

MEMORANDUM

To: Members, Committee on Financial Services

From: Digital Assets, Financial Technology and Inclusion Subcommittee Staff

Date: September 13, 2024

Subject: September 18, 2024, Subcommittee on Digital Assets, Financial Technology and Inclusion Hearing entitled, “Dazed and Confused: Breaking Down the SEC’s Politicized Approach to Digital Assets.”

On Wednesday, September 18, 2024, at 10:00 a.m. the Subcommittee on Digital Assets, Financial Technology and Inclusion of the Committee on Financial Services will hold a hearing in 2128 Rayburn HOB, entitled “Dazed and Confused: Breaking Down the SEC’s Politicized Approach to Digital Assets.” The following witnesses will testify:

- **Mr. Michael Liftik**, *Partner*, Quinn Emanuel Urquhart & Sullivan LLP
- **Honorable Dan Gallagher**, *Chief Legal, Compliance, and Corporate Affairs Officer*, Robinhood Markets, Inc.
- **Mr. Teddy Fusaro**, *President*, Bitwise Asset Management
- **Ms. Jennifer Schulp**, *Director of Financial Regulation Studies*, Center for Monetary and Financial Alternatives
- **Mr. Lee Reiners**, *Lecturing Fellow*, Duke University

Introduction

The Securities and Exchange Commission (SEC) has long struggled with the application of the United States’ securities laws to the digital asset ecosystem. Under Chair Gensler, the SEC has prioritized and pursued an enforcement and regulatory agenda to the detriment of the digital asset ecosystem.

Existing Regulatory Ambiguities

The Securities Act of 1933 (the “Securities Act”) requires every offer or sale of securities to be registered with the SEC or meet a condition for exemption from registration.¹ The Securities Act further defines a security to include an “investment contract,” which was later defined by the seminal Supreme Court in *SEC v. W.J. Howey Co.*² Under the case law developed by *Howey* and the cases that followed, an arrangement qualifies an investment contract if it is: 1) an investment of money; 2) in a common enterprise; 3) with the expectation of profits; 4) derived from the efforts of others. The test is not a “balancing test,” rather, all four factors must be present for the

¹ Paul Vigna, *SEC Clears Blockstack to Hold First Regulated Token Offering*, Wall Street Journal (Jul. 10, 2019), <https://www.wsj.com/articles/sec-clears-blockstack-to-hold-first-regulated-token-offering-11562794848>; Guillermo Jimenez, *SEC Greenlights a Second Crypto Offering: YouNow’s Props Tokens*, Yahoo Finance (Jul. 19, 2019), <https://finance.yahoo.com/news/sec-greenlights-second-crypto-offering-223301606.html>.

² See *SEC v. Howey Co.*, 328 U.S. 293 (1946).

arrangement to constitute an investment contract.³ At issue, is fact that several characteristics of a digital asset may not meet the definition of an investment contract as set out by the *Howey* test. This includes the functional use of a digital asset that negates the expectation of profit; as well as its decentralized nature such that the digital asset no longer relies on the efforts of others.

In 2019, the SEC, under former Chairman Jay Clayton, released the Framework for Investment Contract Analysis of Digital Assets. The framework identified several distinct factors and additional sub-factors that should be considered under the *Howey* test as it applies to digital assets.⁴ The framework does not provide guidance on how the factors should be weighed or the combination of factors that would categorize a digital asset to be a security.

During Chair Gensler’s tenure, the SEC has not released guidance on how the SEC determines whether a digital asset meets the definition of a security. Rather, Chair Gensler and the SEC have publicly opined, including before Congress, that the “vast majority” of digital assets are securities.⁵

Additionally, Chair Gensler has opined on numerous occasions that the “test to determine whether a crypto asset is a security is clear.”⁶ However, Republican SEC Commissioner Hester Peirce disagrees, citing requests “[the SEC] receives for clarity and the consistent outreach to the Commission staff for no-action and other relief.”⁷ Commissioner Peirce has frequently emphasized her concerns with the SEC’s enforcement-centric approach and highlighted guiding principles for regulating the digital asset ecosystem.⁸ Commissioner Uyeda has echoed this sentiment maintaining, “for too long, the Commission’s approach to crypto asset regulation has been to use enforcement actions to introduce novel legal and regulatory theories.”⁹

Legislative Proposals

H.R.5741 - *Uniform Treatment of Custodial Assets Act (Flood)* – The bill would prohibit Federal banking agencies, the National Credit Union Administration, and the SEC from requiring banks to include assets held in custody or safekeeping as a liability on the institution’s balance sheet.

H.R. ___ - *The New Frontiers in Technology (NFT) Act (Timmons)* – This discussion draft clarifies that a covered non-fungible token (NFT) is not an investment contract or a transaction in a security. The draft also requires the GAO to conduct a study on NFTs, which will include an analysis of the size, scope, role, nature, and use of NFTs, the similarities and differences between

³ *Id.*

⁴ SEC, *Framework for “Investment Contract” Analysis of Digital Assets*, https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets#_edn1.

⁵ Gary Gensler, *Testimony Before the United States Senate Committee on Banking, Housing, and Urban Affairs* (Sept. 15, 2022) <https://www.sec.gov/news/testimony/gensler-testimony-housing-urban-affairs-091522>.

⁶ SEC Chairman Gensler Remarks Before the Aspen Security Forum (Aug. 3, 2021), <https://www.sec.gov/news/public-statement/gensler-aspen-security-forum-2021-08-03>.

⁷ Commissioner Peirce and former Commissioner Roisman Public Statement: In the Matter of Coinschedule (Jul. 14, 2021), <https://www.sec.gov/news/public-statement/peirce-roisman-coinschedule>.

⁸ Commissioner Hester M. Peirce Remarks before the Digital Assets at Duke Conference (Jan. 20, 2023), <https://www.sec.gov/news/speech/peirce-remarks-duke-conference-012023>.

⁹ Commissioner Uyeda, “Statement on Proposed Rule Regarding the Safeguarding of Advisory Client Assets” (Feb. 15, 2023) <https://www.sec.gov/newsroom/speeches-statements/uyeda-statement-custody-021523>.

NFTs and other digital assets, the benefits and risks of NFTs, how NFTs have integrated into traditional marketplaces, including the risks of such integration, and the levels and types of illicit activities in NFT markets. GAO must make the report publicly available one year after enactment.

H.R. ___ - *Securing Innovation in Financial Regulation Act (Lucas)* – This discussion draft establishes the SEC Strategic Hub for Innovation and Financial Technology (FinHub), which will assist the SEC with its approach to technological advancements, examine the impact that financial technology (FinTech) innovations have on capital markets, market participants, and investors, and coordinate the SEC’s response to emerging technologies in financial, regulatory, and supervisory systems. FinHub will be managed and overseen by a director who will be appointed by the Commission. FinHub shall submit an annual report to Congress on its activity. The draft also establishes LabCFTC in the CFTC, which will serve as an information source for the CFTC on FinTech innovation. LabCFTC will be managed and overseen by a director who will be appointed by the Commission. The draft further requires LabCFTC to submit an annual report to Congress on its activity.

H.R. ___ - *The Bridging Regulation and Innovation for Digital Global and Electronic (BRIDGE) Digital Assets Act (Rose)* – This discussion draft establishes a Joint CFTC-SEC Advisory Committee on Digital Assets composed of digital asset marketplace stakeholders. Among its many duties, the Joint Advisory Committee will provide recommendations to the CFTC and the SEC regarding their respective promulgation of rules for digital assets. The section also requires the CFTC and the SEC to publicly respond to any recommendations made by the Joint Advisory Committee.

H.R. ___ - *To codify the special purpose broker dealer, and for other purposes* – This discussion draft extends the SEC’s 2020 policy statement that created a framework for broker dealers to offer custody services for tokenized securities for an additional five years. This framework allows broker dealers to handle both tokenized securities and permitted payment stablecoins. The draft also requires the SEC to conduct a study to assess whether additional guidance or rules are necessary to facilitate the development of tokenized securities.