

MiCA and Crypto Asset Regulation in the European Union and the United States: Part 2

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In marked contrast to the European Union's Markets in Crypto Assets Regulation (MiCA), there is no single US regulatory framework dedicated to the regulation of crypto assets and markets. Instead, crypto regulation in the United States involves the application of multiple federal and state regulatory frameworks. Federal banking and securities regulators have each sought to enforce aspects of their respective regulations in the context of crypto assets, as have state payments and securities regulators. This discussion, however, focuses primarily on crypto regulation under the federal securities laws, and the Securities and Exchange Commission (SEC) has been particularly (though not uniquely) active on the crypto regulatory front. In particular, we discuss, briefly, the federal securities laws as they have been applied by the SEC and the courts to the issuance of crypto assets and to the regulation of intermediaries in the crypto asset securities markets. It may be helpful, however, to start by identifying what the SEC has historically identified as a crypto asset.

The SEC's Definition of "Crypto Assets"

In the SEC's own definition, a "crypto asset" (or a "digital asset", since the SEC has used both terms) "refers to an asset that is issued and/or transferred using distributed ledger or blockchain technology, including, but not limited to, so-called virtual currencies, coins, and tokens."¹ The definition appears simple, but it contains hidden complexities. For example, when is an asset truly "issued and/or transferred using distributed ledger or blockchain technology"? What if the blockchain is only one of many means of recording the asset's transfer? What if the

blockchain is a subsidiary means of recording the transfer?

The SEC Staff has noted, in the context of custody, that where "the distributed ledger is not the authoritative record of share ownership," the security may not be regulated as a crypto asset security.² It therefore follows that where the blockchain is not, in fact, the authoritative record of ownership, the asset may not qualify as a crypto asset in the SEC's view. For an asset to truly be a "crypto asset," therefore, it must be either issued and/or transferred on a distributed ledger or blockchain. Importantly, and unlike MiCA, the SEC's definition makes no distinction based on the attributes of the asset or the rights it confers. Unlike MiCA, the SEC's definition covers both a traditional financial asset that is issued on the blockchain (such as common stock or interests in a limited liability company), as well as an asset such as bitcoin.

There are, of course, hundreds, perhaps thousands, of assets that do qualify as "crypto assets" under this SEC definition, for example, the numerous coins or tokens that were distributed through various "initial coin offerings." Successive Chairs of the SEC have asserted that most of these coins are not just "crypto assets," but are specifically crypto assets that are securities for the purposes of the Federal securities laws.³ Section 2(a)(1) of the Securities Act of 1933 (Securities Act), and Section 3(a)(10) of the Securities Exchange Act of 1934 (Exchange Act), respectively enumerate a long (and largely very similar) list of assets that are securities including, among others "any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing

agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract...”⁴

Of these various categories, however, the SEC typically has relied on two categories in particular to assert that various crypto assets are securities. The first is the “investment contract” category, which relies on the application of the 78 year old test laid down in *SEC v. W.J. Howey*,⁵ while the other is the “note” category, which uses the relatively newer test provided in *Reves v. Ernst & Young*.⁶ Of these, the use of the investment contract category has been far more popular in the crypto asset context, which is perhaps unsurprising given the Supreme Court’s observation in *Howey* that Congress defined “security” broadly to embody a “flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.”⁷

Howey states that an “investment contract” (and therefore a security) exists where there is an investment of money or a contribution of value in a common enterprise with a reasonable expectation of profits or returns derived from the entrepreneurial or managerial efforts of others.⁸ Those efforts must be “the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.”⁹ Offerings of securities, whether investment contracts or otherwise, must be registered under Section 5 of the Securities Act,¹⁰ or must be offered pursuant to an exemption from such registration. It is on the basis of the *Howey* test that the SEC has declared dozens of offerings of crypto assets to be securities, while the current Chair of the SEC has noted that many other asset offerings are probably also securities.¹¹ Perhaps as importantly, it is on the basis of *Howey* that senior officers of the SEC have found bitcoin to not be a security, since its value is driven not by the activities of some managerial group or entity, but by millions of transactions by unaffiliated entities, in the same way as the value of a commodity such as gold or silver.¹²

Note, however the increasingly important distinction drawn by several ongoing cases, between the token or asset itself, and the transactions through which the asset is offered or sold. Courts have been quick to note that the crypto asset is not itself a security, although it could be offered as part of a transaction that is an investment contract, and therefore a security.¹³ For example, consider a crypto asset that is offered in an initial public offering by a group of developers who tout the asset’s financial potential, and who promise to develop the network on which the token is based. Sales and purchases of tokens pursuant to that offering may be investment contracts under *Howey*, because token buyers are likely to have bought the token motivated by expectations of profit based on the efforts that the developer group has promised to undertake with respect to the asset.

The distinction between the token or asset itself, and the transaction in which the asset is sold is the basis of a recent, significant split in judicial opinion regarding the status of crypto assets bought and sold in secondary trades. Two federal courts have sought to distinguish between the initial offerings of crypto assets, where buyers bought assets from the asset issuer, motivated by expectations of profit based on the marketing efforts of the issuer, and secondary trades, where the buyers bought the asset in “blind bid/ask” transactions, from sellers who may have been entirely unaffiliated with the issuer.¹⁴ As one of these courts observed, while initial offerings of the asset may have constituted investment contracts under *Howey*, secondary buyers were not relying on the same expectations of profits based on the issuer’s efforts, so that secondary transactions in the asset did not constitute investment contracts.¹⁵ Other courts have disagreed, noting that the representations made by the issuer around a primary offering of tokens may carry through to shape the expectations of buyers in secondary transactions, so that both primary and secondary purchases of such assets are investment contracts under the *Howey* test.¹⁶ The net result, though, is considerable ambiguity—it

appears that unlike common stock or bonds (that is, assets that are themselves securities), crypto assets are not necessarily securities in and of themselves. Rather, their character as a security depends on the specific circumstances of the transaction in which they are bought and sold.

This ambiguity around security status may make it significantly difficult for US crypto market participants to conclusively determine whether they have purchased the asset in a securities transaction. The determination of whether an asset was bought and sold as a security has significant downstream consequences. As noted earlier, securities offerings in the United States must be registered with the SEC or exempt from registration. In addition, any entity or person engaging in the activities of an exchange must register as a national securities exchange¹⁷ or operate pursuant to an exemption from such registration.¹⁸ A person or entity that engages in the business of effecting transactions in securities must register as a broker-dealer.¹⁹

Each of these regulatory obligations is premised on there being a security, and each of these obligations equally applies to both traditional (that is, non-crypto) asset securities and crypto assets that are securities. In the context of crypto assets, however, it is this determination as to security status that may vary from transaction to transaction, thus complicating the regulatory analysis for market participants. Further, and unlike in the case of MiCA, crypto asset security issuers are subject to exactly the same registration and disclosure obligations as traditional security issuers, despite the many protestations from crypto market participants that the nature of crypto assets demands a different, tailored set of disclosures.²⁰

Notably, and unlike MiCA, the SEC has not explicitly carved out either stablecoins or non-fungible assets from the scope of the federal securities laws. While neither the SEC nor the federal courts have sought to assert jurisdiction over stablecoins that do no more than offer a 1:1 backing by a fiat asset, both have treated stablecoins that are offered

as part of an investment scheme as securities under the *Howey* test.²¹

The SEC has also asserted its jurisdiction over non-fungible assets where these are offered as investment contracts under *Howey*. The SEC has largely ignored the fungibility or non-fungibility of these assets and has instead focused primarily on whether these assets were marketed to investors as financial investments, and whether the issuer of the assets made representations as to future efforts around these assets, and the networks on which they were offered.²²

The SEC's Restrictions on Broker-Dealers in Crypto Assets

In spite of the considerable ambiguity surrounding the security status of individual crypto assets, US broker-dealer firms have evinced interest in transacting in crypto assets for several years now. However, despite market interest in crypto assets,²³ brokerage firms are, at best, thinly involved in transacting in crypto asset securities, and the various restrictions that the SEC and the Financial Industry Regulatory Authority (FINRA) have imposed on such firms is undoubtedly a significant reason for the relative paucity of US broker-dealers who transact in crypto assets today.

Unlike MiCA, there had not been, until 2020 (as we discuss further below), any specifically tailored US regime for crypto asset broker-dealers, as opposed to traditional broker-dealers. In fact, the first, and perhaps most significant obstacle for many brokerage firms interested in transacting in crypto assets was the near-total lack of specific guidance from the SEC around the custody of such assets until December 2020. In July 2019, the Staffs of the SEC's Division of Trading and Markets and of FINRA's Office of General Counsel issued a joint statement, noting the importance of safeguarding customer assets, but declining to provide any guidance on how crypto assets should be safeguarded.²⁴ Instead, the Joint Staff Statement outlined certain ways in which broker-dealers could transact in

crypto asset securities without taking custody of such securities or having control over such trades, such as by matching buyers and sellers but leaving the parties to settle the transactions bilaterally, and without the broker-dealer's intermediation.²⁵ Over a year later, the Staff of the SEC's Division of Trading and Markets issued a no-action letter to FINRA permitting certain refinements to these non-custodial trading arrangements, but still providing no guidance on how, if at all, broker-dealers might take custody of their customers' crypto asset securities.²⁶

It was not until the end of 2020 that the SEC issued a statement creating a completely new regime for broker-dealers seeking to take custody of their customers' crypto assets.²⁷ This new "Special Purpose Broker-Dealer" regime provides time-limited no-action relief for a period of five years for a limited class of special purpose broker-dealers who take custody of customers' crypto assets, while adhering to certain specified conditions around these crypto assets. For example, the Special Purpose Broker-Dealer regime requires that a broker-dealer who takes custody of a customers' crypto asset securities must, among other things:

- Have access to the crypto asset securities and the capability to transfer them on the associated blockchain;
- Limit its business to crypto asset securities (although it can hold traditional securities for the purposes of net capital or hedging);
- Establish, maintain, and enforce written policies and procedures to determine whether a particular crypto asset is a security offered and sold pursuant to an effective registration statement or an available exemption from registration;
- Establish, maintain, and enforce written policies and procedures to assess the characteristics of a crypto asset security's blockchain technology and network, before taking custody of the asset;
- Not maintain custody of a crypto asset security if the broker is aware of any material security or operational problems or weaknesses with the

blockchain technology and network used to access and transfer the crypto asset security;

- Establish, maintain, and enforce written policies and procedures, in accordance with industry best practices, to demonstrate that the broker-dealer has exclusive control over the crypto asset securities it holds in custody and to protect against their theft or loss;
- Establish, maintain, and enforce written policies and procedures around special situations such as airdrops or forks, court ordered transfers, or the broker's liquidation;
- Provide written disclosures to customers that the broker-dealer is in possession of crypto asset securities and the risks of investing in and holding such securities, including: (i) that crypto assets that are unregistered investment contracts under the *Howey* test are not securities under the Securities Investor Protection Act and may not be entitled to the protections of that Act; (ii) the risks around fraud, theft, loss, volatility and valuation of crypto assets, and (iii) the security protocols employed by the broker-dealer around safeguarding these assets; and
- Enter into a written agreement with each customer that sets forth the terms and conditions with respect to receiving, purchasing, holding, safekeeping, selling, transferring, exchanging, custodial, liquidating, and otherwise transacting in crypto asset securities on behalf of the customer.²⁸

This is a remarkably restrictive regime, and two restrictions on special purpose broker-dealers, in particular, have drawn significant criticism. The first is that special purpose broker-dealers may not hold traditional securities alongside crypto asset securities (except for the limited purpose of net capital and hedging).²⁹ The second is that special purpose broker-dealers are not permitted to hold any crypto assets that have not been issued pursuant to an effective registration statement, or an exemption from such registration.³⁰ Taken together, these two

restrictions serve to deprive would-be special purpose broker-dealers from being able to transact in the vast majority of crypto assets, while offering little scope for a traditional securities business to offset this. Notably, and unlike MiCA's provisions for Crypto-Asset Service Providers (CASPs), the special-purpose broker-dealer regime is also not a self-contained code. Special purpose broker-dealers would, in addition to adhering to these various requirements, also have to adhere to the various capital, recordkeeping, reporting, supervision and various other FINRA and SEC requirements applicable to traditional broker-dealers as well.

It is therefore perhaps unsurprising that, four years after the special purpose broker-dealer guidance was issued, relatively few entities have applied, and even fewer have been approved to become special purpose broker-dealers, thus far, there have been only two.³¹ It is unclear whether the SEC will persist with the special purpose broker-dealer category after it lapses in 2025, but it certainly does not appear to have been a popular choice for broker-dealers, even would-be broker-dealers in crypto assets.

A handful of broker-dealers continue to transact in crypto asset securities on a non-custodial basis. Besides the SEC's generally restrictive approach that does not permit these broker-dealers to take custody of crypto assets, every broker-dealer that seeks to transact in crypto asset securities must file a Continuing Membership Application (CMA) or (in the case of a new broker-dealer) a New Membership Application (NMA) with FINRA.³² FINRA has worded what is effectively a requirement as a suggestion or a "request," but the effect for most broker-dealer firms who wish to transact in crypto asset securities is that they must file a CMA or an NMA with FINRA and engage in what is often a time-consuming and expensive process. In some respects, this requirement is difficult to understand. A broker-dealer that has been approved by FINRA to transact in privately offered equity securities should surely be able to do so, irrespective of whether those securities are issued in the form of a book-entry or on

the blockchain. Nevertheless, the prevailing state of affairs is that broker-dealers require approval from FINRA to begin transacting in, or to expand their operations to cover crypto asset securities, and this process is often a substantial burden on broker-dealer resources.

As things stand, therefore, broker-dealers generally cannot custody crypto asset securities—only special purpose broker-dealers can do so, and there are only two special purpose broker-dealers in existence. No broker-dealer is permitted to transact in crypto asset non-securities (such as bitcoin) without taking a 100 percent charge on net capital, and thereby severely denting any financial incentive to deal in such crypto assets. No broker-dealer is permitted to transact in any crypto asset that is a security but has not been issued pursuant to an effective registration statement, or an exemption from such registration. Overall, the landscape for broker-dealers and would-be broker-dealers in crypto assets is a forbidding one, made much worse by the fact that there are indications that the SEC views many, perhaps the majority of existing crypto assets as having been illegally offered and sold as unregistered investment contracts. The effect is to deny even the handful of broker-dealers that are approved by FINRA to transact in crypto assets on a non-custodial basis access to a large range of such assets, thus considerably reducing any financial incentive to act as a broker-dealer in this market.

The two most adverse consequences of the extremely restrictive framework for crypto asset broker-dealers are to obstruct liquidity around crypto assets, and to force intermediaries seeking to deal in crypto assets that are non-securities (such as bitcoin), or whose status as a security is contested, out of an entity that is not registered as a broker-dealer. In some arrangements, a broker-dealer operates in parallel to an unregistered entity, with the broker-dealer trading in traditional or crypto asset securities (on a non-custodial basis), while the unregistered entity offers trading in bitcoin, ether and other

crypto assets that are either not securities or not acknowledged to be securities. It is unclear what purpose it serves to have trading in crypto assets continue and be open to retail investors, but be carried out by unregistered, unregulated entities into whose operations the SEC and FINRA have effectively no ongoing oversight or scrutiny. By contrast, MiCA's CASP-specific regulatory approach appears to offer a tailored regulatory framework for crypto market intermediaries which recognizes both the traditional role CASPs play in terms of market intermediation, while simultaneously recognizing that such intermediation is in respect of assets that clearly differ from traditional Financial Instruments.

Crypto Asset Managers and the Custody Rule

The restrictions on broker-dealers seeking to custody crypto assets quite obviously affect broker-dealers, and investors who seek to rely on the services of broker-dealers. But these restrictions also have had a significant impact on asset managers more generally, and on asset management in the area of crypto assets.

The Investment Advisers Act of 1940 (Advisers Act) generally requires registered investment advisers to hold their clients' funds and securities in accordance with the so-called Custody Rule.³³ The Custody Rule requires, among other things, that registered investment advisers maintain their clients' fund and securities with a "qualified custodian."³⁴ The Rule specifies four types of entities that may act as qualified custodians: banks, broker-dealers, futures commissions merchants, and foreign financial institutions.³⁵ The qualified custodian must maintain each client's funds and securities in a separate account under that client's name, or in accounts that contain only the adviser's clients' funds and securities, under the adviser's name as agent or trustee for the clients.³⁶ The qualified custodian must provide quarterly account statements to each client whose funds and securities are custodied with the qualified custodian, and the custodied funds and securities

must be subject to annual "surprise" examination by an independent public accountant.³⁷

Registered investment advisers face a range of problems around the custody of their clients' crypto assets. The first of these is identifying which crypto assets constitute "funds or securities" and are therefore required to be placed with a qualified custodian. As a practical matter, many investment advisers prefer to take a prudential approach, treating most or all crypto assets as securities under the Custody Rule.

Even after identifying most crypto assets as securities required to be custodied by a qualified custodian, however, investment advisers face the difficult task of finding a suitable qualified custodian to take custody of the crypto assets and securities. There are very few qualified custodians equipped to take custody of crypto assets. As we have discussed, there are only two special purpose broker-dealers qualified to take custody of crypto assets, and even they cannot take custody of any crypto asset that is a security but was not issued pursuant to an effective registration statement or an exemption from the registration requirement.³⁸ There is just one bank and three trusts that have been permitted by the Office of the Comptroller of Currency to custody crypto assets.³⁹ Futures commissions merchants can only custody funds and security futures, and cannot custody spot crypto assets, and the SEC has provided practically no guidance on which foreign financial institutions may act as qualified custodians with respect to crypto assets.

Given this paucity of qualified custodians for crypto assets, many registered investment advisers have custodied their crypto assets with various state-chartered trusts, on the theory that such institutions qualify as "banks," under the definition of that term in the Advisers Act.⁴⁰ The SEC has never expressly agreed with this definition, and SEC Staff have instead sought comment on whether state chartered trusts would constitute qualified custodians for the purposes of the Advisers Act.⁴¹ More recently, however, the SEC appears to have tacitly acknowledged

that state chartered trusts may serve as qualified custodians for crypto assets, although the question is still far from clear.⁴²

Even if a qualified custodian can be found, a compliance-minded investment adviser must then assure itself that the qualified custodian supports (that is, provides custodial services for) the specific crypto asset that the investment adviser seeks to have custodied. And even if the custodian agrees to custody that specific crypto asset, the investment adviser must then consider the various economic and governance rights associated with the asset, and how these can best be exercised while the asset is in the custody of the qualified custodian.

In its recently proposed Safeguarding Rule, which the SEC has not yet adopted, the SEC has stated that investment advisers may not remove crypto assets custodied with qualified custodians even for the purposes of trading these assets on a centralized exchange.⁴³ The implications of this restriction are immediately obvious. Deprived of major sources of liquidity, investment advisers would find it harder to dispose of crypto assets on financially advantageous terms, thereby reducing the investment potential of these assets.

The requirement that the assets never leave the qualified custodian, even in order to be traded, has other implications as well. It seems logical to assume that if an investment adviser may not move its crypto assets out of qualified custody in order to trade them (even where the terms of the trade are plainly advantageous, or perhaps even the best available), the investment adviser should also not be able to move the crypto assets out of the qualified custodian to stake them, or to exercise other economic or governance features associated with the crypto asset.

Most crypto assets offer certain economic features (such as the ability to use the asset for staking or yield farming) or the right to vote on the operation of, upgrades to, or other aspects of the network on which the asset is based. To exercise these rights or features associated with the asset, typically it is necessary to remove the asset from custody and place it

into a smart contract or to “lock” the asset while the economic or governance rights are being exercised.

The SEC has not specifically spoken to whether crypto assets can be moved out of qualified custody to exercise these economic or governance rights, but the approach adopted in the proposed Safeguarding Rule, which suggests that the assets can never be moved out of qualified custody for any purpose whatsoever, strongly suggests that the assets cannot be staked, voted on, or used for purposes such as yield farming.

The inability to exercise the myriad economic and governance rights associated with crypto assets, combined with the restrictions on removing crypto assets out of qualified custody to be traded on a centralized exchange, are significantly likely to make investments in crypto assets less attractive for crypto asset managers. More importantly, however, these restrictions may also raise concerns for investment managers in the exercise of their fiduciary duties under the Advisers Act.⁴⁴ For example, an investment adviser who decides that it is in its clients’ best interests to be invested in crypto assets must then consider whether the limitations on the alienation of these assets, or the exercise of the rights associated with these assets are so significant as to deter the adviser from investing in these assets. Put simply, the very considerable uncertainties associated with the custody of crypto assets may cause many investment advisers and asset managers to reconsider investing in crypto assets.

Conclusion

MiCA represents one of many possible regulatory approaches to crypto assets, and it already has been the subject of significant discussion and comment. Yet it represents a significant attempt to both provide clarity to crypto market participants as well as to harmonize diverging or conflicting regulatory approaches to crypto assets across the European Union. Most importantly, perhaps, it represents an attempt to develop regulation that specifically recognizes and accounts for the specific or unique

technological, financial and other attributes of crypto assets.

In many respects, the SEC's approach is effectively the opposite of MiCA's. In its regulatory efforts around crypto so far, the SEC has largely sought to extend the existing traditional securities framework to crypto assets, crypto asset markets, and crypto asset participants, without making specific allowances for features or functionalities of crypto assets. This is an approach that has been strongly resisted by many crypto market participants, as evidenced by the many crypto-related enforcement actions in which the SEC continues to be engaged. Yet even where the SEC has sought to create a specific regulatory framework for crypto asset markets or intermediaries, as with the special purpose broker-dealer regime, its efforts do not appear to have met with significant success.

MiCA's approach could be instructive for the SEC in at least two respects. First, MiCA seeks to distinguish crypto assets, as a class, from traditional Financial Instruments, so that traditional Financial Instruments, whether issued on the blockchain or not, are not subject to MiCA. Second, with respect to the crypto assets that it does cover, MiCA makes no distinction between crypto assets that are securities, and crypto assets that are not. As a result, MiCA empowers CASPs to deal in all manner of crypto assets, whether they are securities or not, provided they are not Financial Instruments. (MiCA does distinguish among certain types of crypto assets such as asset-referenced tokens (ARTs) and electronic money tokens (EMTs), but they are assets within MiCA rather than outside it). To be sure, the European Union has broader regulatory power than the SEC and can therefore regulate assets that are non-securities more effectively, but the SEC might have been able to generate far more interest in the special purpose broker-dealer scheme if it had not expressly forbidden broker-dealers from transacting in crypto assets that are non-securities, and crypto asset securities that were not offered pursuant to a registration statement or an exemption.

Fortunately, the outlook is not entirely bleak on the US crypto regulatory landscape. The SEC's regulatory posture apart, there have been encouraging developments on the legislative front. Earlier this year, the House passed the Financial Innovation and Technology for the 21st Century (FIT21) bill by a large bipartisan majority.⁴⁵ That bill, among other things, seeks to clearly define the range of crypto assets over which the SEC and the Commodity Futures Trading Commission would have jurisdiction, and seeks to create a new regulatory framework for intermediaries in the crypto markets. FIT21 is yet to even be introduced into the Senate, and even if it were introduced, its passage is far from assured. Nevertheless, the basic approach that FIT21 represents, namely tailored regulations for the issuance of a defined and specific class of crypto assets, and for market participants trading in such assets, appears to clearly be a step in the right direction.

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NOTES

- ¹ See "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>.
- ² "[U]ncertificated securities where the issuer or a transfer agent maintains a traditional single master security holder list, but also publishes as a courtesy the ownership record using distributed ledger technology. While the issuer or transfer agent may publish the distributed ledger, in these examples, the broker-dealers have asserted that the distributed ledger is not the authoritative record of share ownership." Division of Trading and Markets, US Securities and Exchange Commission, Office of General Counsel, Financial Industry Regulatory Authority, "Joint Staff Statement on Broker-Dealer

- Custody of Digital Assets” (July 8, 2019) (Joint Staff Statement), available at <https://www.sec.gov/newsroom/speeches-statements/joint-staff-statement-broker-dealer-custody-digital-asset-securities>.
- ³ See, e.g., Chairman Jay Clayton, Statement on Cryptocurrencies and Initial Coin Offerings, (Dec. 11, 2017), available at <https://www.sec.gov/newsroom/speeches-statements/statement-clayton-2017-12-11>.
- ⁴ 15 U.S.C. § 77a-bbbb; 15 U.S.C. § 78. The two provisions have been interpreted by courts to be identical. See *Tcherepnin v. Knight*, 389 U.S. 332, 342 (1967).
- ⁵ *SEC v. W.J. Howey*, 328 U.S. 293 (1946).
- ⁶ *Reves v. Ernst & Young*, U.S. 56 (1990). The *Reves* test, while less commonly resorted to than *Howey*, has also been an important method by which the SEC has sought to assert jurisdiction over debt-like crypto assets, or debt-like arrangements involving crypto assets. See, e.g., In the Matter of BlockFi Lending LLC, SEC Order, (Feb. 14, 2022), available at <https://www.sec.gov/litigation/admin/2022/33-11029.pdf>.
- ⁷ *Howey*, 328 U.S. at 299.
- ⁸ *Id.* at 301.
- ⁹ *SEC v. Glenn W. Turner Enterprises*, 474 F.2d 476, 482 (9th Cir.), cert. denied, 414 U.S. 821, 94 S. Ct. 117, 38 L. Ed. 2d 53 (1973).
- ¹⁰ 15 U.S.C. § 77e.
- ¹¹ Gary Gensler, Remarks Before the Aspen Security Forum, (Aug. 3, 2021), available at <https://www.sec.gov/newsroom/speeches-statements/gensler-aspen-security-forum-2021-08-03>.
- ¹² See William Hinman, Director, Division of Corporation Finance, “Digital Asset Transactions: When Howey Met Gary (Plastic)”, available at <https://www.sec.gov/newsroom/speeches-statements/speech-hinman-061418>. (“And so, when I look at Bitcoin today, I do not see a central third party whose efforts are a key determining factor in the enterprise. The network on which Bitcoin functions is operational and appears to have been decentralized for some time, perhaps from inception.”)
- ¹³ *SEC v. Binance Holdings Ltd., et al.*, No. 23 Civ. 1599, ECF No. 248 (D.D.C. June 28, 2024).
- ¹⁴ See, e.g., *SEC v. Binance Holdings Ltd., et al.*, No. 23 Civ. 1599, ECF No. 248 (D.D.C. June 28, 2024); *SEC v. Ripple Labs, Inc.*, No. 20 Civ. 10832, ECF No. 874 (S.D.N.Y. July 13, 2023).
- ¹⁵ *SEC v. Ripple Labs, Inc.*, No. 20 Civ. 10832, ECF No. 874 (S.D.N.Y. July 13, 2023).
- ¹⁶ See, e.g., *SEC v. Terraform Labs Pte Ltd.*, No. 1:23 Civ. 01346 (JSR), ECF No. 51 (S.D.N.Y. July 31, 2023).
- ¹⁷ Section 5 of the Exchange Act makes it unlawful for any broker, dealer, or exchange, directly or indirectly, to effect any transaction in a security, or to report any such transaction, in interstate commerce, unless the exchange is registered as a national securities exchange under Section 6 of the Exchange Act, or is exempted from such registration. See 15 U.S.C. §78e.
- ¹⁸ One frequently used exemption is for alternative trading systems (ATS). Exchange Act Rule 3a1-1(a)(2) exempts from the definition of “exchange” under Section 3(a)(1) an ATS that complies with Regulation ATS, which includes, among other things, the requirement to register as a broker-dealer and file a Form ATS with the Commission to provide notice of the ATS’s operations.
- ¹⁹ Section 3(a)(4) of the Exchange Act generally defines a “broker” to mean any person, including a company, engaged in the business of effecting transactions in securities for the account of others. Section 3(a)(5) of the Exchange Act generally defines a “dealer” to mean any person, including a company, engaged in the business of buying and selling securities for such person’s own account through a broker or otherwise. Section 15(a) of the Exchange Act provides that, absent an exception or exemption, it is unlawful for any broker or dealer “to...effect any transactions in, or to induce or attempt to induce the purchase or sale, of any security...unless such broker or dealer is registered in accordance” with Section 15(b) of the Exchange Act.
- ²⁰ See, e.g., “Coinbase Petition for Rulemaking—Digital Asset Securities Regulation,” (July 21, 2022) available at <https://www.sec.gov/files/rules/petitions/2022/petn4-789.pdf>.

- ²¹ See, e.g., SEC v. Terraform Labs Pte Ltd., No. 1:23 Civ. 01346 (JSR), ECF No. 51 (S.D.N.Y. July 31, 2023).
- ²² See, e.g., In the Matter of Impact Theory, LLC, SEC Order, (August 28, 2023); In the Matter of Stoner Cats 2, LLC, SEC Order, (September 13, 2023).
- ²³ See Joint Staff Statement, which observes that “Various unregistered entities that intend to engage in broker-dealer activities involving digital asset securities are seeking to register with the Commission and have submitted New Membership Applications (NMAs) to FINRA. Additionally, various entities that are already registered broker-dealers and FINRA members are seeking to expand their businesses to include digital asset securities services and activities.”
- ²⁴ See Joint Staff Statement, generally.
- ²⁵ See Joint Staff Statement, under “Noncustodial Broker-Dealer Models for Digital Asset Securities.”
- ²⁶ SEC Division of Trading and Markets No-Action Letter to FINRA (Sept. 25, 2020) available at <https://www.sec.gov/divisions/marketreg/mr-noaction/2020/finra-ats-role-in-settlement-of-digital-asset-security-trades-09252020.pdf>.
- ²⁷ “SEC Statement and Request for Comment on Custody of Digital Asset Securities by Special Purpose Broker-Dealers”, 86 Fed. Reg. 11627 (Feb. 26, 2021).
- ²⁸ *Id.* at 11631-11632.
- ²⁹ *Id.* at 11631.
- ³⁰ *Id.*
- ³¹ To our knowledge, these are Prometheus and tZero. See Jesse Hamilton, “Prometheus, The Only U.S.-Registered Crypto Platform, Picks Ether as Its First Product,” *CoinDesk* (Feb. 7, 2024), available at <https://www.coindesk.com/policy/2024/02/07/prometheus-the-only-us-registered-crypto-platform-picks-ether-as-its-first-product/>; “tZERO Receives Landmark Approval To Custody Digital Securities and Support End-to-End Digital Securities Lifecycle in the United States” (Sept. 10, 2024), available at <https://www.prnewswire.com/news-releases/tzero-receives-landmark-approval-to-custody-digital-securities-and-support-end-to-end-digital-securities-lifecycle-in-the-united-states-302242412.html>.
- ³² Regulatory Notice 21-25, “FINRA Continues to Encourage Firms to Notify FINRA if They Engage in Activities Related to Digital Assets”, (July 8, 2021), available at <https://www.finra.org/rules-guidance/notices/21-25>. FINRA has consistently asked that each member firm promptly notify its risk monitoring analyst if it, or its associated persons or affiliates, currently engages, or intends to engage, in any activities related to digital assets. Notably, FINRA uses the term “asks,” rather than “requires,” regarding the need to inform risk monitoring analysts of crypto asset activity. See Regulatory Notice 21-25, see also Regulatory Notice 18-20, “FINRA Encourages Firms to Notify FINRA if They Engage in Activities Related to Digital Assets” (July 6, 2018), Regulatory Notice 19-24, “FINRA Encourages Firms to Notify FINRA if They Engage in Activities Related to Digital Assets” (July 18, 2019), Regulatory Notice 20-23, “FINRA Encourages Firms to Notify FINRA if They Engage in Activities Related to Digital Assets” (July 9, 2020).
- ³³ 17 CFR § 275.206(4)-2.
- ³⁴ 17 CFR § 275.206(4)-2(a)(1).
- ³⁵ 17 CFR § 275.206(4)-2(d)(6).
- ³⁶ 17 CFR § 275.206(4)-2(a)(1).
- ³⁷ 17 CFR § 275.206(4)-2(a)(3); 17 CFR § 275.206(4)-2(a)(4).
- ³⁸ See *supra* n.31.
- ³⁹ See Safeguarding Advisory Client Assets, 88 Fed. Reg. 14672, 14740 (Mar. 9, 2023).
- ⁴⁰ *Id.*
- ⁴¹ Division of Investment Management Staff in Consultation with FinHub Staff, 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/newsroom/speeches-statements/statement-im-finhub-wyoming-nal-custody-digital-assets>.
- ⁴² Safeguarding Advisory Client Assets, 88 Fed. Reg. at 14740.
- ⁴³ *Id.* at 14689.

⁴⁴ See generally, Scott Walker & Neel Maitra, *Crypto Asset Custody by Investment Advisers After the SEC's Proposed Safeguarding Rule*, *The Review of Securities and Commodities Regulation*, Vol. 56, No. 6 (Mar. 22, 2023) at 75. 17 L

⁴⁵ “House Passes Financial Innovation and Technology for the 21st Century Act with Overwhelming Bipartisan Support,” (May 22, 2024), available at <https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=409277>.