Securities Regulation Genesis Block Proposal

Ms. Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

via email

Re: Public Request for Rulemaking: Securities Regulation Genesis Block Proposal

Dear Ms. Countryman,

This public request for rulemaking, in the form of a recommended SEC call for comment regarding digital asset regulation, is being submitted by J.W. Verret. I am an Associate Professor at the George Mason University Antonin Scalia School of Law where I teach corporate, securities and banking law and accounting. I am also a member of the SEC's Investor Advisory Committee.[1]

I write to request that the Securities and Exchange Commission issue an open call for comment from the public regarding the need for flexibility in the application of the federal securities laws to digital assets. This call for comment might function as a "genesis block" for the SEC to initiate an open-sourced redesign of regulations enforced pursuant to the Securities Act of 1933 ("33 Act'), Securities Exchange Act of 1934 ("34 Act"), the Investment Advisers Act and Investment Company Act ("40 Acts") and other laws enforced by the SEC.

I am submitting this communication using the SEC's process for a public request for rulemaking, but I am asking merely for the SEC to open a call for public comment. This request is consistent with the logic of similar prior requests for information ("RFIs") by banking regulators regarding the unique design of digital assets.[2] The SEC has similarly opened up calls for public comment when complex and novel questions of securities regulation are at issue, as with Acting Chair Lee's call for public comment on climate disclosure in early 2021.[3]

By way of the statement of personal interest required for requests for rulemaking, I submit a number of reasons for my request.

First, I am an investor in a number of cryptocurrencies, including Bitcoin, Ether, and a number of layer 1 and layer 2 tokens readily available on top tier exchanges that have all received a low rating of the risk of *Howey* "investment contract" determination from the Crypto Rating Council.

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[1] I do not imply that my views represent those of any group of which I am a member or indirectly affiliated with, including George Mason Law School or the SEC or the SEC IAC.
[2] See https://www.fdic.gov/news/press-releases/2021/pr21046.html.
[3] See https://www.sec.gov/news/public-statement/lee-climate-change-disclosures

Based on my own further analysis, none of the tokens in which I am invested are properly classified as securities under the '33 or '34 Acts.

Unfortunately and nevertheless, under the SEC's "strategically ambiguous"[4] interpretation of the *Howey* test regarding classification of investment contracts, I cannot be certain that the SEC will not in the future target one of my token holdings, under the guise of the Commission's investor protection mission, in a manner that would ultimately cause me significant losses as a property owner.

As a property owner in the class of individuals the SEC often purports to protect, I would submit that I fear the SEC may significantly harm me if it continues on its current course.

Second, as a professor of securities law, I have an interest in consistent application of law. It is my considered view that the SEC's current interpretation of the *Howey* test for determination of investment contracts represents a substantial departure from the Supreme Court's clear language in *SEC v. Howey*.

The SEC's present course appears to be one designed to strategically bring cases using the *Howey* test as a weapon against tokens (and token trading services and technologies) which cannot reasonably be registered as securities (or securities exchanges) under the regulations promulgated pursuant to the '33 and '34 Acts, even if they wanted to and were required to do so (despite neither necessarily being true).[5] I believe this is ultimately a losing strategy for the SEC as an institution.

This strategy of obtusely expanding legal doctrine is one that has led the SEC to disaster at the U.S. Supreme Court in the past, and I believe the SEC's current interpretation of the *Howey* test for investment contracts stands at the precipice of such a transformational Supreme Court reversal for the Commission if it continues on its present course.

A better path forward would be to appreciate that digital assets, by their very design, do not fit within the classic framework of regulations designed for equity investments in firms led by boards of directors. None of the above are true for many tokens in the digital asset space which the SEC appears to want to capture within the mandatory registration framework using the "investment contract" test, but which the SEC knows cannot comply with the 88-year old legacy framework of many regulations adopted under the '33 and '34 Acts.

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[4] Commissioner Hester M. Peirce, Remarks before the Investment Advisory Committee, December 2, 2021 (*"The SEC has not provided clarity in response to repeated questions on crypto from reputable players, but has instead embraced an approach that has been described aptly to me as "strategic ambiguity." Such an approach facilitates enforcement actions, but it is costly and treacherous for well-intentioned developers and their lawyers."*). See also Commissioners Hester M. Peirce and Elad L. Roisman, Statement in the matter of Coinschedule ("*There is a decided lack of clarity for market participants around the application of the securities laws to digital assets and their trading, as is evidenced by the requests each of us receives for clarity and the consistent outreach to the Commission staff for no-action and other relief.*")

[5] Commissioner Hester M. Peirce, Statement in the Matter of Poloniex, LLC

Third, as an individual member of the SEC's Investor Advisory Committee, I would hope that the thoughtful panel we hosted last year will be reflected in SEC rulemaking, and I believe this call for comment is the best way to begin that process.[6]

Digital assets represent over $2 trillion in value. Chair Gensler has suggested in a number of public statements that digital asset projects should "just come in and talk to us."[7] And yet some groups may be reluctant to do so out of concern that engaging with the SEC may make their project the next enforcement target of the SEC.

The SEC should appropriately open a public call for comment about digital asset regulation. SEC Commissioners have asked to be contacted individually and suggested that developers reach out to them with questions,[8] and that they should contact Finhub to similarly share issues.

While those avenues are no doubt helpful, as they recognize that the securities laws do not presently fit the parameters of many "crypto" or "defi" projects, these avenues of communication are no substitute for an open call for comment, guided by an initial catalogue of the wealth of uncertainty about how developers and market players could apply with existing rules via a series of questions, shared in one public forum easily accessible on the SEC's website.

This open call for comment is the only way to appropriately crowd source this issue and appropriately develop a digital asset regulation Genesis Block.

An open call for comment could function as the genesis block for a new version of Securities Regulation that better protects owners and developers in digital asset projects that want to register or seek an exemption, and can begin to offer regulatory clarity to developers who are clearly outside the reach of the '33, '34 and '40 Acts who do not need to register or seek an exemption.

This open call for comment wouldn't commit the SEC to doing anything, but it would generate useful feedback in an open forum. It would also allow parties concerned about becoming an enforcement target as a result of their sharing problems to submit comments anonymously, thereby allowing them to participate in the regulatory conversation without exposing them to risk of being targeted because of the communication.

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[6] As noted before, I am clearly not speaking on behalf of the SEC IAC. See https://www.sec.gov/video/webcast-archive-player.shtml?document_id=iac120221-1

[7] https://cointelegraph.com/news/sec-chair-doubles-down-tells-crypto-firms-come-in-and-talk-to-us

[8] For example, see https://gbbcouncil.org/wp-content/uploads/2021/11/IJBL-1.pdf, in which Commissioner Crenshaw asks DeFi developers in FN 25 of her speech for additional feedback utilizing a focused email address that she has created in an earnest effort to commence a dialogue. ("In a recent speech I requested input from digital assets market participants. See "Digital Asset Securities– Common Goals and a Bridge to Better Outcomes,"SEC Speaks, Oct. 12, 2021. Unfortunately, that has not yet yielded much of a response from a community that often says it lacks necessary guidance from the SEC, among others. My door remains open, and I welcome your ideas. I've created a dedicated mailbox for this purpose: Crenshaw-defi@sec.gov.")

I am writing with this request in part because I appreciate the frustration experienced by many developers over the SEC's current "strategically ambiguous" stance on digital assets. In my securities law course, I try to instruct future securities lawyers in how to promote compliance and protect clients from regulatory uncertainty. I know that in that course we have had many classes poring over some nearly impossible questions that developers who want to register their token offering would face, and we have had classes with some heated debates over the proper application of the *Howey* test. I expect that sophisticated conversations of that vein also regularly occur at the staff level at the Commission, particularly at FinHub.

The current rhetoric from the SEC's leadership that developers simply "must register unless they have an exemption" and should "come in and talk to us" does not match that reality and does a disservice to the thoughtful conversations going on at the SEC staff level with digital asset market participants.

Therefore an open call for comment from the digital asset community about the extraordinary depth of amendments and exemptive relief that will be required from the SEC, across all of its Divisions, for many token-based projects to voluntarily register as securities, obtain certainty about the fact that they do not need to register, or alternatively obtain some new non-securities exempt classification, will be essential if the Chairman's notion that digital asset firms or exchanges should "just come in and talk to us" is ever to be taken at face value by members of the digital asset community.

Here is a list of some questions that the SEC should include in the call for comment I suggest in this request. This list of questions is only a beginning of what will no doubt result in hundreds of questions which will need to be contained in a legitimate call for comment. We have to start somewhere, this list of questions below is merely an initial brainstorm.

I appreciate the Commission and the Staff's consideration of this request for the SEC to conduct an open call for comment and thereby write the initial Genesis Block that transforms securities regulation for the 21st century. It is my sincere hope that this is only the beginning of a continued dialogue and open-sourced process.

If my experience in exploring these issues with the sophisticated, compliance focused, and thoughtful securities and corporate attorneys in the digital asset community (e.g., the members of LexDao[9] or LexPunk[10]) are any indication, this recommendation will result in an unparalleled wealth of useful insights for Commission consideration.

Suggested Questions to include in Call for Comment to establish a core Digital Asset Regulation Genesis Block:

What unique investor protections can be designed around digital assets? To what extent do the design of many digital assets, particularly those in the DeFi space, eliminate the need for

[9] https://lexdao.substack.com/
[10] https://www.lexpunk.army/

investor protections contained in the existing regime for publicly traded firms? To what extent do their designs call for different kinds of investor protections (for example, disclosures about software testing, auditing, conflicts, token economics, etc.[11]) than those called for by current securities disclosure regimes?

To what extent does the design of blockchain based tokens in decentralized projects eliminate issues of information asymmetry or conflicts of interest that underlie many aspects of securities regulations? To what extent are new types of conflicts of interest created?

How do the federal securities laws need to be amended to holistically take into account unique aspects of token offerings? By way of just one example, the fact that some tokens may be appropriately classified as securities in the initial distribution, but may later no longer be appropriately classified as securities after the network gets up and running and full decentralization is achieved, may require holistic amendment to a number of assumptions underlying rules promulgated pursuant to the 33 and 34 Acts.

What minimum requirements will the SEC attach to any future Bitcoin spot ETF approval? Have those requirements been consistently applied to previous ETF approvals?

How would Reg NMS need to be adapted to allow digital assets to trade on registered exchanges? How would concepts like best execution be measured in the digital asset space?

Commissioner Peirce asks a number of questions in the Commission's settlement with respect to the Poloniex Matter that will need to be included in the Commission's open call for comment, her questions are quoted below:

> "Assuming Poloniex or another crypto trading platform determines to register with us as an exchange or an ATS, we need to answer a number of questions, including:

- Can the platform custody client assets, a feature typical of centralized crypto trading platforms? If so, how, given our concerns about custody of digital asset securities?
- If not, could a sufficient number of broker-dealers navigate the registration process to make a liquid market?
- Would the conditions placed on their registration permit them to function as market makers or to facilitate trading on behalf of retail investors?
- Can the platform trade non-securities alongside securities? If not, how can the platform, using two entities—a broker-dealer entity for digital asset securities, and an affiliated non-broker-dealer entity for non-securities, offer a seamless, or at least serviceable, trading platform to customers, who are likely, for example, to want to trade both digital

[11] For a list of suggested model disclosures, see Yuliya Guseva, WHEN THE MEANS UNDERMINE THE END: THE LEVIATHAN OF SECURITIES LAW AND ENFORCEMENT IN DIGITAL-ASSET MARKETS, The Stanford Journal of Blockchain Law & Policy (forthcoming 2022), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3694709.

assets and digital asset securities and pay for transactions in digital asset securities using non-security digital assets?
- How can a trading platform and its customers determine whether a particular digital asset is a security?
- If a token was sold in a securities offering as part of an investment contract, how long must secondary transactions in that token be deemed to be securities transactions by platforms trading the tokens?
- What are the mechanics of registering tokens sold as part of an investment contract as a class of "equity security" under the Exchange Act?"[12]

In what ways do the '33 and '34 Acts need to adapt to consider the unique design of Defi and other blockchain projects? '33 Act concepts like "underwriter" and "control person" are a difficult fit here, should the SEC exempt decentralized projects from those concepts?

If the text of a prospectus is built into the ledger does it count as delivery?

Can DAO governance models provide for seamless shareholder engagement and shareholder empowerment in ways that eliminate the need for rules like 14a-8? Should DAO projects that may choose to register with the SEC, that utilize governance tokens and thereby do not require proxy voting, simply be exempt from the proxy rules?

How should projects that are classified as securities by the SEC, but that function as cryptocurrency (with a foundation that curates the ledger) account for the foundation on its books? The foundation is a separate entity, but foundations also often provide technical support or market making to the network.[13] This model doesn't quite fit the entity assumption that underlies existing GAAP. Concepts in GAAP like related parties, special purpose vehicles, and subsidiary consolidation do not quite fit this unique relationship.

To what extent will the SEC consolidate disparate entities collectively as the issuer of securities in a token offering, as it suggested it may do in the comments regarding Blockstack's Regulation A registration? Is that approach inconsistent with the approach the SEC has taken in administration of the '40 Acts, which treat related companies as distinct entities (investment fund vs. fund adviser), and in various aspects of broker-dealer regulation?

To what extent are the '40 Acts an inappropriate fit for projects where the initial developer continues to hold tokens after decentralization?

The SEC's call for comment should further request comment regarding a number of thoughtful proposals that have already been developed for how the SEC might address the unique needs of digital assets. Those proposals include, without limitation, Commissioner Peirce's proposal

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[12] https://www.sec.gov/news/public-statement/pierce-statement-poloniex-080921#_ftn7

[13] I will have to agree to disagree with the SEC that those activities will by themselves meet the *Howey* test.

for a three-year safe harbor[14] and a subsequent version[15] that "forks" her safe harbor developed by attorneys in the digital asset community that offers a more detailed safe harbor with recommended standardized disclosures for token distributions.

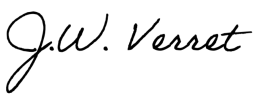
The questions presented in this communication are just the beginning. If the SEC issues this recommended call for comment, it will doubtless lead to even more questions than answers. It would nevertheless be the beginning of a constructive dialogue that can promote both investor protection and capital formation in the digital asset sector and provide meaningful guidance and clear rules of the road for developers.

This can be the genesis block, and all five SEC Commissioners have a unique opportunity to stake this development with their own priorities via the design of the call for comment.

This Digital Asset Reg Genesis Block can commence an interactive process that can make securities regulation more flexible, more robust, and ultimately better protect investors.

Chair Gensler has asked for the digital asset community to "come in and talk to us." Consider this request for a Commission level "Genesis Block" call for public comment regarding unique issues presented by digital assets as my knock on the door of your office.

Sincerely,



J.W. Verret

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Member, SEC Investor Advisory Committee

[14] https://www.sec.gov/news/public-statement/peirce-statement-token-safe-harbor-proposal-2.0
[15] See extensive safe harbor proposal available at https://github.com/lex-node/SafeHarbor-X/.