

January 27, 2020

Via email to [innovation@dfs.ny.gov](mailto:innovation@dfs.ny.gov)

The New York State Department of Financial Services  
1 State Street  
New York, NY 10004-1511

Re: Proposed Coin Listing Policy Framework

The Securities and Exchange Commission’s (SEC’s) Strategic Hub for Innovation and Financial Technology (FinHub) serves as a point of contact for external engagement with the SEC on FinTech-related issues, including distributed ledger technology and digital assets. FinHub staff (SEC Staff or Staff) welcomes the opportunity to submit comments to the New York State Department of Financial Services (DFS) on its proposed “Coin Listing Policy Framework.”<sup>1</sup>

The DFS has previously established a framework for regulating what are called “virtual currency firms” and, pursuant to this framework, has issued “BitLicenses” and trust charters that allow these firms to conduct certain activities in New York with respect to what DFS refers to as “virtual currencies.” On December 11, 2019, the DFS published “Proposed Guidance Regarding Adoption or Listing of Virtual Currencies” (the Proposed Guidance).<sup>2</sup> In the Proposed Guidance, the DFS seeks comment on two proposed “coin adoption or listing options” that it wishes to make available to DFS VC licensees:

1. A proposed DFS web-page that will contain a list of all coins that are permitted for the Virtual Currency Business Activities of the VC licensees, without the prior approval of DFS, which list may be updated from time to time, as long as such listed coins have not been subject to any modification, division, or change after their listing on the DFS web-page; and
2. A proposed model framework for a coin-listing or adoption policy that can be tailored to a VC licensee’s specific business model and risk profile to create a firm specific coin listing or adoption policy (a “company coin-listing policy”) that, if approved by DFS, will enable the licensee to self-certify the listing or adoption of new coins in addition to those listed under 1 above, without DFS’s prior approval.<sup>3</sup>

SEC Staff recognizes the important role that state financial services regulators play in protecting their citizens by regulating the activities of banking and money services businesses

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<sup>1</sup> This submission to DFS represents SEC Staff views and is not a rule, regulation, or statement of the SEC. The SEC has neither approved nor disapproved its content. This submission is not binding on the Divisions or the SEC. It does not constitute legal advice, for which market participants should consult legal counsel. It does not modify or replace any existing applicable laws, regulation, or rules.

<sup>2</sup> New York State Department of Financial Services, [Proposed Guidance Regarding Adoption or Listing of Virtual Currencies](#) (Dec. 11, 2019).

<sup>3</sup> [Id.](#)

within their states. Distinct from these state regulatory regimes, however, are the important investor and market protections provided by the federal and state securities laws. SEC Staff and state securities regulators work closely to promote capital formation, investor protection and securities market integrity, including in the digital asset arena.

We note that the Proposed Guidance urges DFS VC licensees to “conduct and document a full risk assessment of [digital assets] ... including risks related to compliance with all applicable laws, rules and regulatory guidances, such as guidances issued by the [SEC] ... .”<sup>4</sup> The SEC Staff has reviewed the Proposed Guidance and, for the reasons discussed below, would suggest that the final guidance caution market participants that reliance on the guidance or on a DFS VC license alone does not ensure that market participants are adhering to federal securities laws that apply when their activities involve digital assets that are securities. The guidance could also encourage market participants to reach out to the SEC Staff through its FinHub portal at [www.sec.gov/finhub](http://www.sec.gov/finhub) with questions as to the federal securities laws.

### **Overview of the Applicability of Securities Laws**

As the digital asset markets continue to evolve, market participants, including DFS VC licensees, should be aware that they may be conducting activities that are encompassed within the federal securities laws and thus fall within the jurisdiction of the SEC.

For purposes of operating in compliance with the federal securities laws, market participants must assess whether the federal securities laws apply to any digital assets in which they transact. The determination of whether a digital asset is a security under the federal securities laws depends on the specific facts and circumstances, and requires a careful analysis under applicable statutory provisions, rules, and case law.<sup>5</sup> Relevant to this analysis are the “economic reality”<sup>6</sup> 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.”<sup>7</sup>

In its “Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO” (the DAO Report),<sup>8</sup> the SEC explained that, if a digital asset is a security, all offers and sales of that digital asset security must be registered with the SEC or must qualify for an exemption from the registration requirements. Additionally, any entity or person engaging in the activities of an exchange must register as a national securities exchange or operate pursuant to an exemption from such registration, such as that available for alternative trading

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<sup>4</sup> New York State Department of Financial Services, [Proposed Guidance Regarding Adoption or Listing of Virtual Currencies](#) (Dec. 11, 2019).

<sup>5</sup> See, e.g., *Id.*

<sup>6</sup> *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298 (1946). See also *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967) (“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”).

<sup>7</sup> *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 352-53 (1943).

<sup>8</sup> Securities and Exchange Commission, [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).

systems (ATSS) that comply with Regulation ATS<sup>9</sup> which includes, among other things, the requirement to register as a broker-dealer and file a Form ATS with the SEC to provide notice of the ATS's operations. Further, an entity that facilitates the issuance or trading of digital asset securities in an initial offering or secondary trading may be acting as a "broker" or "dealer" that is required to register with the SEC. A broker-dealer must also become a member of a self-regulatory organization, typically FINRA. The registration requirements of the federal securities laws are intended to provide investors and the markets with material information and other important protections such as those preventing fraudulent and manipulative acts and trading practices.

In short, if a digital asset is a security under the federal securities laws, market participants must adhere to the well-established federal securities law framework when dealing with that asset, regardless of the form in which the asset is issued or trading.<sup>10</sup> This is the case regardless of other registrations or licenses an entity or person may obtain from a state agency.

As part of a continuing effort to assist those seeking to comply with the federal securities laws, the FinHub publishes relevant materials on its webpage at [www.sec.gov/finhub](http://www.sec.gov/finhub). The SEC Staff recommends that those looking to engage in activities involving digital assets consult with legal counsel concerning the application of the federal securities laws and contact FinHub Staff, as necessary, for assistance.

### **Market Participants Should Not Confuse Adherence to Industry Standards or State Licensing Requirements as Compliance with Securities Laws**

SEC Staff notes that the Proposed Guidance would incorporate a "model framework" that appears to be similar to certain industry-developed frameworks for evaluating regulatory and other risks associated with trading or holding a particular digital asset. These model frameworks often assign a "score" to a particular digital asset, or may designate particular digital assets for inclusion on a so-called "whitelist." SEC Staff notes that these model frameworks or whitelists are industry-developed, and neither the SEC nor the Staff has endorsed or approved the use of any such model framework or whitelist in determining whether a particular digital asset is a security.<sup>11</sup> SEC Staff has been advised that certain of these model frameworks are in fact used by entities to assess the likelihood that the entity is engaging in illegal securities activities under the federal securities laws. SEC Staff is concerned that certain market participants are already engaging in, and in the future will continue to engage in, illegal activity in trading digital assets that are securities, based on this type of risk assessment and their own business considerations, rather than an accurate classification of the digital asset under the federal securities laws, supported by, for example, legal analysis and opinion of securities counsel.

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<sup>9</sup> See, e.g., [Adopting Release for Regulation ATS](#).

<sup>10</sup> See Division of Corporation Finance, Division of Investment Management, and Division of Trading and Markets, [Statement on Digital Asset Securities Issuance and Trading](#) (Nov. 16, 2018).

<sup>11</sup> SEC Staff has published its own framework to assist market participants in determining whether a particular digital asset is an investment contract and therefore a security. See SEC Strategic Hub for Innovation and Financial Technology, [Framework for Investment Contract Analysis of Digital Assets](#) (Apr. 3, 2019).

Market participants should not rely on a model framework, whitelist, or state license when evaluating compliance with the federal securities laws – without also undergoing careful legal analysis under the federal securities laws. Moreover, investors using platforms or other intermediaries should not assume – based only on an entity’s status as a DFS VC (or other state) licensee – that the entity is in compliance with the federal securities laws. Similarly, participants complying with federal securities laws should not rely on that compliance when evaluating compliance with state licensing requirements.

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SEC Staff encourages responsible innovation and the application of beneficial technologies in our securities markets. However, SEC Staff has significant concerns that many digital assets continue to be issued and traded in potential violation of the federal securities laws, and that market participants involved in the issuance or trading of such assets may be acting in violation of the federal securities laws.<sup>12</sup> The failure of issuers of digital asset securities or other market participants transacting in such securities to follow the federal securities laws may result in the SEC taking action to enforce these laws. The SEC’s Division of Enforcement has been and will remain active in pursuing misconduct involving offerings and trading of digital asset securities, which may include digital assets that virtual currency firms determine to “list” or “adopt” pursuant to the Proposed Guidance.<sup>13</sup>

As the DFS considers revisions to its virtual currency regulations, the Staff urges the DFS to work with the federal and state securities regulators to maintain the federal and state commitment to investor protection and securities market integrity.

SEC Staff thanks the DFS for this opportunity to comment on the Proposed Guidance and remains willing to assist in any way the Staff can. If you have questions or would like to discuss further, please contact Valerie A. Szczepanik or you may reach out to FinHub staff at [www.sec.gov/finhub](http://www.sec.gov/finhub).

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<sup>12</sup> See Division of Trading and Markets and Division of Enforcement, [Statement on Potentially Unlawful Online Platforms for Trading Digital Assets](#) (Mar. 7, 2018).

<sup>13</sup> See [www.sec.gov/spotlight/cybersecurity-enforcement-actions](http://www.sec.gov/spotlight/cybersecurity-enforcement-actions).