and our partners around the world to close some of these gaps.

In my view, the legislative priority should center on crypto trading, lending, and DeFi platforms. Regulators would benefit from additional plenary authority to write rules for and attach guardrails to crypto trading and lending.

Right now, large parts of the field of crypto are sitting astride of — not operating within — regulatory frameworks that protect investors and consumers, guard against illicit activity, ensure for financial stability, and yes, protect national security.

Standing astride isn't a sustainable place to be. For those who want to encourage innovations in crypto, I'd like to note that financial innovations throughout history don't long thrive outside of our public policy frameworks.

At the heart of finance is trust. And at the heart of trust in markets is investor protection. If this field is going to continue, or reach any of its potential to be a catalyst for change, we better bring it into public policy frameworks.

Thank you. I look forward to your questions.

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- [1] See Satoshi Nakamoto, “Bitcoin: A Peer-to-Peer Electronic Cash System,” *available at* <https://bitcoin.org/bitcoin.pdf>.
- [2] See Haseeb Qureshi “The Cypherpunks” (Dec. 29, 2019), *available at* <https://nakamoto.com/the-cypherpunks/>.
- [3] See “Bitcoin P2P e-cash paper” (Oct. 31, 2008), *available at* <https://satoshi.nakamotoinstitute.org/emails/cryptography/1/>.
- [4] Numbers as of Aug. 2, 2021. See CoinMarketCap, *available at* www.coinmarketcap.com. Crypto asset figures are not audited or reported to regulatory authorities.
- [5] See Michael Casey, Jonah Crane, Gary Gensler, Simon Johnson, and Neha Narula, “The Impact of Blockchain Technology on Finance: A Catalyst for Change” (2018), *available at* <https://www.sipotra.it/wp-content/uploads/2018/07/The-Impact-of-Blockchain-Technology-on-Finance-A-Catalyst-for-Change.pdf>.
- [6] See SEC v. Howey Co., 328 U.S. 293 (1946), “Framework for ‘Investment Contract’ Analysis of Digital Assets,” *available at* <https://supreme.justia.com/cases/federal/us/328/293/>.
- [7] See Jay Clayton, Testimony United States Senate Committee on Banking, Housing, And Urban Affairs, “Virtual Currencies: The Oversight Role of the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission” (Feb. 6, 2018), *available at* <https://www.banking.senate.gov/hearings/virtual-currencies-the-oversight-role-of-the-us-securities-and-exchange-commission-and-the-us-commodity-futures-trading-commission> (see approx. 32:00 mark).
- [8] See Cornerstone Research, “Cornerstone Research Report Shows SEC Establishes Itself as a Key U.S. Cryptocurrency Regulator” (May 11, 2021), *available at* <https://www.cornerstone.com/Publications/Press-Releases/Cornerstone-Research-Report-Shows-SEC-Establishes-Itself-as-a-Key-U-S-Cryptocurrency-Regulator>.
- [9] See Alexander Osipovich, “U.S. Crypto Traders Evade Offshore Exchange Bans” (July 30, 2021), *available at* <https://www.wsj.com/articles/u-s-crypto-traders-evade-offshore-exchange-bans-11627637401>.
- [10] Numbers as of Aug. 1. See The Block, “Total Stablecoin Supply,” *available at* <https://www.theblockcrypto.com/data/decentralized-finance/stablecoins>.
- [11] See The Block, “Share of Trade Volume by Pair Denomination,” *available at* <https://www.theblockcrypto.com/data/crypto-markets/spot>.
- [12] See “Readout of the Meeting of the President’s Working Group on Financial Markets to Discuss Stablecoins” (July 19, 2021), *available at* <https://home.treasury.gov/news/press-releases/jy0281>.
- [13] See Grayscale® Bitcoin Trust, *available at* <https://grayscale.com/products/grayscale-bitcoin-trust/>.
- [14] See Securities and Exchange Commission, “Staff Statement on WY Division of Banking’s ‘NAL on Custody of Digital Assets and Qualified Custodian Status’” (Nov. 9, 2020), *available at* <https://www.sec.gov/news/public-statement/statement-im-finhub-wyoming-nal-custody-digital-assets>. See Securities and Exchange Commission, “SEC Issues Statement and Requests Comment Regarding the Custody of Digital Asset Securities by Special Purpose Broker-Dealers” (Dec. 23, 2020), *available at* <https://www.sec.gov/news/press-release/2020-340>.

RESPONDENT

AMERICAN CRYPTO FED DAO LLC

EXHIBIT 2

Framework for “Investment Contract” Analysis of Digital Assets¹

I. Introduction

If you are considering an Initial Coin Offering, sometimes referred to as an “ICO,” or otherwise engaging in the offer, sale, or distribution of a digital asset,² you need to consider whether the U.S. federal securities laws apply. A threshold issue is whether the digital asset is a “security” under those laws.³ The term “security” includes an “investment contract,” as well as other instruments such as stocks, bonds, and transferable shares. A digital asset should be analyzed to determine whether it has the characteristics of any product that meets the definition of “security” under the federal securities laws. In this guidance, we provide a framework for analyzing whether a digital asset has the characteristics of one particular type of security – an “investment contract.”⁴ Both the Commission and the federal courts frequently use the “investment contract” analysis to determine whether unique or novel instruments or arrangements, such as digital assets, are securities subject to the federal securities laws.

The U.S. Supreme Court’s *Howey* case and subsequent case law have found that an “investment contract” exists when there is the investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others.⁵ The so-called “*Howey* test” applies to any contract, scheme, or transaction, regardless of whether it has any of the characteristics of typical securities.⁶ The focus of the *Howey* analysis is not only on the form and terms of the instrument itself (in this case, the digital asset) but also on the circumstances surrounding the digital asset and the manner in which it is offered, sold, or resold (which includes secondary market sales). Therefore, issuers and other persons and entities engaged in the marketing, offer, sale, resale, or distribution of any digital asset will need to analyze the relevant transactions to determine if the federal securities laws apply.

The federal securities laws require all offers and sales of securities, including those involving a digital asset, to either be registered under its provisions or to qualify for an exemption from registration. The registration provisions require persons to disclose certain information to investors, and that information must be complete and not materially misleading. This requirement for disclosure furthers the federal securities laws’ goal of providing investors with the information necessary to make informed investment decisions. Among the information

that must be disclosed is information relating to the essential managerial efforts that affect the success of the enterprise.⁷ This is true in the case of a corporation, for example, but also may be true for other types of enterprises regardless of their organizational structure or form.⁸ Absent the disclosures required by law about those efforts and the progress and prospects of the enterprise, 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.

II. Application of *Howey* to Digital Assets

In this guidance, we provide a framework for analyzing whether a digital asset is an investment contract and whether offers and sales of a digital asset are securities transactions. As noted above, under the *Howey* test, an “investment contract” exists when there is the investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others. Whether a particular digital asset at the time of its offer or sale satisfies the *Howey* test depends on the specific facts and circumstances. We address each of the elements of the *Howey* test below.

A. The Investment of Money

The first prong of the *Howey* test is typically satisfied in an offer and sale of a digital asset because the digital asset is purchased or otherwise acquired in exchange for value, whether in the form of real (or fiat) currency, another digital asset, or other type of consideration.⁹

B. Common Enterprise

Courts generally have analyzed a “common enterprise” as a distinct element of an investment contract.¹⁰ In evaluating digital assets, we have found that a “common enterprise” typically exists.¹¹

C. Reasonable Expectation of Profits Derived from Efforts of Others

Usually, the main issue in analyzing a digital asset under the *Howey* test is whether a purchaser has a reasonable expectation of profits (or other financial returns) derived from the efforts of others. A purchaser may expect to realize a return through participating in

distributions or through other methods of realizing appreciation on the asset, such as selling at a gain in a secondary market. When a promoter, sponsor, or other third party (or affiliated group of third parties) (each, an “Active Participant” or “AP”) provides essential managerial efforts that affect the success of the enterprise, and investors reasonably expect to derive profit from those efforts, then this prong of the test is met. Relevant to this inquiry is the “economic reality”¹² of the transaction and “what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.”¹³ The inquiry, therefore, is an objective one, focused on the transaction itself and the manner in which the digital asset is offered and sold.

The following characteristics are especially relevant in an analysis of whether the third prong of the *Howey* test is satisfied.

1. Reliance on the Efforts of Others

The inquiry into whether a purchaser is relying on the efforts of others focuses on two key issues:

- Does the purchaser reasonably expect to rely on the efforts of an AP?
- Are those efforts “the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise,”¹⁴ as opposed to efforts that are more ministerial in nature?

Although no one of the following characteristics is necessarily determinative, the stronger their presence, the more likely it is that a purchaser of a digital asset is relying on the “efforts of others”:

- An AP is responsible for the development, improvement (or enhancement), operation, or promotion of the network,¹⁵ particularly if purchasers of the digital asset expect an AP to be performing or overseeing tasks that are necessary for the network or digital asset to achieve or retain its intended purpose or functionality.¹⁶
 - Where the network or the digital asset is still in development and the network or digital asset is not fully functional at the time of the offer or sale, purchasers

would reasonably expect an AP to further develop the functionality of the network or digital asset (directly or indirectly). This particularly would be the case where an AP promises further developmental efforts in order for the digital asset to attain or grow in value.

- There are essential tasks or responsibilities performed and expected to be performed by an AP, rather than an unaffiliated, dispersed community of network users (commonly known as a “decentralized” network).
- An AP creates or supports a market for,¹⁷ or the price of, the digital asset. This can include, for example, an AP that: (1) controls the creation and issuance of the digital asset; or (2) takes other actions to support a market price of the digital asset, such as by limiting supply or ensuring scarcity, through, for example, buybacks, “burning,” or other activities.
- An AP has a lead or central role in the direction of the ongoing development of the network or the digital asset. In particular, an AP plays a lead or central role in deciding governance issues, code updates, or how third parties participate in the validation of transactions that occur with respect to the digital asset.
- An AP has a continuing managerial role in making decisions about or exercising judgment concerning the network or the characteristics or rights the digital asset represents including, for example:
 - Determining whether and how to compensate persons providing services to the network or to the entity or entities charged with oversight of the network.
 - Determining whether and where the digital asset will trade. For example, purchasers may reasonably rely on an AP for liquidity, such as where the AP has arranged, or promised to arrange for, the trading of the digital asset on a secondary market or platform.
 - Determining who will receive additional digital assets and under what conditions.
 - Making or contributing to managerial level business decisions, such as how to deploy funds raised from sales of the digital asset.

- Playing a leading role in the validation or confirmation of transactions on the network, or in some other way having responsibility for the ongoing security of the network.
- Making other managerial judgements or decisions that will directly or indirectly impact the success of the network or the value of the digital asset generally.
- Purchasers would reasonably expect the AP to undertake efforts to promote its own interests and enhance the value of the network or digital asset, such as where:
 - The AP has the ability to realize capital appreciation from the value of the digital asset. This can be demonstrated, for example, if the AP retains a stake or interest in the digital asset. In these instances, purchasers would reasonably expect the AP to undertake efforts to promote its own interests and enhance the value of the network or digital asset.
 - The AP distributes the digital asset as compensation to management or the AP's compensation is tied to the price of the digital asset in the secondary market. To the extent these facts are present, the compensated individuals can be expected to take steps to build the value of the digital asset.
 - The AP owns or controls ownership of intellectual property rights of the network or digital asset, directly or indirectly.
 - The AP monetizes the value of the digital asset, especially where the digital asset has limited functionality.

In evaluating whether a digital asset previously sold as a security should be reevaluated at the time of later offers or sales, there would be additional considerations as they relate to the “efforts of others,” including but not limited to:

- Whether or not the efforts of an AP, including any successor AP, continue to be important to the value of an investment in the digital asset.
- Whether the network on which the digital asset is to function operates in such a manner that purchasers would no longer reasonably expect an AP to carry out essential managerial or entrepreneurial efforts.
- Whether the efforts of an AP are no longer affecting the enterprise's success.

2. *Reasonable Expectation of Profits*

An evaluation of the digital asset should also consider whether there is a reasonable expectation of profits. Profits can be, among other things, capital appreciation resulting from the development of the initial investment or business enterprise or a participation in earnings resulting from the use of purchasers' funds.¹⁸ Price appreciation resulting *solely* from external market forces (such as general inflationary trends or the economy) impacting the supply and demand for an underlying asset generally is not considered "profit" under the *Howey* test.

The more the following characteristics are present, the more likely it is that there is a reasonable expectation of profit:

- The digital asset gives the holder rights to share in the enterprise's income or profits or to realize gain from capital appreciation of the digital asset.
 - The opportunity may result from appreciation in the value of the digital asset that comes, at least in part, from the operation, promotion, improvement, or other positive developments in the network, particularly if there is a secondary trading market that enables digital asset holders to resell their digital assets and realize gains.
 - This also can be the case where the digital asset gives the holder rights to dividends or distributions.
- The digital asset is transferable or traded on or through a secondary market or platform, or is expected to be in the future.¹⁹
- Purchasers reasonably would expect that an AP's efforts will result in capital appreciation of the digital asset and therefore be able to earn a return on their purchase.
- The digital asset is offered broadly to potential purchasers as compared to being targeted to expected users of the goods or services or those who have a need for the functionality of the network.

- The digital asset is offered and purchased in quantities indicative of investment intent instead of quantities indicative of a user of the network. For example, it is offered and purchased in quantities significantly greater than any likely user would reasonably need, or so small as to make actual use of the asset in the network impractical.
- There is little apparent correlation between the purchase/offering price of the digital asset and the market price of the particular goods or services that can be acquired in exchange for the digital asset.
- There is little apparent correlation between quantities the digital asset typically trades in (or the amounts that purchasers typically purchase) and the amount of the underlying goods or services a typical consumer would purchase for use or consumption.
- The AP has raised an amount of funds in excess of what may be needed to establish a functional network or digital asset.
- The AP is able to benefit from its efforts as a result of holding the same class of digital assets as those being distributed to the public.
- The AP continues to expend funds from proceeds or operations to enhance the functionality or value of the network or digital asset.
- The digital asset is marketed, directly or indirectly, using any of the following:
 - The expertise of an AP or its ability to build or grow the value of the network or digital asset.
 - The digital asset is marketed in terms that indicate it is an investment or that the solicited holders are investors.
 - The intended use of the proceeds from the sale of the digital asset is to develop the network or digital asset.
 - The future (and not present) functionality of the network or digital asset, and the prospect that an AP will deliver that functionality.

- The promise (implied or explicit) to build a business or operation as opposed to delivering currently available goods or services for use on an existing network.
- The ready transferability of the digital asset is a key selling feature.
- The potential profitability of the operations of the network, or the potential appreciation in the value of the digital asset, is emphasized in marketing or other promotional materials.
- The availability of a market for the trading of the digital asset, particularly where the AP implicitly or explicitly promises to create or otherwise support a trading market for the digital asset.

In evaluating whether a digital asset previously sold as a security should be reevaluated at the time of later offers or sales, there would be additional considerations as they relate to the “reasonable expectation of profits,” including but not limited to:

- Purchasers of the digital asset no longer reasonably expect that continued development efforts of an AP will be a key factor for determining the value of the digital asset.
- The value of the digital asset has shown a direct and stable correlation to the value of the good or service for which it may be exchanged or redeemed.
- The trading volume for the digital asset corresponds to the level of demand for the good or service for which it may be exchanged or redeemed.
- Whether holders are then able to use the digital asset for its intended functionality, such as to acquire goods and services on or through the network or platform.
- Whether any economic benefit that may be derived from appreciation in the value of the digital asset is incidental to obtaining the right to use it for its intended functionality.
- No AP has access to material, non-public information or could otherwise be deemed to hold material inside information about the digital asset.

3. *Other Relevant Considerations*

When assessing whether there is a reasonable expectation of profit derived from the efforts of others, federal courts look to the economic reality of the transaction.²⁰ In doing so, the courts also have considered whether the instrument is offered and sold for use or consumption by purchasers.²¹

Although no one of the following characteristics of use or consumption is necessarily determinative, the stronger their presence, the less likely the *Howey* test is met:

- The distributed ledger network and digital asset are fully developed and operational.
- Holders of the digital asset are immediately able to use it for its intended functionality on the network, particularly where there are built-in incentives to encourage such use.
- The digital assets' creation and structure is designed and implemented to meet the needs of its users, rather than to feed speculation as to its value or development of its network. For example, the digital asset can only be used on the network and generally can be held or transferred only in amounts that correspond to a purchaser's expected use.
- Prospects for appreciation in the value of the digital asset are limited. For example, the design of the digital asset provides that its value will remain constant or even degrade over time, and, therefore, a reasonable purchaser would not be expected to hold the digital asset for extended periods as an investment.
- With respect to a digital asset referred to as a virtual currency, it can immediately be used to make payments in a wide variety of contexts, or acts as a substitute for real (or fiat) currency.
 - This means that it is possible to pay for goods or services with the digital asset without first having to convert it to another digital asset or real currency.
 - If it is characterized as a virtual currency, the digital asset actually operates as a store of value that can be saved, retrieved, and exchanged for something of value at a later time.

- With respect to a digital asset that represents rights to a good or service, it currently can be redeemed within a developed network or platform to acquire or otherwise use those goods or services. Relevant factors may include:
 - There is a correlation between the purchase price of the digital asset and a market price of the particular good or service for which it may be redeemed or exchanged.
 - The digital asset is available in increments that correlate with a consumptive intent versus an investment or speculative purpose.
 - An intent to consume the digital asset may also be more evident if the good or service underlying the digital asset can only be acquired, or more efficiently acquired, through the use of the digital asset on the network.
- Any economic benefit that may be derived from appreciation in the value of the digital asset is incidental to obtaining the right to use it for its intended functionality.
- The digital asset is marketed in a manner that emphasizes the functionality of the digital asset, and not the potential for the increase in market value of the digital asset.
- Potential purchasers have the ability to use the network and use (or have used) the digital asset for its intended functionality.
- Restrictions on the transferability of the digital asset are consistent with the asset's use and not facilitating a speculative market.
- If the AP facilitates the creation of a secondary market, transfers of the digital asset may only be made by and among users of the platform.

Digital assets with these types of use or consumption characteristics are less likely to be investment contracts. For example, take the case of an online retailer with a fully-developed operating business. The retailer creates a digital asset to be used by consumers to purchase products only on the retailer's network, offers the digital asset for sale in exchange for real currency, and the digital asset is redeemable for products commensurately priced in that real currency. The retailer continues to market its products to its existing customer base, advertises

its digital asset payment method as part of those efforts, and may “reward” customers with digital assets based on product purchases. Upon receipt of the digital asset, consumers immediately are able to purchase products on the network using the digital asset. The digital assets are not transferable; rather, consumers can only use them to purchase products from the retailer or sell them back to the retailer at a discount to the original purchase price. Under these facts, the digital asset would not be an investment contract.

Even in cases where a digital asset can be used to purchase goods or services on a network, where that network’s or digital asset’s functionality is being developed or improved, there may be securities transactions if, among other factors, the following is present: the digital asset is offered or sold to purchasers at a discount to the value of the goods or services; the digital asset is offered or sold to purchasers in quantities that exceed reasonable use; and/or there are limited or no restrictions on reselling those digital assets, particularly where an AP is continuing in its efforts to increase the value of the digital assets or has facilitated a secondary market.

III. Conclusion

The discussion above identifies some of the factors market participants should consider in assessing whether a digital asset is offered or sold as an investment contract and, therefore, is a security. It also identifies some of the factors to be considered in determining whether and when a digital asset may no longer be a security. These factors are not intended to be exhaustive in evaluating whether a digital asset is an investment contract or any other type of security, and no single factor is determinative; rather, we are providing them to assist those engaging in the offer, sale, or distribution of a digital asset, and their counsel, as they consider these issues. We encourage market participants to seek the advice of securities counsel and engage with the Staff through www.sec.gov/finhub.

¹ This framework represents the views of the Strategic Hub for Innovation and Financial Technology (“FinHub,” the “Staff,” or “we”) of the Securities and Exchange Commission (the “Commission”). It is not a rule, regulation, or statement of the Commission, and the Commission has neither approved nor disapproved its content. Further, this framework does not replace or supersede existing case law, legal requirements, or statements or guidance from the

Commission or Staff. Rather, the framework provides additional guidance in the areas that the Commission or Staff has previously addressed. See, e.g., *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO* (Exchange Act Rel. No. 81207) (July 25, 2017) (“*The DAO Report*”); William Hinman, *Digital Asset Transactions: When Howey Met Gary (Plastic)*, Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018), available at <https://www.sec.gov/news/speech/speech-hinman-061418>.

² The term “digital asset,” as used in this framework, refers to an asset that is issued and transferred using distributed ledger or blockchain technology, including, but not limited to, so-called “virtual currencies,” “coins,” and “tokens.”

³ The term “security” is defined in Section 2(a)(1) of the Securities Act of 1933 (the “Securities Act”), Section 3(a)(10) of the Securities Exchange Act of 1934, Section 2(a)(36) of the Investment Company Act of 1940, and Section 202(a)(18) of the Investment Advisers Act of 1940.

⁴ This framework is intended to be instructive and is based on the Staff’s experiences to date and relevant law and legal precedent. It is not an exhaustive treatment of the legal and regulatory issues relevant to conducting an analysis of whether a product is a security, including an investment contract analysis with respect to digital assets generally. We expect that analysis concerning digital assets as securities may evolve over time as the digital asset market matures. Also, no one factor is necessarily dispositive as to whether or not an investment contract exists.

⁵ *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) (“*Howey*”). See also *United Housing Found., Inc. v. Forman*, 421 U.S. 837 (1975) (“*Forman*”); *Tcherepnin v. Knight*, 389 U.S. 332 (1967) (“*Tcherepnin*”); *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943) (“*Joiner*”).

⁶ Whether a contract, scheme, or transaction is an investment contract is a matter of federal, not state, law and does not turn on whether there is a formal contract between parties. Rather, under the *Howey* test, “form [is] disregarded for substance and the emphasis [is] on economic reality.” *Howey*, 328 U.S. at 298. The Supreme Court has further explained that the term security “embodies a flexible rather than a static principle” in order to meet the “variable schemes devised by those who seek the use of the money of others on the promise of profits.” *Id.* at 299.

⁷ Issuers of digital assets, like all issuers, must provide full and fair disclosure of material information consistent with the requirements of the federal securities laws. Issuers of digital assets should be guided by the regulatory framework and concepts of materiality. What is material depends upon the nature and structure of the issuer’s particular network and circumstances. See *TSC Industries v. Northway*, 426 U.S. 438, 449 (1976) (a fact is material “if there is a substantial likelihood that a reasonable shareholder would consider it important” in making an investment decision or if it “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available” to the shareholder).

⁸ See *The DAO Report*.

⁹ The lack of monetary consideration for digital assets, such as those distributed via a so-called “bounty program” does not mean that the investment of money prong is not satisfied. As the Commission explained in *The DAO Report*, “[i]n determining whether an investment contract exists, the investment of ‘money’ need not take the form of cash” and “in spite of *Howey*’s reference to an ‘investment of money,’ it is well established that cash is not the only form of contribution or investment that will create an investment contract.” *The DAO Report* at 11 (citation omitted). See *In re Tomahawk Exploration LLC*, Securities Act Rel. 10530 (Aug. 14, 2018) (issuance of tokens under a so-called “bounty program” constituted an offer and sale of securities because the issuer provided tokens to investors in exchange for services designed to advance the issuer’s economic interests and foster a trading market for its securities). Further, the lack of monetary consideration for digital assets, such as those distributed via a so-called “air drop,” does not mean that the investment of money prong is not satisfied; therefore, an airdrop may constitute a sale or distribution of securities. In a so-called “airdrop,” a digital asset is distributed to holders of another digital asset, typically to promote its circulation.

¹⁰ In order to satisfy the “common enterprise” aspect of the *Howey* test, federal courts require that there be either “horizontal commonality” or “vertical commonality.” See *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87-88 (2d Cir. 1994) (discussing horizontal commonality as “the tying of each individual investor’s fortunes to the fortunes of the other investors by the pooling of assets, usually combined with the pro-rata distribution of profits” and two variants of vertical commonality, which focus “on the relationship between the promoter and the body of investors”). The Commission, on the other hand, does not require vertical or horizontal commonality *per se*, nor does it view a “common enterprise” as a distinct element of the term “investment contract.” *In re Barkate*, 57 S.E.C. 488, 496 n.13 (Apr. 8, 2004); see also the Commission’s Supplemental Brief at 14 in *SEC v. Edwards*, 540 U.S. 389 (2004) (on remand to the 11th Circuit).

¹¹ Based on our experiences to date, investments in digital assets have constituted investments in a common enterprise because the fortunes of digital asset purchasers have been linked to each other or to the success of the promoter’s efforts. See *SEC v. Int’l Loan Network, Inc.*, 968 F.2d 1304, 1307 (D.C. Cir. 1992).

¹² *Howey*, 328 U.S. at 298. See also *Tcherepnin*, 389 U.S. at 336 (“in searching for the meaning and scope of the word ‘security’ in the [Acts], form should be disregarded for substance and the emphasis should be on economic reality.”)

¹³ *Joiner*, 320 U.S. at 352-53.

¹⁴ *SEC v. Glenn W. Turner Enter., Inc.*, 474 F.2d 476, 482 (9th Cir.), cert. denied, 414 U.S. 821, 94 S. Ct. 117, 38 L. Ed. 2d 53 (1973) (“*Turner*”).

¹⁵ In this guidance, we are using the term “network” broadly to encompass the various elements that comprise a digital asset’s network, enterprise, platform, or application.

¹⁶ We recognize that holders of digital assets may put forth some effort in the operations of the network, but those efforts do not negate the fact that the holders of digital assets are relying on the efforts of the AP. That a scheme assigns “nominal or limited responsibilities to the [investor] does not negate the existence of an investment contract.” *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 483 n.15 (5th Cir. 1974) (citation and quotation marks omitted). If the AP provides efforts that are “the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise,” and the AP is not merely performing ministerial or routine tasks, then there likely is an investment contract. See *Turner*, 474 U.S. at 482; see also *The DAO Report* (although DAO token holders had certain voting rights, they nonetheless reasonably relied on the managerial efforts of others). Managerial and entrepreneurial efforts typically are characterized as involving expertise and decision-making that impacts the success of the business or enterprise through the application of skill and judgment.

¹⁷ See, e.g., *Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce Fenner & Smith*, 756 F.2d 230 (2d Cir. 1985).

¹⁸ See *Forman*, 421 U.S. at 852.

¹⁹ Situations where the digital asset is exchangeable or redeemable solely for goods or services within the network or on a platform, and may not otherwise be transferred or sold, may more likely be a payment for a good or service in which the purchaser is motivated to use or consume the digital asset. See discussion of “Other Relevant Considerations.”

²⁰ As noted above, under *Howey*, courts conduct an objective inquiry focused on the transaction itself and the manner in which it is offered.

²¹ See *Forman*, 421 U.S. at 852-53 (where a purchaser is not “‘attracted solely by the prospects of a return’ on his investment . . . [but] is motivated by a desire to use or consume the item purchased . . . the securities laws do not apply.”).