Testimony of Michael E. Liftik

Partner and Co-Chair of the SEC Enforcement Defense Practice and Co-Chair of the Blockchain and Digital Asset Practice, Quinn Emanuel Urquhart & Sullivan LLP

"Dazed and Confused: Breaking Down the SEC's Politicized Approach to Digital Assets"

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Chairman Hill, Ranking Member Lynch and members of the Subcommittee, thank you for inviting me to speak today on the topic of the SEC's approach to regulating digital assets.

Background

My name is Michael Liftik. I am a partner at Quinn Emanuel Urquhart & Sullivan LLP, where I co-chair both our SEC Enforcement Defense and our Blockchain and Digital Asset practices. I am also the co-head of our Washington DC office. My practice focuses on defending SEC investigations and litigated matters, and complex private securities litigation. A significant portion of my practice involves the cryptocurrency industry.

Before joining Quinn Emanuel in 2017, I spent nearly a decade at the U.S. Securities and Exchange Commission in various roles, as an Enforcement staff attorney, then as counsel to Enforcement Director Rob Khuzami, and then as Chair Mary Jo White's Senior Advisor on Enforcement. I concluded my tenure at the SEC as the agency's Deputy Chief of Staff, advising the Chair on all aspects of the agency's operations, regulatory policy, exams and enforcement programs. I have worked at all levels of the agency and have experience with the enforcement and policymaking divisions from all angles.

I have been on the front lines of digital asset regulation since 2013, when the SEC first began grappling with blockchain technology. In private practice, I have represented blockchain platform companies; layer one and layer two developers; leading digital asset venture and investment funds; digital asset exchanges; founders of and investors in digital asset companies; creators and platforms in the NFT space; and cryptocurrency miners. I have experienced firsthand the challenges of advising clients in an evolving and uncertain regulatory environment.

My remarks today are based on my experiences both at the SEC as well as in private practice. I appear before you on my own behalf and not on behalf of my law firm or any client of the firm.

Introduction

Over the last few years, the SEC has missed an opportunity to become the leading global regulator of digital assets and blockchain technology. Instead, the SEC has refused to issue new rules, regulations, or meaningful guidance relating to digital assets and, at the same time, has engaged in a "whack-a-mole" enforcement approach that the SEC holds up as a replacement for rulemaking. This approach has stifled innovation, caused companies to move offshore and out of

the SEC's reach, and ultimately harms U.S. consumers' ability to engage reliably with this industry.

For digital asset platforms, the SEC widely advertised offers to market participants to "come in and register," but this was a false promise, because the SEC has remained inflexible in its approach to registration, failing to offer real solutions for real companies and market participants. Cryptocurrency is a 21st century asset that deserves 21st century regulation. The innovators in this space need certainty and predictability, as do their customers and the public. The United States has the deepest and most sophisticated capital markets in the world and leads innovation worldwide. Regulators outside the U.S. have looked to the U.S. for guidance, but finding none, have pushed forward where the U.S. has faltered. They have embraced digital assets by adopting frameworks such as ESMA's Markets in Crypto-Assets Regulation (MiCA), which institutes uniform EU market rules for digital assets or the UK's Financial Conduct Authority's rules for "cryptoasset financial promotion."

The SEC has not seized the moment. Rather than being an epicenter of financial innovation, as it should be and is in other contexts, the U.S. has turned itself into a crypto "no fly zone," where "stay outside the U.S." has become a common refrain among digital asset market participants. There must be a better way to address digital assets, encourage innovators and market participants to operate within a defined regulatory regime, while preserving safe access for U.S. consumers and markets participants.

A Chronology of the SEC's Crypto Enforcement Agenda

The global focus and regulation of cryptocurrency has changed dramatically since I first began working on issues related to digital assets over ten years ago. I am a securities lawyer, not a technologist. My interest in cryptocurrencies and blockchain technology then, and still today, stems from its promise and capacity as a new asset class, as a novel way to settle financial transactions securely and permanently, and for its potential to expand access to the mechanisms of finance to those without access to the traditional financial institutions and services.

To understand how the SEC has let the public down through its response to the proliferation of digital assets and blockchain technology, it is important to review how the SEC has reacted over time to various "phases" of the crypto industry's evolution.

In 2013, while serving as Chair White's Senior Advisor on Enforcement, I spearheaded the agency's first intra-agency group focused on digital assets as the SEC began working on understanding cryptocurrency and blockchains. At that time, the agency was wrestling with understanding Bitcoin and focused most of its efforts on the then-elusive question whether Bitcoin transactions should be considered investment contracts under the federal securities laws.[1]

[1] Although it is common parlance to talk about whether a digital asset is "a security," the Securities Act of 1933 regulates securities *transactions. See* Securities Act Section 5(a) and Section 5(c). Thus, in the context of cryptocurrencies, the relevant legal question is whether transactions in digital assets are securities transactions. This is where the now-infamous *Howey* enters the analysis. As cryptocurrency tokens do not fit in any typical category of "security" as defined in Section 3(a)(1) of the Securities Act (e.g. stock, bond, convertible note, etc.), the only

At the same time, the SEC was learning about blockchains (or "distributed ledger technology" as commonly referred to at the time). This was a period of learning and analysis. The public record reveals that the agency chose a path of letting the technologies evolve before making any definitive pronouncements. The Division of Enforcement focused its efforts on protecting the investing public against fraud. And, indeed, the first few "crypto cases" were fraud-based.[2] These early cases were traditional investment fraud schemes, with a "bitcoin wrapper," rather than cases about the nature of the bitcoin transactions themselves.

In 2017, in response to the Initial Coin Offering (or "ICO") boom, the SEC started staking out more wide-ranging positions, pulling more crypto tokens and transactions within the SEC's enforcement ambit. The SEC issued the DAO Report on Investigation,[3] which was the first time the agency publicly explained its rationale for how a token offering could meet the *Howey* test.[4] Shortly after the DAO Report, the SEC's Division of Enforcement brought a series of enforcement cases in which the SEC asserted that digital asset (or "tokens") transactions were "investment contracts" under *Howey*, and that these projects therefore violated Section 5 of the Securities Act's prohibition on issuances of securities in unregistered transactions.[5] Early on, the defense bar reacted to the SEC's new focus by seeking to engage with the agency, to explain that—in many cases—a blockchain project's token minting did not meet the elements of *Howey*. Examples include tokens given away as part of a free airdrop, projects that were not promoted as intending to generate profit for participants, and tokens with utility and consumable purposes.

These efforts were greeted by a series of ever-shifting SEC staff speeches and non-binding, informal staff guidance, and a wave "regulation by enforcement" to which the industry struggled to respond. For example, in response to the SEC's allegation that tokens were issued primarily to appreciate in value (akin to equity in a company), some blockchain projects emphasized the consumptive use, or "utility," component of the token. The industry also sought to explain to the SEC that a cryptographically secure token is essential to a functional blockchain—in other words, there cannot be a distributed blockchain project without a token—and, accordingly, that

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possible statutory term on which the SEC can claim tokens could fit is "investment contract." The Supreme Court's decision in *Howey* and an extensive progeny of case law define whether a transaction creates an "investment contract" under the Securities Act.

[2] *See SEC Charges Texas Man With Running Bitcoin-Denominated Ponzi Scheme*, SEC Press Rel. No. 2013-132 (Jul. 23, 2013), *available at* https://www.sec.gov/newsroom/press-releases/2013-132; see also *Homero Joshua Garza*, SEC Litig. Rel. No. 23415 (Dec. 1, 2015), *available at* https://www.sec.gov/enforcement-litigation/litigation-releases/lr-23415.

[3] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, SEC Rel. No. 81207 (July 25, 2017) ("DAO Report"), *available at* https://www.sec.gov/litigation/investreport/34-81207.pdf.

[4] In *SEC v. W.J. Howey Co.* the Supreme Court explained that under the Securities Act an investment contract is (i) an investment of money in (ii) a common enterprise, with (iii) a reasonable expectation of profits that are (iv) to be derived through the entrepreneurial efforts of others. 328 U.S. 293, 299-301 (1946).

[5] *See, e.g.*, *SEC Exposes Two Initial Coin Offerings Purportedly Backed by Real Estate and Diamonds*, SEC Press Rel. No. 2017-185 (Sep. 29, 2017), *available at* https://www.sec.gov/newsroom/press-releases/2017-185; *SEC Emergency Action Halts ICO Scam*, SEC Press Rel. No. 2017-219 (Dec. 4, 2017), *available at* https://www.sec.gov/newsroom/press-releases/2017-219; *Company Halts ICO After SEC Raises Registration Concerns*, SEC Press Rel. No. 2017-227 (Dec. 11, 2017), *available at* https://www.sec.gov/newsroom/press-releases/2017-227.

the SEC's assertions that tokens (or digital asset transactions) are themselves "investment contracts" is, in essence, a ban on blockchain technology in the U.S.[6]

Other projects decided to try to comply with the SEC's rules for private securities offerings. Without conceding that token offerings are securities transactions, companies issued tokens in compliance with Regulation D and Regulation S. Technical compliance with those exemptions proved challenging for cryptocurrencies, however. Before projects learned to hard code lock-ups into tokens, for example, it was difficult to prevent secondary market transactions before holding periods were met. Likewise, it was difficult to prevent tokens issued to offshore persons from "flowing back" to the U.S. through secondary market exchanges. Rather than work with projects to craft workable pathways for blockchain projects to use the long-established Reg D and Reg S exemptions, however, the SEC brought enforcement actions for technical violations.[7]

In 2018 and 2019, the SEC shifted focus to the importance of "decentralization," the transfer of control and decision-making from a centralized entity (individual, organization, or group) to a distributed network.[8] The blockchain industry was initially optimistic, as it seemed like a viable path forward was emerging. Projects devoted considerable time to charting a course to "decentralize" before and shortly after launch. Commissioner Hester Peirce proposed a decentralization safe harbor[9] that would have provided cryptocurrency projects—and the entire industry—with concrete, written rules they could follow.

Heartened by the SEC's public statements, blockchain projects that emerged after the 2018-2019 staff guidance on decentralization generally were thoughtfully constructed to avoid issuing tokens in ways the SEC indicated — through enforcement cases — was problematic, and with a focus on decentralization. This included, for example, developing projects completely before launching any tokens to the public and building decentralized autonomous organizations (DAOs) to enable dispersed voting on the ongoing governance of projects, rather than vesting control of projects with founders and developers.

But the industry's optimism was short-lived. The SEC did not pursue Commissioner Peirce's proposal and quickly retreated from its public comments on decentralization. Instead, the SEC doubled-down on Enforcement's chasing-fireflies approach to regulating digital assets. As a

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[6] As recently as last week, the SEC staff acknowledge that it had used confusing terminology in calling the tokens themselves "securities." *See* Plaintiff SEC's Mem. of Law in Supp. of Mot. for Leave to Amend at 24 n.6, *Sec. & Exch. Comm'n v. Binance Holdings Ltd.*, No. 23-1599-ABJ-ZMF (D.D.C. Sep. 12, 2024) (ECF No. 273-1). The federal securities laws contain no statute defining digital assets (or tokens, or cryptocurrencies) as a security.

[7] *See, e.g.*, *In the Matter of CoinAlpha Advisors LLC*, Securities Act Rel. No. 10582 (Dec. 7, 2018), *available at* https://www.sec.gov/files/litigation/admin/2018/33-10582.pdf; *In the Matter of The Registration Statement of American CryptoFed DAO LLC*, Securities Act Rel. No. 11134 (Nov. 18, 2022), *available at* https://www.sec.gov/files/litigation/admin/2022/33-11134.pdf.

[8] 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; *Framework for "Investment Contract" Analysis of Digital Assets* (April 3, 2019), *available at* https://www.sec.gov/about/divisions-offices/division-corporation-finance/framework-investment-contract-analysis-digital-assets#_ednref1.

[9] Commissioner Hester M. Peirce, *Running on Empty: A Proposal to Fill the Gap Between Regulation and Decentralization* (Feb. 6, 2020), *available at* https://www.sec.gov/newsroom/speeches-statements/peirce-remarks-blockress-2020-02-06.

result, although projects, venture capital firms, and corporate securities lawyers devoted incredible amounts of time working on decentralization, the parade of Enforcement cases against blockchain projects continued unabated.[10]

It became increasingly clear that decentralization was not significant to new SEC leadership. Accordingly, although the industry still believed that demonstrating decentralization would avoid or reduce SEC scrutiny, it also became apparent that this line of reasoning was not persuasive to the SEC or its staff.[11]

Around the same time, the SEC's Division of Enforcement began shifting its focus to centralized crypto asset trading and custody platforms. From the outside, the Division and its growing cryptocurrency specialized unit and dozens of new hires appeared to shift their efforts from the pursuit of one-off unregistered offering cases, to systemically shutting down crypto in the United States by taking out the platforms that make tokens available to the U.S. public, one by one.[12] In the years that followed, the SEC has targeted and brought enforcement actions against every significant digital asset exchange with a strong U.S. presence — Binance US, Coinbase, Kraken, Bittrex among them.[13]

It is also now clear that the SEC views virtually all digital assets as securities. Until the SEC publicly announced the closing of its investigation into Ethereum 2.0, even the SEC's position on

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[10] *See, e.g., SEC Charges Issuer With Conducting $100 Million Unregistered ICO*, SEC Press Rel. No. 2019-87 (Jun. 4, 2019), *available at* https://www.sec.gov/newsroom/press-releases/2019-87; SEC Charges Blockchain Company for $6.3 Million Unregistered ICO, Administrative Proceeding File No. 3-19332 (Aug. 12, 2019), *available at* https://www.sec.gov/enforcement-litigation/administrative-proceedings/33-10671-s; *SEC Charges ICO Incubator and Founder for Unregistered Offering and Unregistered Broker Activity*, SEC Press Rel. No. 2019-181 (Sep. 18, 2019), *available at* https://www.sec.gov/newsroom/press-releases/2019-181; *ICO Issuer Settles SEC Registration Charges, Agrees to Return Funds and Register Tokens As Securities*, SEC Press Rel. No. 2020-27 (Feb. 19, 2020), *available at* https://www.sec.gov/newsroom/press-releases/2020-37; *SEC Charges Founders and Issuer for Conducting Fraudulent and Unregistered ICO*, Litigation Rel. No. 24804 (Apr. 24, 2020), *available at* https://www.sec.gov/enforcement-litigation/litigation-releases/lr-24804; *SEC Charges Ripple and Two Executives with Conducting $1.3 Billion Unregistered Securities Offering*, SEC Press Rel. No. 2020-338 (Dec. 22, 2020), *available at* https://www.sec.gov/newsroom/press-releases/2020-338.

[11] *See, e.g.*, *SEC Charges Digital Asset Trading Platform and Its CEO with Registration Violations*, Litigation Rel. No. 25032 (Feb. 17, 2021), *available at* https://www.sec.gov/enforcement-litigation/litigation-releases/lr-25032; SEC Charges New Hampshire Issuer of Digital Asset Securities with Registration Violations, Litigation Rel. No. 25060 (Mar. 29, 2021), *available at* https://www.sec.gov/enforcement-litigation/litigation-releases/lr-25060.

[12] Indeed, well-funded projects were fighting back, draining significant resources from Enforcement staff. *See, e.g., SEC v. Telegram Group Inc. et al*, 19-cv-09439-PKC, S.D.N.Y. (filed Oct. 11, 2019), (S.D.N.Y. Oct 11, 2019), *SEC v. Kik Interactive, Inc.*, 19-cv-05244-AKH, S.D.N.Y. (filed Jun. 4, 2019); *SEC v. Ripple Labs, Inc., et al*, No. 20-cv-10832, S.D.N.Y. (filed Dec. 22, 2020).

[13] *SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao*, SEC Press Rel. No. 2023-101 (Jun. 5, 2023), *available at* https://www.sec.gov/newsroom/press-releases/2023-101; *SEC Charges Coinbase for Operating as an Unregistered Securities Exchange, Broker, and Clearing Agency*, SEC Press Rel. No. 2023-102 (Jun. 6, 2023), *available at* https://www.sec.gov/newsroom/press-releases/2023-102; *SEC Charges Kraken for Operating as an Unregistered Securities Exchange, Broker, Dealer, and Clearing Agency*, SEC Press Rel. No. 2023-237 (Nov. 20, 2023), *available at* https://www.sec.gov/newsroom/press-releases/2023-237; *SEC Charges Crypto Asset Trading Platform Bittrex and its Former CEO for Operating an Unregistered Exchange, Broker, and Clearing Agency*, SEC Press Rel. No. 2023-78 (Apr. 17, 2023), *available at* https://www.sec.gov/newsroom/press-releases/2023-78.

whether ETH is a security was murky.[14] The SEC's cases against trading platforms therefore pose an existential threat to the ability of U.S. consumers to access this asset class. If the SEC prevails in its pending actions against trading platforms, it will have succeeded in shutting down virtually the entire U.S. market to purchase or sell most digital assets.

Despite these headwinds, the industry continues to innovate and accept the risks of the uncertain and unforgiving SEC enforcement and regulatory environment, to try to provide the U.S. public with access to digital assets and technology. For example, right now the industry is working on exciting advancements in "DeFi protocols," including a proliferation of restaking protocols, which do not require the use of centralized exchanges. However, unless there is a sea change in approach, it appears the SEC's Division of Enforcement is looking at those projects as well.[15]

Observations and Lessons Learned

This history underscores the limitations of trying to glean meaning on how to act lawfully from the SEC's hodgepodge of enforcement cases and unofficial guidance. At various inflection points, the SEC has missed the opportunity to provide clarity, and indeed, has actively avoided doing so. Instead of engaging in notice and comment rule making, or thoughtfully deploying its exemptive authority under the Securities Exchange Act of 1934,[16] the SEC has brought case after case in the crypto space with the agency's position revealed piecemeal. Only now, more than ten years after the agency first started studying crypto, has the agency's position crystalized — and still not through official statements of the Commission but through a mosaic of enforcement cases — finally revealing that the SEC believes virtually all cryptocurrencies except BTC and ETH are securities, and appears that it will not stop until there is no digital asset industry left in the United States and available to U.S. market participants.[17]

It is worth noting that there is considerable ambiguity over whether the SEC has jurisdiction over digital assets in the first place. The only reason the SEC arguably has authority over digital assets is when they are transacted in "investment contracts." There is no other statutory authority the SEC can point to over digital assets. Yet *Howey* is a dated decision about a "catch all" term (investment contract) that is heavily facts-and-circumstances dependent. Thus, *Howey* provides no predictability or certainty — it is an uneven, moving target. Both consumers and market participants have no way to know how the SEC might view any particular transaction. This is no way for a vibrant, technologically cutting-edge industry to develop. And that is why this uncertainty is pushing more and more blockchain companies overseas.

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[14] *See, e.g.,* https://www.youtube.com/watch?v=VhA1dZXeao0 (Chairman McHenry questioning SEC Chair Gensler on Ether at Hearing to Conduct Oversight of the SEC); *see also* Reuters, Crypto firm Consensys says US regulator has closed inquiry into Ethereum 2.0 (Jun. 19, 2024), *available at* https://www.reuters.com/legal/crypto-firm-consensys-says-us-regulator-has-closed-inquiry-into-ethereum-20-2024-06-19/.

[15] *See, e.g., SEC Charges Consensys Software for Unregistered Offers and Sales of Securities Through Its MetaMask Staking Service*, SEC Press Rel. No. 2024-79 (Jun. 28, 2024), *available at* https://www.sec.gov/newsroom/press-releases/2024-79.

[16] Section 36 of the Securities Exchange Act of 1934 grants the SEC broad authority to "exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions" from the statutes and rules of the federal securities laws. 15 U.S.C. § 78mm.

[17] *See eToro Reaches Settlement with SEC and Will Cease Trading Activity in Nearly All Crypto Assets*, SEC Press Rel. No. 2024-125 (Sep. 12, 2024), *available at* https://www.sec.gov/newsroom/press-releases/2024-125.

The SEC's approach to cryptocurrency, however, shows an agency that has aggressively asserted jurisdiction over the industry, a foundational topic on which Congress has not spoken. Yet, the agency has no stated plan to address and engage with this industry, the asset class, or the technology other than through Enforcement. Although the Enforcement Division has obviously been very active, the other divisions have rarely engaged in proactive rulemaking — they have instead issued staff guidance or used rulemakings designed to address other areas of the market to have an indirect impact on the cryptocurrency industry. The SEC also has not endowed its FinHub Office with a true regulatory "sandbox" to allow for experimentation before rolling out potential solutions to the market.

To be clear, on the enforcement side, the Division of Enforcement has and should always aggressively pursue fraud falling within its authority. Thus, crypto investment schemes where funds are pooled and raised supposedly to be used for one purpose and are in fact used for another should be held to account. The SEC has always stood as the bulwark against securities fraud, but as history demonstrates, fraud happens in the traditional throughways of our capital markets, not just the backroads – Madoff, WorldCom, Theranos, being very high-profile examples. Last fiscal year, the SEC brought 167 actions it primarily categorized as tied to securities offerings, which includes offering frauds.[18] Thus, justifying the SEC's approach to crypto as an industry rife with fraud is no justification at all. Enforcement Division staff will always pursue fraud, no matter the flavor.

But just as the SEC pursues various rulemakings to facilitate capital formation or foster fair and efficient markets, even while fraudsters may continue to pursue their schemes in traditional finance, so too should the SEC pursue rulemaking and other formal mechanisms to provide guidance and guardrails to an industry over which the SEC appears to believe it has complete dominion.

The SEC's current approach has several downsides. First, it allows the law to develop in a haphazard way. We have seen federal District Judges thoughtfully address challenging and novel questions over the application of the federal securities laws in cases pursued by the SEC and private class action plaintiffs over the last few years. Not surprisingly, different judges from different federal districts reach different conclusions. Thus, with each decision, a new signal is sent – from *Telegram* to *Kik* to *Ripple* to *Terraform* to *Coinbase* to *Binance* to *Kraken*, the law continues to change. Thus, for example, on the critical issue of whether secondary market sales are securities transaction under *Howey*, the industry pivots from court decision to decision, while the SEC continues to provide no realistic, workable path forward on this issue.[19] Decisions by

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[18] SEC Announces Enforcement Results for Fiscal Year 2023, SEC Press Rel. No. 2023-234 (Nov. 14, 2023), available at https://www.sec.gov/newsroom/press-releases/2023-234; *Addendum to Division of Enforcement Press Release Fiscal Year 2023*, *available at* https://www.sec.gov/files/fy23-enforcement-statistics.pdf.

[19] *Sec. & Exch. Comm'n v. Ripple Labs, Inc.*, 682 F. Supp. 3d 308, 331 (S.D.N.Y.), motion to certify appeal denied, 697 F. Supp. 3d 126 (S.D.N.Y. 2023) ("[T]he SEC does not develop the argument that these secondary market sales were offers or sales of investment contracts"); *Sec. & Exch. Comm'n v. Binance Holdings Ltd.*, No. CV 23-1599 (ABJ), 2024 WL 3225974, at *22 (D.D.C. June 28, 2024) (finding that "the complaint does not include sufficient facts to support a plausible inference that any particular secondary sales satisfy the Howey test for an investment contract"); *Order Denying Motion to Dismiss and Setting Case Management Conference*, Dkt. No. 90 at 18-19, *Sec.*

federal appellate courts are nascent and U.S. Supreme Court review of these fundamental questions is likely years away.

Second, in its eagerness to bring cases against an industry that the SEC's Chair has accused of "widespread fraud, bankruptcies, failures, and misconduct,"[20] the SEC may have fostered a culture that led to the DebtBox debacle.[21] Much ink has been spilled on that case and the Enforcement Division has appropriately owned up to the mistakes made, but the core question to be asked is not why those mistakes occurred in that particular case, but how the agency got to the point where those mistakes could happen in the first place? In my experience, such an outcome and scolding for the SEC in district court is unprecedented. So, it is reasonable to wonder whether the agency's constant messaging around the ills of crypto created an environment where this could occur.

Third, the SEC has refused to engage in rulemaking in the crypto space.[22] What this means is that areas that cry out for appropriate regulation to clarify a workable path for digital assets go unaddressed. It is simply untenable for the SEC to continue to claim that this new asset class and technology require no regulatory innovation to match. This is contrary to precedent. As new assets emerge or as financial innovation changes market processes, the SEC routinely engages in rulemaking to address it. For example, with the rise in popularity of crowdsourced fundraising mechanisms such as Kickstarter, the SEC adopted Reg CF to allow for crowdsourced securities fundraising.[23] As technology for clearance and settlement has advanced, the SEC has closed the time to settle equity securities transactions from 3 days to 2 and more recently from 2 days to 1.[24]

Proposing a comprehensive rulemaking agenda for the appropriate regulation of digital assets and blockchain-based technologies is beyond my expertise as an enforcement defense attorney. But even apart from the core question how it should be determined which digital assets are securities, if any, it is not difficult to see areas where appropriate and modest modifications of existing rules could readily bring more of the cryptocurrency industry "under the tent." For example, custody rules for both broker-dealers and investment advisers should be modified to address the challenges of custodying digital assets that may be created on bespoke blockchains. Although custody solutions are emerging for "main stream" digital assets that are tied to the established blockchains, as new blockchain protocols are created, digital assets tied to those new protocols take time to be adopted by third-party custody solution providers. The rules should be modified to recognize that although some custody mechanisms are preferred, that does not mean there are not other safe and secure custody methods that could be deployed, with full disclosure

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& Exch. Comm'n v. Payward Ventures (d/b/a "Kraken"), et al., No. 23-cv-06003-WHO (N.D. Cal. Aug. 23, 2024) ("[T]he fact that the transactions in question occurred on a secondary market does not by itself prevent those transactions from involving investment contracts, it simply means that the *Howey* test must be applied to the transactions as they occurred on the secondary market.")

[20] Chair Gary Gensler, *Statement on the Financial Innovation and Technology for the 21st Century Act* (May 22, 2024) *available at* https://www.sec.gov/newsroom/speeches-statements/gensler-21st-century-act-05222024.

[21] Turner Wright, *Judge dismisses DEBT Box case, orders SEC to pay $1.8M in fees,* Cointelegraph (May 28, 2024), https://cointelegraph.com/news/judge-order-debt-box-sec-fees.

[22] https://www.sec.gov/files/rules/petitions/2023/4-789-letter-secretary-grewal-121523.pdf.

[23] 17 CFR § 227.

[24] 17 C.F.R. § 240.15c6-1 (shortening the standard settlement cycle for most broker-dealer transactions from T+2 to T+1); see also https://www.finra.org/investors/insights/understanding-settlement-cycles ("This isn't the first time such a change has occurred. In 2017, the SEC shortened the settlement cycle from T+3 to T+2.")

of the attendant risks, when the preferred option is not available or is being adapted to a new blockchain. Otherwise, the SEC is effectively picking winners and losers for all U.S. consumers by limiting the digital assets that can be held by brokers or investment advisers.

Likewise, the regulations for registering as an exchange should be adapted to fit the technological realities of digital asset exchanges. This may mean that not every statute or rule in place for national securities exchanges such as NYSE and NASDAQ would be applied to a registered digital asset exchange. It is disingenuous for the SEC to call for market participants to "come in and register" when the SEC will consider no compromise, no modification, no exemption to the rules that are simply structurally impossible in the context of digital assets recorded on distributed ledgers; or, at the very least, cannot work in the current state of the market. For example, the members of a national securities exchange must be registered broker-dealers.[25] But there are only two registered broker-dealer approved for digital assets.[26]

And, in an ironic twist, national securities exchanges may only effect trades in registered securities.[27] So, this creates two immediate problems: First, to the extent the SEC has determined that Bitcoin and Ether are *not* securities, the SEC would not permit a national securities exchange to trade Bitcoin and Ether along with registered securities. (But, of course, BTC and ETH make up a significant volume of all daily traded digital assets[28] and without BTC and ETH available to serve as the "other" half of a token pair, most exchange business would be hampered.) Second, there is the ultimate "chicken or the egg" problem, which is that there are only a handful of digital assets that are registered securities (mostly as a result of early SEC enforcement actions),[29] and those digital assets have functionally ceased to trade. This means that even if an entity manages to register as a national securities exchange and is approved by the Commission to conduct trading in digital asset securities, when that entity opens for business, on day one . . . it will have precisely no business it can conduct.

Fourth, the SEC inexplicably has put its thumb on the scale of which particular digital asset products are being made available to retail consumers. For years, the SEC resisted approving the registration of a "spot" exchange traded products (ETP) for Bitcoin. The attempts of the industry to create this product and the SEC's repeated denials of approval are well documented.[30] Finally, on January 10, 2024, after losing before DC Circuit Court of Appeals on the issue, the SEC approved the Greyscale Bitcoin Trust, which tracks the movements of the spot market for

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[25] Exchange Act Section 3(a)(3)(A)

[26] https://brokercheck.finra.org/firm/summary/312784. Just last week, it was reported that a second special purpose broker-dealer has been approved for FINRA membership. https://brokercheck.finra.org/firm/summary/316189.

[27] In this context, registration is required under Section 12 of the Exchange Act, which registers the actual securities themselves, not the transaction-based approach under the Securities Act.

[28] https://finance.yahoo.com/u/yahoo-finance/watchlists/crypto-top-volume-24hr/, reflecting that as of September 16, 2024, Bitcoin and Ethereum have the second and third highest daily trading volume among digital currencies.

[29] *See, e.g.*, In the Matter of CarriereQ, Inc., D/B/A Airfox, Securities Act. Rel. No. 10575 (Nov. 16, 2018); In the Matter of Paragon Coin, Inc., Securities Act Rel. No. 10574 (Nov. 16, 2018); In the Matter of Blockchain of Things, Inc., Securities Act Rel. No. 10736 (Dec. 18, 2019).

[30] *See, e.g.*, Chair Gary Gensler, *Statement on the Approval of Spot Bitcoin Exchange-Traded Products* (Jan. 10, 2024), (acknowledging that "[b]eginning under Chair Jay Clayton in 2018 and through March 2023, the Commission disapproved more than 20 exchange rule filings for spot bitcoin ETPs"), *available at* https://www.sec.gov/newsroom/speeches-statements/gensler-statement-spot-bitcoin-011023.

Bitcoin.[31] As detailed in the briefing on the appeal of the SEC's initial denial of approval, a spot Bitcoin ETP is an easy, safe, liquid way to provide U.S. retail investors exposure to Bitcoin, without the complexity of purchasing Bitcoin directly.[32] Although the SEC had previously approved several Bitcoin futures ETPs, it had determined that retail investors should not have access to Bitcoin spot ETPs. The effect of this decision was to drive demand outside the U.S. where spot Bitcoin ETPs were available.[33] It should not have taken a court order to remedy this situation. Since the approval of the Grayscale spot Bitcoin ETP, many other market participants including Blackrock, Invesco, Fidelity, and others have successfully launched their own products.[34] And more recently the SEC approved spot ETH ETPs.[35] This is an encouraging sign that the SEC is allowing crypto-based financial products to diversify.

Path Forward

So where does the SEC go from here? I believe the answer lies in the very heart of the industry the SEC is trying to regulate. Innovation. Through innovation, the SEC can approach digital asset regulation not with a blank slate, but through the time-tested regulatory regime that has been put in place since the agency's creation, modified to fit this new industry. Through regulatory innovation for example, the SEC can try out different approaches to potential rulemaking frameworks through a sandbox approach led by its FinHub office. The SEC has broad exemptive authority under Exchange Act Section 36(a). It can deploy that authority to empower FinHub to selectively and carefully craft pathways to registration for securities transactions under the Securities Act, for securities under the Exchange Act, for broker-dealers and exchanges and clearing agencies. It can adopt the broker-dealer and investment adviser regime to better fit the realities of digital assets.

With regards to Enforcement, I believe that our markets are stronger with vigorous and vigilant law enforcement. The SEC's Division of Enforcement must continue to root out fraud and pursue other violations of the federal securities law that threaten the U.S. investing public. But at the same time, the Division must ask itself, how does the current program and priorities help investors? Perpetual investigations and litigation into potential registration violations consume vast amounts of SEC resources and can harm, rather than help, the very people the SEC is charged with protecting. In many cases, participants in digital asset projects targeted by the SEC wind up losing money, as projects are forced to shut down, their property becomes worthless and

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[31] *See Grayscale Invs., LLC v. Sec. & Exch. Comm'n*, 82 F.4th 1239 (D.C. Cir. 2023); Order Granting Accelerated Approval of Proposed Rule Changes, as Modified by Amendments Thereto, to List and Trade Bitcoin-Based Commodity-Based Trust Shares and Trust Units, Rel. No. 34-99306 (Jan. 10, 2024), *available at* https://www.sec.gov/files/rules/sro/nysearca/2024/34-99306.pdf.

[32] *See* Brief for Amici Curiae, by Consent, of the Blockchain Association, the Chamber of digital Commerce, Chamber of Progress and Coin Center in Support of Petitioner and Reversal, *Grayscale Investments, LLC v. Sec. & Exch. Comm'n*, No. 22-1142 (D.C. Cir. Oct. 18, 2022) ('Blockchain Association Brief").

[33] Blockchain Association Brief at 11.

[34] https://crsreports.congress.gov/product/pdf/IF/IF12573

[35] Harrison Miller, Ethereum ETFs Win SEC Approval. Trading Starts Today, Investors.com (Jul. 23, 2024), https://www.investors.com/news/ethereum-etf-sec-approval/#:~:text=The%20Securities%20and%20Exchange%20Commission,at%20market%20open%20on%20Tuesday; Order Granting Accelerated Approval of Proposed Rule Changes, as Modified by Amendments Thereto, to List and Trade Shares of Ether-Based Exchange-Traded Products, Rel. No. 34-100224 (May 23, 2024), *available at* https://www.sec.gov/files/rules/sro/nysearca/2024/34-100224.pdf.

undivestable, and they are precluded from trading. In contrast, in the traditional areas of the SEC's jurisdiction, such an outcome is rare, and typically limited to fraudulent conduct. In a departure from usual practice, SEC enforcement matters in the crypto space often result in the business closing down, even absent fraud or any showing of harm to the platform's purchasers or customers.[36]

Moreover, in crypto matters, the Division should clearly and transparently communicate what it is investigating, what the basis for its concerns are, and the factors that it is considering. Too often defense attorneys in these investigations are left guessing at what the SEC thinks is wrong with the products, companies, or the industry, setting off a costly and time-consuming process of shadowboxing.

Ultimately, however, the best way to reduce the cycle of regulation by enforcement is for the SEC to regulate. And if it will not, then it is for Congress to legislate. The passage of FIT21[37] in a bipartisan manner shows the promise of how difficult policy issues related to digital assets can be addressed for the benefit of the American public.

I want to conclude by thanking the Subcommittee for its continued focus on this important area.

[36] In these cases, the SEC often then embarks, ironically, on a cumbersome and lengthy process of trying to give money back to the same consumers whom the SEC's enforcement actions have impacted. *See, e.g.*, *In the Matter of Flyfish Club, LLC,* Order Instituting Cease and Desist Proceedings at ¶ 23, *available at* https://www.sec.gov/files/litigation/admin/2024/33-11305.pdf.

[37] https://www.congress.gov/bill/118th-congress/house-bill/4763/text?s=1&r=1&q=%7B%22search%22%3A%5B%22Financial+Innovation+and+Technology+for+the+21st+Century+Act.%22%5D%7D