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Statement on the Financial Innovation and Technology for the 21st Century Act
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Introduction

For 90 years, the federal securities laws have played a crucial role in protecting the public. These critical protections were created in the wake of the Great Depression after many Americans suffered the consequences of inadequately regulated capital markets. We saw sky-high unemployment, bread lines, and shantytowns springing up due to mass foreclosures.

Back then, the rules didn't exist. That's why President Roosevelt and Congress created the SEC and the laws it administers.

At their core is the critical concept of registering securities that will be offered to the public and registering the intermediaries that facilitate the exchange of those securities. For securities, registration means that issuers provide robust disclosures and are liable if their material statements are untruthful. For intermediaries, registration brings with it rulebooks that prevent fraud and manipulation, safeguards against conflicts of interest, proper disclosures, segregation of customer assets, oversight by a self-regulatory organization, and routine inspection by the SEC.

Today, these rules do exist.

Many market participants in the crypto industry, however, have shown their unwillingness to comply with applicable laws and regulations for more than a decade, variously arguing that the laws do not apply to them or that a new set of rules should be created and retroactively applied to them to excuse their past conduct. Widespread noncompliance has resulted in widespread fraud, bankruptcies, failures, and misconduct.[1] As a result of criminal charges and convictions, some of the best-known leaders in the crypto industry are now in prison, awaiting sentencing, or subject to extradition back to the United States.

The SEC, during both Republican and Democratic Administrations, has allocated enforcement resources to holding crypto market participants accountable. Courts have time and

[1] *See* Chainalysis, "2024 Crypto Crime Trends: Illicit Activity Down as Scamming and Stolen Funds Fall, But Ransomware and Darknet Markets See Growth" (Jan. 18, 2024), *available at* https://www.chainalysis.com/blog/2024-crypto-crime-report-introduction/ (Independent analysts found more than $24 billion in crypto assets transferred via illicit computer addresses, almost $15 billion of which were from U.S.-sanctioned computer addresses); *See also* Khristopher J. Brooks, CBS News, "Cryptocurrency fraud is now the riskiest scam for consumers, according to BBB" (March 6, 2024), *available at* https://www.cbsnews.com/news/crypto-scam-risk-bbb-report/ (Retail investor fraud in crypto is rampant. Eighty percent of individuals targeted by crypto scams lost money, with 67,000 scams with a median amount lost of $3,800, according to data from the Better Business Bureau); *See also* Federal Bureau of Investigation, "Internet Crime Report 2023," *available at* https://www.ic3.gov/Media/PDF/AnnualReport/2023_IC3Report.pdf (Approximately $3.94 billion in crypto assets was stolen in scams in 2023.).

again agreed with the SEC, ruling that the securities laws apply when crypto assets or crypto-related investment schemes are offered or sold as investment contracts.[2]

The Financial Innovation and Technology for the 21st Century Act

The Financial Innovation and Technology for the 21st Century Act ("FIT 21") would create new regulatory gaps and undermine decades of precedent regarding the oversight of investment contracts, putting investors and capital markets at immeasurable risk.

First, the bill would remove investment contracts that are recorded on a blockchain from the statutory definition of securities and the time-tested protections of much of the federal securities laws.

Further, by removing this set of investment contracts from the statutory list of securities, the bill implies what courts have repeatedly ruled – but what crypto market participants have attempted to deny – that many crypto assets are being offered and sold as securities under existing law.

Second, the bill allows issuers of crypto investment contracts to self-certify that their products are a "decentralized" system and then be deemed a special class of "digital commodities"

[2] *See*, e.g., *SEC v. Coinbase, Inc*., 2024 U.S. Dist. LEXIS 56994, at *3, *43 (S.D.N.Y. Mar. 27, 2024) (explaining that "the challenged transactions fall comfortably within the framework that courts have used to identify securities for nearly eighty years"); *SEC v. Genesis Glob. Capital, LLC*, No. 23-cv-00287 (ER), 2024 U.S. Dist. LEXIS 44372, at *44-45 (S.D.N.Y. Mar. 13, 2024) ("Under both *Howey* and Reves, the SEC has plausibly alleged that Defendants offered and sold unregistered securities through the Gemini Earn program."); *SEC v. Wahi*, No. 2:22-cv-01009-TL, 2024 U.S. Dist. LEXIS 36788, at *21 (W.D. Wash. Mar. 1, 2024) (holding that, "under *Howey*, all of the crypto assets that Ramani purchased and traded were investment contracts," including to the extent that the assets were traded on the secondary market); *SEC v. Terraform Labs Pte. Ltd.*, No. 23-cv-1346 (JSR), 2023 U.S. Dist. LEXIS 230518, at *43 (S.D.N.Y. Dec. 28, 2023) (stating that "*Howey's* definition of 'investment contract' was and remains a binding statement of the law, not dicta" and finding that "[t]here is no genuine dispute that the elements of the *Howey* test – '(i) investment of money (ii) in a common enterprise (iii)with profits to be derived solely from the efforts of others' [ ] have been met for UST, LUNA, wLUNA, and MIR [the crypto assets at issue]"); *SEC v. Ripple Labs, Inc.*, 20-cv-10832 (AT), 2023 U.S. Dist. LEXIS 120486, at *19-20 (S.D.N.Y. July 13, 2023) (rejecting defendants' argument that, in addition to satisfying the *Howey* test, all investment contracts must contain certain additional "essential ingredients" and finding that Ripple's institutional sales of its XRP crypto token constituted the unregistered offer and sale of investment contracts and therefore securities); *SEC v. Terraform Labs Pte. Ltd.*, No. 23-cv-1346 (JSR), 2023 U.S. Dist. LEXIS 132046, at *21-22 (S.D.N.Y. July 31, 2023) (rejecting argument that the Major Questions Doctrine "prevent[s] the SEC from alleging the company's digital assets to be 'investment contracts'" and explaining that "Defendants cannot wield a doctrine intended to be applied in exceptional circumstances as a tool to disrupt the routine work that Congress expected the SEC and other administrative agencies to perform."); *SEC v. LBRY, Inc.*, 639 F. Supp. 3d 211, 221–22 (D.N.H. 2022) (granting summary judgment for SEC and rejecting fair notice defense, explaining that "[t]he SEC has not based its enforcement action here on a novel interpretation of a rule that by its terms does not expressly prohibit the relevant conduct. Instead, the SEC has based its claim on a straightforward application of a venerable Supreme Court precedent that has been applied by hundreds of federal courts across the country over more than 70 years."); *SEC v. NAC Found., LLC*, 512 F. Supp. 3d 988, 994 (N.D. Cal. 2021) (denying motion to dismiss and noting that motion "falls well short of demonstrating that the SEC's characterization of ABTC as a 'security' is implausible for pleading purposes"); *SEC v. Kik Interactive Inc.*, 492 F. Supp. 3d 169, 174, 182–84 (S.D.N.Y. 2020) (granting SEC summary judgment on grounds that Kik offered digital currency Kin as a security); *SEC v. Telegram Grp. Inc.*, 448 F. Supp. 3d 352, 371 (S.D.N.Y. 2020) (granting the SEC's motion for a preliminary injunction notwithstanding Telegram's argument that investors "bought Grams with the expectation to use them as currency" and not "with an expectation of profit").

and thus not subject to SEC oversight. Whether something is a "digital commodity" would be subject to self-certification by "any person" that files a certification. The SEC would only have 60 days to review and challenge the certification that a product is a digital commodity. Those that the SEC successfully challenges would be re-classified as restricted digital assets and subject to the bill's lighter-touch SEC oversight regime that excludes many core protections. There are more than 16,000 crypto assets that currently exist. Given limits on staff resources, and no new resources provided by the bill, it is implausible that the SEC could review and challenge more than a fraction of those assets. The result could be that the vast majority of the market might avoid even limited SEC oversight envisioned by the bill for crypto asset securities.

Third, the bill's regulatory structure abandons the Supreme Court's long-standing *Howey* test that considers the economic realities of an investment to determine whether it is subject to the securities laws. Instead, the bill makes that determination based on labels and the accounting ledger used to record transactions. It is akin to determining the level of investor protection based on whether a transaction is recorded in a notebook or a software database. But it's the economic realities that should determine whether an asset is subject to the federal securities laws, not the type of recordkeeping ledger. The bill's result would be weaker investor protection than currently exists for those assets that meet the *Howey* test.

Fourth, for those crypto investment contracts that would still fall under the SEC's remit, the bill seeks to replace Roosevelt's investor protection framework with fewer protections than investors are afforded in every other type of investment. Doing so increases risk to the American public.

Fifth, the bill specifically excludes crypto asset trading systems from the definition of an exchange and thus removes, for investors on crypto asset trading platforms, the protections that benefit investors on registered exchanges. These crypto trading platforms would be able to legally comingle their functions in a way that fosters conflicts of interest, may allow trading against their customers, and reduces custody protections for their customers.

Sixth, the legislation creates an exemption from regulation under this Act for any entity or organization that falls under a broadly defined category called "Decentralized Finance." Any number of firms would qualify for the exemption, regardless of potential conflicts of interest. This would include firms that intermediate crypto securities transactions.

Finally, the bill could be read to functionally eliminate the current Regulation A and Regulation D offering restrictions for crypto securities by creating a new exempt offering framework. Non-accredited investors would be allowed to purchase crypto assets worth up to 10 percent of their net worth or annual income before the issuer would be required to provide any disclosure. That's a lot of risk for ordinary investors to take on without disclosure.

Risks to the Broader Capital Markets

The self-certification process contemplated by the bill risks investor protection not just in the crypto space; it could undermine the broader $100 trillion capital markets by providing a path for those trying to escape robust disclosures, prohibitions preventing the loss and theft of customer

funds, enforcement by the SEC, and private rights of action for investors in the federal courts. It could encourage non-compliant entities to try to choose what regulatory regimes they wish to be subjected to – not based on economic realities, but potentially based on a label.

What if perpetrators of pump and dump schemes and penny stock pushers contend that they're outside of the securities laws by labeling themselves as crypto investment contracts or self-certifying that they are decentralized systems? The SEC would only have 60 days to contest their self-certification.

Conclusion

History has shown for 90 years that robust securities regulation both creates trust in markets and fosters innovation. There are countless examples of American companies across many industries that have made world-changing innovations while also registering their securities. It is through the securities laws that we get full, fair, and truthful disclosure that arms investors with the information they need to make investment decisions and enables regulators to guard against the types of fraud we've seen in the crypto field.

The crypto industry's record of failures, frauds, and bankruptcies is not because we don't have rules or because the rules are unclear. It's because many players in the crypto industry don't play by the rules. We should make the policy choice to protect the investing public over facilitating business models of noncompliant firms.