CENTRAL EUROPEAN UNIVERSITY

PROTECTION OF INVESTORS INTO CRYPTO ASSETS – THE CASE OF THE UNITED STATES

by Vi Tuong Duong

LLM Capstone Thesis
SUPERVISOR: Tibor Tajti
Central European University Private University
Quellenstrasse 51-55, 1100 Vienna
Austria

June 16, 2023

TABLE OF CONTENTS

List of Abbreviations 3

Abstract 4

Introduction 5

1) The vulnerability of investors into crypto assets 5

2) Why the United States Federal Securities Laws? 6

3) Methodology 6

4) Structure of the thesis 7

CHAPTER 1 - DEFINITION OF SECURITIES UNDER THE UNITED STATES FEDERAL SECURITIES LAWS 8

1.1. What is a Security? 8

1.2. Crypto assets, investment contract and the Howey Test 9

1.2.1. First prong - an investment of money 10

1.2.2. Second prong - a common enterprise 11

1.2.3. Third prong - a reasonable expectation of profits to be derived from the efforts of others 13

CHAPTER 2 – TO BE OR NOT TO BE…SECURITIES? AN EXISTENTIAL QUESTION FOR CRYPTO ASSETS 15

2.1. The SEC's position in protecting crypto asset investors 15

2.2. The Howey Test – when failing a test is more relieved than passing it 15

2.3. The SEC's enforcement actions 21

2.3.1. Education tools.....21

2.3.2. Enforcement actions.....23

2.3.2.1. Effective enforcement actions with international cooperation 24

(i) Disgorgement 24

(ii) Freeze order.....25

2.3.3. The SEC's approach to crypto assets: clear or unclear? 26

Conclusion 32

Bibliography 33

LIST OF ABBREVIATIONS

Exchange Act	The Securities and Exchange Act of 1934
Framework	The Framework for "Investment Contract" Analysis of Digital Assets
Howey Case	SEC v. W.J. Howey Co., 328 U.S. 293 (1946)
ICO	Initial Coin Offering
IPO	Initial Public Offering
SEC	The U.S. Securities and Exchange Commission
Securities Act	The Securities Act of 1933

ABSTRACT

The development of technology has led to the emergence of many new investment forms, one of which is crypto assets. Although crypto assets might benefit investors in many ways, such as substantial profits, it is undeniable that the risks borne by investors are significantly higher than those associated with conventional investment vehicles like common stock. While several countries have banned crypto asset investment, the United States has taken a cautious approach to regulating it. One of the negative consequences of this approach has been the attempt by crypto asset businesses to find ways to avoid it, such as excluding US investors during initial coin offerings or labeling the crypto assets to avoid classification as securities. Regardless of how hard these businesses may try, investor protection efforts by US regulators continue to manifest in various forms of enforcement, despite controversial debates among the regulators themselves and the frustration of the crypto community.

By analyzing US statutory material, case law and public materials from relevant regulatory agencies regarding crypto assets, this thesis aims to provide an analysis of how investors in crypto assets are protected under US federal securities laws, and to draw conclusions about whether the regulatory responses of US regulators, with a specific focus on the SEC, benefit the investors. A brief discussion of the impact of such responses on crypto asset businesses will also be included in this thesis.

INTRODUCTION

1) The vulnerability of investors into crypto assets

In recent years, crypto assets[1] have experienced a surge in investment, as well as different regulatory reactions from various countries around the world, ranging from bans like China to welcoming policies like those of Malta. For investors, investing in crypto assets can result in either sweet fruit in the form of increased funds in their bank accounts or a bitter one in the form of losses. While some may argue that crypto assets are similar to other investment vehicles and that gains and losses are common in financial markets, they are actually unparalleled for one simple reason: crypto assets are largely unregulated.

This means that in cases of fraud, investors may still have hope of recovering their investment via legitimate protection means and remedies if what they invested in is regulated under the law, where remedies of classical branches of law are available. However, for something as new and rapidly developing as crypto assets, which appear to be ahead of and beyond the scope of current regulations, such hope may vanish or may not exist at all. While the speculative nature of crypto assets catches the attention of investors as potential investment opportunities, their vulnerability also makes them preferred options for criminal activities, such as frauds and scams. In addition, factors such as high volatility, market manipulation, lack of transparency,

[1] The U.S. Securities and Exchange Commission, 'SEC Proposes to Enhance Private Fund Reporting' (*SEC.gov*, 10 August 2022) <https://www.sec.gov/news/press-release/2022-141> accessed 1 June 2023.

In the proposal to amend sections of Form PF; Reporting Requirements for All Filers and Large Hedge Fund Advisers, the SEC defined the term "*crypto assets*" through the term "*digital assets*" as follows (content set in **bold** is intended solely for the purpose of emphasis):

"In connection with these proposed amendments, we propose to define the term "digital asset" as an asset that is issued and/or transferred using distributed ledger or blockchain technology ("distributed ledger technology"), including, but not limited to, so-called "virtual currencies," "coins," and "tokens."
These types of assets also are commonly referred to as "crypto assets.". We view these terms as synonymous. *We are proposing the term and definition to be consistent with the SEC's recent statement on digital assets, and we believe that such term and definition would provide a consistent understanding of the type of assets we intend to address. The SEC proposed to add the same term and definition to SEC's section of Form PF in the 2022 SEC Form PF Proposal. The definition is designed to help ensure that advisers report digital asset strategies accurately."*

In Footnote 111 of this proposal, the SEC noted that "*crypto assets*" is another industry term of "*digital assets*", which had been defined in the FSOC 2021 Annual Report of the Financial Stability Oversight Council <https://home.treasury.gov/system/files/261/FSOC2021AnnualReport.pdf> as below:

"Digital Asset
A digital asset is an electronic representation of value that may be issued or transferred using distributed ledger technology, including blockchain technology. Ownership may be established through cryptographic means. Digital assets include instruments that may qualify under applicable U.S. laws as securities, commodities, and security- or commodity-based instruments such as futures or swaps. Other industry terms used for these assets include cryptocurrencies, ***crypto assets****, virtual currencies, digital currencies, stablecoins, and crypto tokens."*

and limited access to investment information also render investors much more vulnerable when investing in crypto assets.

2) Why the United States Federal Securities Laws?

The United States has long been known as a jurisdiction with a well-established regulatory foundation for securities, whose primary goal is to protect investors and the integrity of the market. This foundation is actively regulated and overseen by a wide range of regulatory bodies and agencies, such as the SEC, with strong enforcement actions, making it one of the most powerful financial markets globally due to its market integrity, transparency, and fairness. The US has also been considered a role model jurisdiction for other countries in the world in several areas, and crypto assets are no exception. Given that the US has the largest number of crypto investors, investment funds, and crypto communities, including crypto exchanges and trading platforms[2], how this powerful jurisdiction regulates crypto assets with its extraterritorial effects can have a substantial impact on other legal systems and crypto businesses worldwide.

3) Methodology

By applying a doctrinal approach in this thesis, I will analyze statutory law, case law, and publicly available materials from regulatory agencies to answer the main question of how crypto asset investors are protected under United States federal securities laws. The publicly available materials will mostly come from the SEC, as several enforcement actions taken by this agency have been criticized for creating regulatory confusion for crypto asset businesses, resulting in fewer investment opportunities for US investors, such as US citizens being excluded from certain transactions involving crypto assets by ICO issuers. While answering the main question, the following sub-question will also be taken into account:

- Which enforcement actions are realistically helpful to protect investors in case transactions in relation to crypto assets are transnational?

While securities in the US can be governed by federal securities laws and the regulation of each state, known as "Blue Sky Laws"[3], the state securities laws will not be discussed as the purpose of this thesis aims to analyze the protection of investors on the federal level. During the process

[2] Susannah Hammond and Todd Ehret, 'Cryptocurrency Regulations by Country' (*thomsonreuters.com*, 2022) <https://www.thomsonreuters.com/en-us/posts/wp-content/uploads/sites/20/2022/04/Cryptos-Report-Compendium-2022.pdf> accessed 16 April 2023.

[3] The SEC's Office of Investor Education and Advocacy, 'Blue Sky Laws' (*Investor.gov*) <https://www.investor.gov/introduction-investing/investing-basics/glossary/blue-sky-laws> accessed 15 June 2023.

of researching and writing the thesis, I also found it challenging in finding an official definition for the term "*crypto assets*". This challenge arose due to the inconsistent use of terminology not only among the US regulators themselves but also between the US regulators and the sector. It became apparent that different regulatory bodies within the US utilized different terms to refer to the same concept or subject matter in relation to crypto assets, while simultaneously witnessing discrepancies between the language used by the regulators and that employed within the sector. This lack of consistency and coherence has contributed to the difficulty in obtaining a standardized definition for "*crypto assets*".

4) Structure of the thesis

This thesis is divided into two chapters as follows:

The first chapter will provide an overview of the securities regulation under the United States federal securities laws, with a focus on the definition of securities and its broad definition under the Securities Act of 1933 and the Securities and Exchange Act of 1934, and the general possibility of crypto assets being deemed as a security in the first subsection. The next subsection will provide the definition of an investment contract, a type of security under which transactions involving crypto assets are associated with and classified by US regulators, mostly by the SEC. The three elements in the Howey Test, a test that has been developed from the Howey Case in 1946[4] to identify the existence of an investment contract, will also be discussed in detail. This will include an examination of the differences in interpretation and application of those elements among the US courts and between the SEC and the courts.

The second chapter will focus on the enforcement actions taken against crypto assets by the SEC, including an analysis of whether these actions, which have been carried out in the name of investor protection, could have unintended negative consequences for investors. Furthermore, a discussion on which enforcement actions might be realistically efficient to protect crypto asset investors in transnational cases will be included. Additionally, the reactions of the crypto sector and other regulators towards the SEC's current approach over crypto assets will also form part of this chapter.

[4] *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

CHAPTER 1 - DEFINITION OF SECURITIES UNDER THE UNITED STATES FEDERAL SECURITIES LAWS

1.1. What is a Security?

In the US, when an investment vehicle is classified as a security, the federal securities laws can be applied. This means that the definition of a security determines whether the jurisdiction of federal securities laws applies or not. However, the question remains: What exactly constitutes a "*security*"? Although the Securities Act of 1933[5] and the Securities and Exchange Act of 1934[6] both provide text defining the term "security", these statutory definitions are incredibly broad, giving federal securities laws virtually unlimited power to classify any instrument as a security, "*unless the context otherwise requires*". The purpose for this breadth is, as frequently quoted by the U.S. Supreme Court[7] when settling cases determining whether an investment vehicle is a security such as in United Housing Found. v. Forman[8] or Reves v. Ernst & Young[9],

[5] Under Section 2(a)(1) of the Securities Act of 1933, the term "*security*" is defined as follows:
"The term ''security'' means 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, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a ''security'', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

[6] Section 3(a)(10) of the Securities and Exchange Act of 1934 gives the definition of "*security*" as below:
"The term ''security'' means any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a ''security''; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

[7] quoting H.R.Rep. No. 85, 73d Cong., 1st Sess., 11 (1933).
[8] *United Housing Found. v. Forman*, 421 U.S. 837, 847-48 (1975).
[9] *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

that in order to protect investors, U.S. Congress "*sought to define 'the term "security" in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security*." That is to say, security can literally mean anything, from identifiable instruments like bond, stocks to unusual one like contracts for sale of chinchillas[10], which is labelled as "investment contract". While unconventional investment vehicles such as contracts for selling chinchillas can still fall into the category of securities, new and trending ones like crypto assets, which are rapidly emerging in the financial landscape, might also find themselves being classified under the same category as the former.

1.2. Crypto assets, investment contract and the Howey Test

Crypto assets started their journey in 2008 when the mysterious Satoshi Nakamoto made the Bitcoin White Paper public, proposing "*a system for electronic transactions without relying on trust"*[11]. Since then, crypto assets have quickly blossomed in the financial markets, posing new legal issues for regulators worldwide, including those in the US, to solve.

Recent years have seen numerous regulatory actions in the United States concerning crypto assets, most of which are from The U.S. Securities and Exchange Commission regarding whether a transaction involving crypto assets is deemed a security under the US federal securities laws, i.e., the investment contract.

Although the term "*investment contract*" is listed in the definition of security in the Securities Act, it is left undefined[12] in both federal and state laws, including in the Securities Act and

[10] *Miller v. Cent. Chinchilla Grp., Inc.*, 494 F.2d 414 (8th Cir. 1974).
[11] Satoshi Nakamoto, 'Bitcoin: A Peer-to-Peer Electronic Cash System' (*bitcoin.org*, 2008) <https://bitcoin.org/bitcoin.pdf> accessed 16 April 2023.
[12] In *S.E.C. v. Howey Co.*, 328 U.S. 293 (1946), the court discussed the "*undefined*" investment contract as follows:

Exchange Act. Instead, its definition has been shaped through judicial interpretation, most notably in the case SEC v. W.J. Howey Co.[13]. This case law has created a crucial foundation for the widely used Howey Test, which is employed by courts and regulatory agencies such as the SEC to determine whether an investment contract exists in a given scenario. The Howey Test evaluates all of the following prongs to identify whether transactions, including those involving crypto assets, are subject to securities regulations: *(i) an investment of money (ii) in a common enterprise (iii) with a reasonable expectation of profits to be derived from the efforts of others*. Although both the courts and the SEC use the Howey Test as a standard for investment contracts, there are differences among the courts and between the courts and the SEC in the interpretation and application of the prongs. While the test serves as a tool to protect investors and the integrity of the markets, in my view, such differences may negatively impact investors' rights and benefits in certain situations.

1.2.1. First prong - an investment of money

The first prong of the Howey Test requires the existence of "*an investment of money*". While the wording taken from the Howey Case is "*money*", the investment made in question is not necessary to be always in the form of cash. It can be, as the U.S courts have ruled in several cases, "*goods and services*", or value exchange[14]. Significant rulings by courts have also

"The term "investment contract" is undefined by the Securities Act or by relevant legislative reports. But the term was common in many state "blue sky" laws in existence prior to the adoption of the federal statute and, although the term was also undefined by the state laws, it had been broadly construed by state courts so as to afford the investing public a full measure of protection."

[13] In *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), the term "*investment contract*" was defined as follows:
"For purposes of the Securities Act, an investment contract (undefined by the Act) means a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise."
[14] *Uselton v. Comm. Lovelace Motor Freight, Inc.*, 940 F.2d 564, 574 (10th Cir. 1991).

recognized that investment made in Bitcoin can constitute an investment of money[15], making the application of the Howey Test more applicable and flexible to the crypto asset context.

1.2.2. Second prong - a common enterprise

This prong has seen courts over the US take different approaches towards it in determining whether this second element in the Howey Test is met since there is no official definition to answer the question of what is a "*common enterprise*". Assessment can be made either on the relationship among the investors or that between the investors and the promoter. The current popular approaches are as follows:

- **Horizontal commonality**

  Under the view of courts adopting horizontal commonality approach, relationship among the investors, "pooling of funds" and "pro-rata basis" are crucial factors that determine the presence of a common enterprise. That is, a common enterprise exists when there is pooling of funds from multiple investors and each investor will be entitled to benefits or suffer loss on a pro-rata based on their fund contribution.

- **Vertical commonality**

  While courts in favor of horizontal commonality focus on existence of a group of investors, those applying vertical commonality pay attention to the connection between the investors and the promoter. Depending on each court's approach, this commonality will be analyzed under either a broad level or a strict one. Broad vertical commonality requests that the investors' fortunes lean on the expertise of the promoter[16], strict vertical

[15] *SEC v. Shavers*, No. 4:13-CV-416, 2014 WL 4652121, at *1 (E.D. Tex. Sept. 18, 2014).
[16] The court in *Long v. Shultz Cattle Co., Inc.*, 881 F.2d 129, 140-41 (5th Cir. 1989) has differentiated broad vertical commonality and strict vertical commonality as follows:

commonality, on the other hand, looks for the existence of the tie between the investors' fortunes and that of the promoter.

Though there are different approaches among the US courts towards common enterprise, this prong is still a distinct element to the courts when identifying the existence of an investment contract. The SEC, surprisingly, differs from the courts, stating in its Framework for "Investment Contract" Analysis of Digital Assets that it does not either require the "*vertical or horizontal commonality per se*" or take "*common enterprise*" as a distinct requirement like the courts do[17]. More interestingly, despite its statement, the SEC acknowledges the existence of common enterprise in transactions involving digital assets based on its experience[18]. In contrast

"Although we cited the Ninth Circuit's opinion in Glenn W. Turner with approval in Koscot, id., our paths have since diverged in the content that we have given to the term "vertical commonality." The Ninth Circuit imposes a stringent requirement that in order to establish a common enterprise, there must be a direct correlation between the promoter's success or failure and the investors' profits or losses. Under the Ninth Circuit standard, there is no common enterprise if, for example, the promoter receives a flat commission irrespective of whether the investor makes or loses money on the underlying venture. Brodt v. Bache & Co., 595 F.2d 459, 461 (9th Cir.1978).
We have stated, in contrast, that "the critical inquiry is confined to whether the fortuity of the investments collectively is essentially dependent upon promoter expertise." Continental Commodities, 497 F.2d at 522. While our standard requires interdependence between the investors and the promoter, it does not define that interdependence narrowly in terms of shared profits or losses. Rather, the necessary interdependence may be demonstrated by the investors' collective reliance on the promoter's expertise even where the promoter receives only a flat fee or commission rather than a share in the profits of the venture."

[17] The U.S. Securities and Exchange Commission, 'Framework for "Investment Contract" Analysis of Digital Assets' (*SEC.gov*, 3 April 2019) <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets#_ednref10> accessed 14 April 2023.

Footnote No. 10 of the Framework says that:
"[10] In order to satisfy the "common enterprise" aspect of the Howey test, federal courts require that there be either "horizontal commonality" or "vertical commonality." See Revak v. SEC Realty Corp., 18 F.3d. 81, 87-88(2d Cir. 1994) (discussing horizontal commonality as "the tying of each individual investor's fortunes to the fortunes of the other investors by the pooling of assets, usually combined with the pro-rata distribution of profits" and two variants of vertical commonality, which focus "on the relationship between the promoter and the body of investors"). The Commission, on the other hand, does not require vertical or horizontal commonality per se, nor does it view a "common enterprise" as a distinct element of the term "investment contract." In re Barkate, 57 S.E.C. 488, 496 n.13 (Apr. 8, 2004); see also the Commission's Supplemental Brief at 14 in SEC v. Edwards, 540 U.S. 389 (2004) (on remand to the 11th Circuit)."

[18] Footnote No.11 of the Framework says that:
"[11] Based on our experiences to date, investments in digital assets have constituted investments in a common enterprise because the fortunes of digital asset purchasers have been linked to each other or to the success of the promoter's efforts. See SEC v. Int'l Loan Network, Inc., 968 F.2d 1304, 1307 (D.C. Cir. 1992)."

Regarding the link between the term "*digital assets*" and "*crypto assets*":

to the courts, the SEC appears to be more flexible in its assessment of the presence of investment contracts, allowing for either horizontal commonality or broad vertical commonality. Courts, on the other hand, may adopt a specific approach towards commonality and reject other forms of commonality, despite acknowledging their existence.

1.2.3. Third prong - a reasonable expectation of profits to be derived from the efforts of others

In addition to satisfying the two aforementioned prongs, the third prong of the Howey Test is met if investors expect to receive benefits derived from the efforts of others. Originally, this third prong developed by the court in the Howey Case required that the investors have motives to gain profits "*solely*" from the efforts of others[19]. However, over the time, the significance of the "*solely*" factor has been gradually lessened as the courts have broadened the interpretation of this prong to protect the investors and prevent situations where a promoter or third party abuses the word "*solely*" by assigning tasks to investors to escape the application of the Howey Test[20]. Several variations in replacement of "*solely*" are as follows:

In Footnote No. 2 of the Framework, the term "*digital asset*" used in the Framework refers to "*an asset that is issued and transferred using distributed ledger or blockchain technology, including, but not limited to, so-called "virtual currencies," "coins," and "tokens.*"

In the '*IAC Views on Crypto Assets*' released on 6 April 2023, the U.S. Securities and Exchange Commission's (SEC) Investor Advisory Committee (IAC) has noted that "*crypto assets are a subset of digital assets*" (Footnote No. 3, The U.S. Securities and Exchange Commission's (SEC) Investor Advisory Committee, 'IAC Views on Crypto Assets' (*SEC.gov*, 6 April 2023) <https://www.sec.gov/files/20230406-iac-letter-cryptocurrency.pdf> accessed 14 April 2023.)

[19] *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

[20] In *Securities & Exchange Commission v. Glenn W. Turner Enterprises Inc.*, 474 F.2d 476, 482 (9th Cir. 1973), the court explained that:
"We hold, however, that in light of the remedial nature of the legislation, the statutory policy of affording broad protection to the public, and the Supreme Court's admonitions that the definition of securities should be a flexible one, the word "solely" should not be read as a strict or literal limitation on the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities. Within this context, we hold that Adventures III and IV, and the $1,000 Plan, are investment contracts within the meaning of the 1933 and 1934 Acts. Strict interpretation of the requirement that profits to be earned must come "solely" from the efforts of others has been subject to criticism. See, e.g., State

- *"with an expectation of profits produced by the efforts of others*[21]*;*
- *"in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others"*[22].

of Hawaii v. Hawaii Market Center, Haw. 1971, 485 P.2d 105. Adherence to such an interpretation could result in a mechanical, unduly restrictive view of what is and what is not an investment contract. It would be easy to evade by adding a requirement that the buyer contribute a modicum of effort. Thus the fact that the investors here were required to exert some efforts if a return were to be achieved should not automatically preclude a finding that the Plan or Adventure is an investment contract. To do so would not serve the purpose of the legislation. Rather we adopt a more realistic test, whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."

[21] In *Warfield v. Alaniz*, 569 F.3d 1015, 1020 (9th Cir. 2009), the court explained that (content set in **bold** is intended solely for the purpose of emphasis):
"We distilled Howey's definition into a three-part test requiring "(1) an investment of money (2) in a common enterprise (3) ***with an expectation of profits produced by the efforts of others.****" SEC v. Rubera, 350 F.3d 1084, 1090 (9th Cir. 2003) (internal quotation marks omitted). The third prong of this test, requiring "an expectation of profits produced by the efforts of others," involves two distinct concepts: whether a transaction involves any expectation of profit and whether expected profits are the product of the efforts of a person other than the investor."*

[22] In *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975), the court explained that (content set in **bold** is intended solely for the purpose of emphasis):
"We perceive no distinction, for present purposes, between an "investment contract" and an "instrument commonly known as a `security.'" In either case, the basic test for distinguishing the transaction from other commercial dealings is "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." Howey, 328 U.S., at 301.
This test, in shorthand form, embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone is the presence of an investment ***in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.****"*

CHAPTER 2 – TO BE OR NOT TO BE…SECURITIES? AN EXISTENTIAL QUESTION FOR CRYPTO ASSETS

2.1. The SEC's position in protecting crypto asset investors

Having been known as the "*policeman of Wall Street"*[23] since its establishment by the US Congress in the 1930s in accordance with the Securities Exchange Act of 1934[24], the SEC with its powerful jurisdiction has been an active player in safeguarding the application of the federal securities laws. The SEC's missions, as stated in its website, are to "*protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation"*[25]. Therefore, it comes as no surprise when the recent years have witnessed many continuously strong moves and actions from the SEC towards crypto asset related matters in the name of investor protection, varying from publishing investor bulletins warning about crypto scams to bringing lawsuits against crypto asset businesses. Such lawsuits have sparkled many public debates, depicting the on-going disagreement, among other crypto asset relevant topics, that has been long existed between the SEC and the crypto asset community about the legal status of crypto assets: "*To be or not to be… securities?"*

2.2. The Howey Test – when failing a test is more relieved than passing it

Has been long used as a judicial indication to determine whether a scheme or transaction is an investment contract, Howey Test is the one that not so many ICO issuers are eager to pass. Satisfying this test would mean that complicated procedures and requirements applied to any

[23] John C. Coffee Jr., Hillary A. Sale and Charles K. Whitehead, *Securities regulation cases and materials* (14th edn, Foundation Press 2021) 4.
[24] The U.S. Securities and Exchange Commission, 'About the SEC' (*SEC.gov*, 25 June 2018) <https://www.sec.gov/strategic-plan/about> accessed 10 June 2023.
[25] The U.S. Securities and Exchange Commission, 'About the SEC' (*SEC.gov*, 22 November 2016) <https://www.sec.gov/about> accessed 5 June 2023.

investment vehicle being identified as a "*security*" under the federal securities laws, such as proper, lengthy registration process and disclosure, await those issuers who want to put their tokens into the markets, no matter how hard they have attempted to name or structure such tokens as consumptive ones. Furthermore, whether their ICOs are exempted from registration or not, antifraud provisions of the federal securities laws still apply[26]. In other words, failing the Howey Test might be more relieved than passing it.

So, what would really happen that makes those issuers are so hesitant when hearing of the Howey Test?

As mentioned above, passing this test means that their token offering will be treated as a security offering with a substantive number of requirements under the federal securities laws, i.e., the registration and disclosure, that need them to comply with.

Securities Act prohibits the offer and sale of a security that has not been registered with the SEC, unless it falls into the exemption categories. Accordingly, in case of registration, those who seek to access to capital by way of offering securities to investors, must perform a registered public offering by filing a registration statement with the SEC and can only carry out the sale when such statement is declared effective by the SEC. This registration process will accompany with the disclosure requirements for the investor's information, starting first with the attachment of a prospectus along with the registration statement. Information is requested to be disclosed as follows[27]:

- *A description of the company's properties and business;*

[26] The U.S. Securities and Exchange Commission, 'Frequently Asked Questions about Exempt Offerings' (*SEC.gov*, 6 April 2023) <https://www.sec.gov/education/smallbusiness/exemptofferings/faq> accessed 12 June 2023.

[27] The SEC's Office of Investor Education and Advocacy, 'Registration Under the Securities Act of 1933' (*Investor.gov*) <https://www.investor.gov/introduction-investing/investing-basics/glossary/registration-under-securities-act-1933> accessed 7 June 2023.

- *A description of the security to be offered for sale;*
- *Information about the management of the company; and*
- *Financial statements certified by independent accountants.*

Disclosure has many purposes, but its primary aim is to provide investors with information sufficient enough for them to make informed investment decisions. While the SEC requires the companies to provide accurate material information when disclosing, it is not required by the law to verify how accurate such information is[28]. Based on the public information disclosure, investors need to consider the risks before making any investment decision. In case they believe that they were victims to frauds, deceits, inaccurate or incomplete disclosure, they can use their rights stipulated under the federal securities laws to seek justice. Disclosure plays a significantly crucial part in protecting investors due to the characteristics of securities. While products in trade on other markets have specific features that allow purchasers to examine them, for example, checking fruits in supermarket to see if they are fresh to buy, securities are different. Investors cannot inspect the issuers' business on their own if material information is held back or provided inaccurately, insufficiently by the issuers. They can neither evaluate the value of the security in question nor compare it to other securities being offered in the market. In such situation, investors will be much more hesitant to invest in such security due to lack of essential information and high chance of risks to be either manipulated by market participants or deceived by the issuers. Crypto assets, with their volatility and digital nature, along with ongoing debates centering around the appropriate regulatory framework to govern them, are no doubt an attractive paradise for frauds, deceits and manipulations to blossom.

[28] The SEC's Office of Investor Education and Advocacy, 'Registration Under the Securities Act of 1933' (*Investor.gov*) <https://www.investor.gov/introduction-investing/investing-basics/glossary/registration-under-securities-act-1933> accessed 7 June 2023.

Not only is the disclosure requested, but also the lengthy period with strict requirements of the registration process can make any company that plans to raise capital have to weigh the option of offering securities carefully, especially for those firms going public for the first time. A well-prepared IPO might take from 3 to 6 months[29] to finish, while other sources provide the estimated period from 6 to 9 months[30]. After IPO, the company will also be subject to continuous reporting regime applied for publicly held companies, which requests it to submit quarterly, annual and current reports to the SEC. While the information required in the quarterly and annual reports is mostly the same as what is needed in the registration statement, there is an additional requirement to report specific events to the SEC through current reports. These events usually need to be reported within 04 business days after they occur[31].

Given the lengthy and complicated registered public offering process as mentioned above, businesses might want to seek other solutions to raise capital. The development of crypto assets has opened a new door for them, not only facilitating quick access to finance within minutes on a wider scale but also often allowing businesses to raise capital with very little information transparency[32]. This practice, despite the potential challenges it poses for investor protection and market oversight, provides businesses the opportunity to secure funds while disclosing limited information about their operations. In fact, mobilizing capital in form of crypto assets, i.e., coin issuance or "token sales", has become popular all over the world.

[29] Brian D. Hirshberg and others, 'Equity Capital Markets in United States: Regulatory Overview' (*uk.practicallaw.thomsonreuters.com*, 1 January 2022) <https://uk.practicallaw.thomsonreuters.com/9-501-3333?contextData=(sc.Default)> accessed 9 June 2023.

[30] Global Shares, 'IPO Process, Pros & Cons & FAQs' (*GlobalShares.com*, 27 April 2021) <https://www.globalshares.com/academy/step-by-step-guide-ipo/> accessed 9 June 2023.

[31] The U.S. Securities and Exchange Commission, 'Exchange Act Reporting and Registration' (*SEC.gov*, 6 April 2023) <https://www.sec.gov/education/smallbusiness/goingpublic/exchangeactreporting> accessed 9 June 2023.

[32] Deloitte, 'ICOs – The New IPOs? How to Fund Innovation in the Crypto Age' (*deloitte.com*) <https://www2.deloitte.com/content/dam/Deloitte/de/Documents/Innovation/ICOs-the-new-IPOs.pdf> accessed 11 June 2023.

One famous example that marked the strong reaction of the SEC towards ICOs is the Decentralized Autonomous Organization ("**DAO**") case. With the aim of creating a decentralized venture capital fund, it had its ICO launched in 2016 from 30 April 2016 to 28 May 2016 and raised around USD150 million by offering and selling the DAO tokens in exchange for the virtual currency[33], Ether. In the investigation report[34] released in 2017, by applying the Howey Test, the SEC stated that DAO tokens are securities under the federal securities laws, thereby leading to the conclusion that the DAO's ICO was an unregistered offering.

According to the analysis of the SEC, the DAO has met the Howey Test as follows:

- Investment made by the DAO investors in virtual currency, i.e., Ether, satisfied the first prong of the Howey Test on the existence of an investment contract.
- The DAO token purchasers were investing in a common enterprise and had reasonable expectation of gaining profits derived from the managerial and entrepreneurial efforts of others. Such efforts, in the DAO's case, came from Slock.it, Slock.it's co-founders, and curators of the DAO. The investors' expectation was reasonable as the marketing of the DAO and the active roles in the DAO of those just mentioned led the investors

[33] The Financial Action Task Force, 'Virtual Currencies: Key Definitions and Potential AML/CFT Risks' (*fatf-gafi.org*, June 2014) <https://www.fatf-gafi.org/en/publications/Methodsandtrends/Virtual-currency-definitions-aml-cft-risk.html> accessed 8 June 2023.

In this report, the Financial Action Task Force has defined "*virtual currency*" as follows:
"Virtual currency is a digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued nor guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinguished from fiat currency (a.k.a. "real currency," "real money," or "national currency"), which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency."

[34] The U.S. Securities and Exchange Commission, 'Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO' (*SEC.gov*, 25 July 2017) <https://www.sec.gov/litigation/investreport/34-81207.pdf> accessed 11 June 2023.

to believe so. Furthermore, though the investors had voting rights, they still had to rely much on Slock.it, Slock.it's co-founders, and curators as their voting rights were limited.

Though the SEC did not pursue any enforcement action towards the DAO, it has made clear its awareness of and attention to ICOs. The DAO investigation report also sheds light on the SEC's perspective regarding systems similar to the DAO that such system can hardly stay out of the sight of regulatory oversight. It implies that one should bear in mind, in the context of the DAO, that the definition of security under the Securities Act and Exchange Act or the application of the Howey or Reves test are not the sole considerations. Other statutory and protective regimes, such as the Investment Company Act of 1940, may also hold relevance.

Come back to the ICOs story, the DAO, in fact, is not the only incident where the SEC voiced its concerns. Several ICOs have also received the attention from the SEC, such as in the matter of Munchee Inc.[35] in which the offering for sales of the MUN[36], which was labelled as "utility tokens" by its issuer for purchasing goods or services in Munchee's future ecosystem, in 2017 was stopped by the SEC with the conclusion that the MUN were securities. The interesting fact in this matter is that Munchee, in their white paper, explicitly mentioned performing a Howey Test analysis on the MUN design. Based on their evaluation, they concluded that the offering of the MUN "*does not pose a significant risk of implicating federal securities laws"*[37]. Thus, Munchee did not register their ICO under the US federal securities laws, and the company stated that the ICO did not fall into any registration exemption under the Securities Act.

[35] *In the Matter of Munchee Inc.*, SEC Admin Proc. File No. 3-18304 (Dec. 11, 2017).
[36] Munchee, a US-based company developed the Munchee app ("**App**"), a mobile application for visual food reviews. To raise fund for the development of the App during the span of 2018 and 2019, Munchee planned to introduce an Ethereum-based token called the MUN in exchange for Ether and Bitcoin. They began selling the MUN about or on 31 October 2017 and stopped the sale on 1 November 2017 after the SEC staff contacted them. At that time, Munchee had not delivered the MUN to any investors yet and it quickly returned all the money it had received from the investors.
[37] Sanjeev Verma, Nghi Bui and Chelsea Lam, 'Munchee Token: A Decentralized Blockchain Based Food Review/Rating Social Media Platform'.

However, the SEC reached a different conclusion than Munchee. In its cease-and-desist order[38] to Munchee, which made reference to the DAO report, it concluded that:

- The MUN qualified as securities under Section 2(a)(1) of the Securities Act, i.e., investment contracts;
- Munchee's actions were in violation of the Securities Act, specifically Sections 5(a) and 5(c), as they offered and sold the MUN without registering it with the SEC or qualifying as an exemption from registration.

For those who want to mobilize capital from public for their projects in form of token sales, the above incidents can serve as reminders from the SEC that ICO might no longer be an ideal solution to fully get away from the application of the federal securities laws.

2.3. The SEC's enforcement actions

2.3.1. Education tools

As the "*policeman of Wall Street"*[39], the SEC has actively carried out various measures to protect the investors and safeguard the integrity of the market. Raising awareness of the investors through education tools is one of those.

While ICOs may open new door for businesses to raise capital, it is also a promising land for scam and frauds to proliferate. Recognizing the need to address the dark side of ICOs, the SEC

[38] The Securities Enforcement Remedies and Penny Reform Act of 1990 allows the SEC to impose a cease-and-desist order on any person who the SEC suspects that such person "*is violating, has violated, or is about to violate any provision"* of the federal securities laws (Smith AM, 'Sec Cease-and-Desist Orders' (1999) 51 Administrative Law Review 1197). In other words, when the SEC issues the cease-and-desist order, it means that the respondent has to stop immediately engaging in the violations and comply with the securities laws. Furthermore, the SEC can also request accounting and disgorgement (15 U.S. Code § 78u–3).

[39] John C. Coffee Jr., Hillary A. Sale and Charles K. Whitehead, *Securities regulation cases and materials* (14th edn, Foundation Press 2021) 4.

introduced HoweyCoins[40], a fictitious and simulated cryptocurrency, along with its associated ICO website[41]. This initiative did not aim to lure investors into investing in any "token sale" by the SEC, but just a mockery version to raise awareness among potential investors about the risks and red flags commonly associated with those too-good-to-be-true ICOs. The mock ICO website featured alluring promises of extraordinary returns, celebrity endorsement, and exclusive investment opportunities. In addition, by incorporating a countdown clock, the website effectively emulated the tactics employed by fraudsters who seek to intensify the FOMO (fear of missing out) phenomenon, compelling investors to quickly join or else face the possibility of missing a once-in-a-lifetime opportunity.

The SEC's choice to name the fictitious "HoweyCoins" after the Howey Test also carries a certain irony in a sense since ICO issuers often strive to avoid being categorized as securities, i.e., the investment contract under the Howey Test. By naming the mock cryptocurrency HoweyCoins, the SEC brings attention to the test and emphasizes its significance in distinguishing legitimate investments from potential frauds. This irony arises from the fact that the SEC also employs the same test that ICO issuers may attempt to circumvent, reinforcing the need for investors to stay alert and caution when analyzing any ICO investments.

[40] The SEC's Office of Investor Education and Advocacy, 'HoweyCoins' (*Investor.gov*) <https://www.investor.gov/ico-howeycoins> accessed 9 June 2023.

[41] The U.S. Securities and Exchange Commission, 'The SEC Has an Opportunity You Won't Want to Miss: Act Now!' (*SEC.gov*, 16 May 2018) <https://www.sec.gov/news/press-release/2018-88> accessed 9 June 2023.
At the time of this thesis, the website https://www.howeycoins.com/ is no longer accessible. However, according to the SEC's Press Release above, the website was described as follows:
"The SEC set up a website, HoweyCoins.com, that mimics a bogus coin offering to educate investors about what to look for before they invest in a scam. Anyone who clicks on "Buy Coins Now" will be led instead to investor education tools and tips from the SEC and other financial regulators.
[…]
The website features several of the enticements that are common to fraudulent offerings, including a white paper with a complex yet vague explanation of the investment opportunity, promises of guaranteed returns, and a countdown clock that shows time is quickly running out on the deal of a lifetime."

2.3.2. Enforcement actions

During the period from July 2013 to 31 December 2022, the SEC has taken 127 enforcement actions related to crypto assets, including 83 litigations and 45 administrative proceedings[42]. The year 2022 marked a significant milestone, with the highest number of litigations ever conducted by the SEC in a single year since 2013. Out of the total 30 enforcement actions against crypto-asset market participants[43] undertaken in that year, an impressive 24 litigations were brought. These 30 enforcement actions also showcase the following figures[44]:

- Nearly 50% of the actions are in relation to ICOs;
- 70% of 30 enforcement actions are alleged fraud, 73% are alleged violation of unregistered public offering while 50% are for both allegations.

The total amount of monetary penalties imposed by the SEC is also impressive, reaching a figure of USD 2.61 billion as of 31 December 2022. Out of this amount, 91% was derived from disgorgement and prejudgment interest, while approximately 9% stemmed from civil penalties[45].

The provided statistics offer valuable insights into the proactive involvement of the SEC in the regulation of crypto assets. This raises the question: What do these enforcement activities truly signify and reveal about the extent of the SEC's authority?

[42] Simona Mola, 'SEC Cryptocurrency Enforcement: 2022 Update' (*cornerstone.com*, 2023) <https://www.cornerstone.com/wp-content/uploads/2023/01/SEC-Cryptocurrency-Enforcement-2021-Update.pdf> accessed 11 June 2023.

[43] The U.S. Securities and Exchange Commission's (SEC) Investor Advisory Committee, 'IAC Views on Crypto Assets' (*SEC.gov*, 6 April 2023) <https://www.sec.gov/files/20230406-iac-letter-cryptocurrency.pdf> accessed 14 April 2023.

[44] Simona Mola, 'SEC Cryptocurrency Enforcement: 2022 Update' (*cornerstone.com*, 2023) <https://www.cornerstone.com/wp-content/uploads/2023/01/SEC-Cryptocurrency-Enforcement-2021-Update.pdf> accessed 11 June 2023.

[45] Simona Mola, 'SEC Cryptocurrency Enforcement: 2022 Update' (*cornerstone.com*, 2023) <https://www.cornerstone.com/wp-content/uploads/2023/01/SEC-Cryptocurrency-Enforcement-2021-Update.pdf> accessed 11 June 2023.

Under the framework of federal securities laws, the SEC has been equipped with two primary enforcement tools: civil injunctive actions and administrative proceedings[46]. When the Securities Enforcement Remedies and Penny Reform Act of 1990 came into effect, it has armed the SEC with further civil remedies, which are cease and desist orders, corporate bar orders and civil fines. While acknowledging the existence and effectiveness of all existing enforcement actions available to the SEC, I will specifically focus on some of them that I believe are realistically helpful in protecting investors in crypto assets, which are typically transnational, such as ICOs. The SEC's cooperation with foreign authorities also plays a crucial role in making these enforcement actions effective.

2.3.2.1. Effective enforcement actions with international cooperation

(i) Disgorgement

Disgorgement refers to the process which wrongdoers is required to give up the illicit gains profits and return them to the affected investors. It serves as an effective enforcement tool with deterrent effect for the SEC in deterring wrongdoers from violating federal securities laws as "*the effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable"*[47] and *"the deterrent effect of an SEC enforcement action would be greatly undermined if securities law violators were not required to disgorge illicit profits"*[48].

[46] Linda Chatman Thomsen, '2005 PROGRAM' (*SEC.gov*) <https://www.sec.gov/about/offices/oia/oia_enforce/overviewenfor.pdf> accessed 12 June 2023.
In this document published by the SEC, administrative proceedings were explained as below:
"*proceedings that are litigated before a Commission administrative law judge and that are subject to appeal directly to the Commission and thereafter to a U.S. Court of Appeals. The Commission, while it acts in a prosecutorial capacity in authorizing the enforcement action, acts in a judicial capacity if it reviews the administrative law judge's initial decision on appeal.*"
Furthermore, under 17 C.F.R. § 201 et seq., the administrative proceedings are governed by the Rules of Practice of the SEC, which is available at http://www.sec.gov/about/rulesofpractice.shtml

[47] *SEC vs Manor Nursing Centers, Inc.*, 458 F.2d, 1104 (2d Cir. 1972).
[48] *SEC vs Manor Nursing Centers, Inc.*, 458 F.2d, 1104 (2d Cir. 1972).

With its ability to strip violators of their ill-gotten profits, disgorgement is not only helpful for the SEC to protect harmed investors regarding violations under the federal securities laws in general but also those involve in crypto related transactions. One popular case where disgorgement reached a remarkable amount can be taken as an example on how powerful disgorgement can be is SEC v. Telegram Group Inc.[49], in which the SEC cooperated with "*nearly a dozen foreign authorities to obtain information"*[50].

In this case, the SEC alleged the defendants, i.e., Telegram Group Inc. and its subsidiary TON Issuer Inc., for engaging in unregistered public offering of Grams, a cryptocurrency, overseas and in the US. The court's final judgment is in favor of the SEC, prohibited a global distribution of Grams and made the defendants to disgorge the amount of USD1,224,000,000 in ill-gotten gains from the sale of Grams to the initial investors[51].

(ii) Freeze order

Freeze order or freeze of assets "*is designed to preserve the status quo by preventing the dissipation and diversion of assets"*[52] *and "assures that any funds that may become due can be collected"*[53]. In other words, a freeze order granted by the courts over the assets of the wrongdoers can enable the SEC to enhance the possibilities of harmed investors getting their money back. It serves as an efficient tool in preserving and safeguarding funds, ensuring that there are available resources to support remedies such as disgorgement, prejudgment interest,

[49] *Securities and Exchange Commission v. Telegram Group Inc.* et al., No. 1:2019cv09439 - Document 227 (S.D.N.Y. 2020).
[50] U.S. Department of Justice, 'The Report of the Attorney General Pursuant to Section 8(b)(Iv) of Executive Order 14067: How To Strengthen International Law Enforcement Cooperation For Detecting, Investigating, And Prosecuting Criminal Activity Related To Digital Assets' (*justice.gov*, 6 June 2022) <https://www.justice.gov/ag/page/file/1510931/download> accessed 11 June 2023.
[51] The U.S. Securities and Exchange Commission, 'Telegram to Return $1.2 Billion to Investors and Pay $18.5 Million Penalty to Settle SEC Charges' (*SEC.gov*, 26 June 2020) <https://www.sec.gov/news/press-release/2020-146> accessed 11 June 2023.
[52] *U.S. Securities Exchange v. the Infinity GP*, 212 F.3d 180, 197 (3d Cir. 2000) (quoting SEC v. Capital Counselors, Inc., 512 F.2d 654 (2d Cir. 1975)).
[53] *S.E.C. v. UNIFUND SAL*, 910 F.2d 1028, 1041 (2d Cir. 1990).

or civil penalties. In the context of crypto assets, the SEC can have its enforcement actions enforced through international cooperation such as assistance from the foreign authorities. By obtaining such assistance, not only can the SEC locate those wrongdoers, trace, freeze and repatriate funds overseas but also receive information, documents and testimony from witnesses abroad for investigation purposes[54].

In the case of SEC v. PlexCorps, No. 17-cv-07007 (E.D.N.Y.)[55], through the cooperation with Quebec's Autorité des marchés financiers in Canada, the SEC was successful in freezing the assets of Canadian-based defendants who engaged in the PlexCoin ICO, which was deemed as an illegal and unregistered securities offering by the SEC under the US federal securities laws. Upon the court's judgment, the defendants had to disgorge the amount of USD4,563,468, USD348,145 for prejudgment interest and USD2,000,000 for civil penalties.

2.3.3. The SEC's approach to crypto assets: clear or unclear?

While fully acknowledging of the SEC's efforts in protecting investors into crypto assets, in my personal view, the current approach by the SEC, which has been criticized from the

[54] U.S. Department of Justice, 'The Report of the Attorney General Pursuant to Section 8(b)(Iv) of Executive Order 14067: How To Strengthen International Law Enforcement Cooperation For Detecting, Investigating, And Prosecuting Criminal Activity Related To Digital Assets' (*justice.gov*, 6 June 2022) <https://www.justice.gov/ag/page/file/1510931/download> accessed 11 June 2023.
[55] *SEC v. PlexCorps, Dominic LaCroix, and Sabrina Paradis-Royer* Case No. 17-cv-7007 (CBA) (RML) (E.D.N.Y.).

business community and other regulators[56] as "*regulation by enforcement*", "*lack of clarity"*[57], seems harsh for the crypto business and can harm investors. This harshness does not come from

[56] The U.S. Senate Committee on Banking, Housing & Urban Affairs, 'Toomey: Gensler's Refusal to Give Crypto Regulatory Clarity Hurt Consumers' (*banking.senate.gov*, 27 July 2022) <https://www.banking.senate.gov/newsroom/minority/toomey-genslers-refusal-to-give-crypto-regulatory-clarity-hurt-consumers> accessed 12 June 2023.
Ranking Member Toomey criticized the refusal of the SEC on regulatory clarity, causing harms to investors, in a letter to SEC Chairman Gary Gensler as follows (content set in **bold** is intended solely for the purpose of emphasis):

"*I write to express my concern about the Securities and Exchange Commission's ("SEC") uncompromising refusal to give regulatory clarity to the cryptocurrency community and consumers. Instead,* ***the SEC has pursued a capricious and ineffective approach to consumer protection known as regulation-by-enforcement that is chilling financial innovation and contributing to significant financial losses for unsuspecting American consumers****.*

In recent weeks, several companies whose crypto lending services were arguably within the SEC's purview have collapsed. These firms often promised enormous, seemingly unsustainable interest rates to depositors, 1 and at least one business allegedly engaged in risky practices. One of these enterprises, Celsius, reportedly had nearly $12 billion in assets under management, using funds from thousands of Americans to make loans to entities making short-term crypto investments. Customer funds have been frozen since mid-June, leaving in question the status of billions of dollars worth of deposits.

Had the SEC responded to calls for clarity on how it would apply existing securities laws to novel digital assets and services, things might have been different. Companies could have adjusted product offerings accordingly, preventing investor losses today, and the SEC would have been free to focus enforcement efforts on the worst actors.*[…]*

Instead, the SEC is choosing to regulate by enforcement, selectively deciding to apply its opaque position on when digital assets and services are securities*. For example, on July 21st, the SEC announced insider trading charges against a former employee of cryptocurrency exchange Coinbase and two other persons, claiming they illegally traded nine digital asset securities.* ***In this circumstance and elsewhere, the SEC ostensibly had a clear opinion on why it thinks these digital assets are securities, yet it did not disclose that view publicly before launching an enforcement action. There are many reasons to be skeptical of the SEC's view that most digital assets are securities.*** *Among those reasons is that an associated token may not give its owner any claim to the profits or assets of an enterprise, potentially calling into question whether there could be a reasonable expectation of profits or an investment in a common enterprise under the Howey test. Similarly, there may be other reasons why a token may not have all the features of a common enterprise. By contrast, a security typically has both of these features.* ***Hence, regulatory clarity is needed to resolve these questions and many others involving digital assets and services****.[…]"*

[57] The Chamber of Commerce of the United States of America, 'In Re: Coinbase Inc (23-1779) - Brief of Amicus Curiae the Chamber of Commerce of the United States of America in Support of Petitioner' (*uschamber.com*, 9 May 2023) <https://www.uschamber.com/assets/documents/U.S.-Chamber-Amicus-Brief-In-re-Coinbase-Third-Circuit.pdf> accessed 12 June 2023.
In a court filing in 2023, the United States Chamber of Commerce has criticized the SEC for its "*lack of clarity*" and "*regulatory uncertainty*" over the matter which digital assets are securities as follows:

"As it stands today, nobody knows for certain which digital assets, if any, are "securities" under federal law. That is no small question. It has immense implications for every person involved in the $1 trillion digital-asset economy, and it is the threshold regulatory question from which all others flow. But remarkably, the Securities and Exchange Commission—despite proclaiming itself the primary regulator of digital assets—has refused to resolve this threshold question. The Commission has instead offered a series of one-off enforcement actions, supplemented by public speeches and other statements that one commissioner broadly described as "confusing, unhelpful, and inconsistent." And it has refused to engage in any rulemaking or other systematic process to explain what its claimed authority means."

a clear regulatory scheme. In contrast, it is harsh because it is unclear and uncertain. It is undeniable that the fast-paced development of crypto assets has led to the proliferation of many scams, frauds, deceit and manipulation, it also creates chance for new investment opportunities. As protecting investors is among the SEC's core missions, it is understandable that the SEC should do what they need to protect the investors. Leaving the investors clueless and uninformed in the market full of scams, too-good-to-be-true investment opportunities with lack of necessary information disclosure like crypto assets is not something that the SEC will do. While proper regulation can boost the investors' confidence when making investment decisions, a harsh and uncertain regulation like the SEC's current approach can be a double-edged sword for the investors since it can drive issuers and potential businesses away. The market competitiveness and development of innovation of the US can also be affected. The US, as an active securities market, seems to have more to offer to the development of innovation than those appear to be the bank-centered markets like Germany or Japan[58]. Unlike the bank-centered markets, the US can offer new entrants to the markets, especially "*start-ups that can convince investors of the value of their latest technological innovations"*[59], thereby boosting the innovation's development. In my opinion, the lack of clarity in the SEC's current approach may negatively impact innovation. How can those who possess the latest technological innovations enter the market and access capital legitimately when the regulation seems uncertain and in a state of limbo like this?

Come back to the "*regulation by enforcement*", here in this analysis, I do not possess any negative view about the SEC's enforcement tools. In contrast, I view those tools as efficient ones that can guarantee the high possibilities of investors to be protected. What I am attempting

[58] John C. Coffee Jr., Hillary A. Sale and Charles K. Whitehead, *Securities regulation cases and materials* (14th edn, Foundation Press 2021) 9.
[59] John C. Coffee Jr., Hillary A. Sale and Charles K. Whitehead, *Securities regulation cases and materials* (14th edn, Foundation Press 2021) 10.

to analyze here is the approach or direction that those enforcement tools are being employed. Perhaps those in the crypto industry may perceive the current approach as being too harsh on them. However, it is important to consider that when multiple concerns are voiced by various parties, including other regulators, the notion of bias should be re-assessed. It is necessary to determine whether it is indeed a bias or a legitimate concern. Furthermore, regulatory uncertainty creates a challenging legal barrier for even well-intentioned crypto businesses to ensure compliance with the regulations of the SEC. How can these businesses be confident in their ability to comply with federal securities laws when there are inconsistencies and confusions arising from the SEC's actions? Even the application of the elements of the Howey Test by the SEC itself has created confusion, as the SEC's interpretation differs from that of the courts. Regarding the 2nd prong on "*common enterprise*", this prong is still a distinct element to the courts when identifying the existence of an investment contract, despite different approaches among them. The SEC, however, differs from the courts, stating in its Framework for "Investment Contract" Analysis of Digital Assets that it does not either require the "*vertical or horizontal commonality per se*" or take "*common enterprise*" as a distinct requirement like the courts do.

In June 2023, the SEC sued Coinbase[60], an American public company, alleging that the largest US-based crypto trading platform had violated federal securities laws by failing to register as a broker, exchange and clearing agency[61]. In March, Coinbase received a Wells notice from

[60] The U.S. Securities and Exchange Commission, 'SEC Charges Coinbase for Operating as an Unregistered Securities Exchange, Broker, and Clearing Agency' (*SEC.gov*, 6 June 2023) <https://www.sec.gov/news/press-release/2023-102> accessed 12 June 2023.

[61] The U.S. Securities and Exchange Commission, 'SEC Charges Coinbase for Operating as an Unregistered Securities Exchange, Broker, and Clearing Agency' (*SEC.gov*, 6 June 2023) <https://www.sec.gov/news/press-release/2023-102> accessed 12 June 2023.

the SEC, warning that there might be an enforcement action coming its way[62]. On its website[63], Coinbase expressed that before receiving the Wells notice, it had attempted to engage with the SEC to seek for regulatory clarity and register, but received none from the SEC[64]. According to Coinbase, its business model had been reviewed and approved by the SEC before it went public in 2021. While expressing its frustration that "*instead of developing a regulatory framework for crypto, the SEC is continuing to regulate by enforcement only"*[65], Coinbase had also made efforts to work with the SEC for a clear registration path. Additionally, Coinbase filed a petition for rulemaking[66], comment letter[67] and amicus brief[68] on the lack of guidance for crypto businesses.

Therefore, in my opinion, while the enforcement tools are really strong, the current enforcement approach by the SEC can negatively affect investors. When the SEC has not provided clarity on how it will apply the existing federal securities laws to crypto assets, those in the crypto business will not have opportunities to adjust their businesses, products, and services accordingly to mitigate potential losses for investors. The DAO report or the Framework for "Investment Contract" Analysis of Digital Assets is not sufficient, as analyzed

[62] Rohan Goswami and MacKenzie Sigalos, 'Coinbase Offers a Fiery Response to the SEC's Threat of Enforcement Action' (*cnbc.com*, 27 April 2023) <https://www.cnbc.com/2023/04/27/coinbase-offers-fiery-response-to-sec-wells-notice-.html> accessed 12 June 2023.

[63] Paul Grewal, 'We Asked the SEC for Reasonable Crypto Rules for Americans. We Got Legal Threats Instead.' (*coinbase.com*, 22 March 2023) <https://www.coinbase.com/blog/we-asked-the-sec-for-reasonable-crypto-rules-for-americans-we-got-legal> accessed 12 June 2023.

[64] Paul Grewal, 'We Asked the SEC for Reasonable Crypto Rules for Americans. We Got Legal Threats Instead.' (*coinbase.com*, 22 March 2023) <https://www.coinbase.com/blog/we-asked-the-sec-for-reasonable-crypto-rules-for-americans-we-got-legal> accessed 12 June 2023.
On its website, Coinbase expressed that "*The SEC will not let crypto companies "come in and register" – we tried*."

[65] Paul Grewal, 'We Asked the SEC for Reasonable Crypto Rules for Americans. We Got Legal Threats Instead.' (*coinbase.com*, 22 March 2023) <https://www.coinbase.com/blog/we-asked-the-sec-for-reasonable-crypto-rules-for-americans-we-got-legal> accessed 12 June 2023.

[66] Faryar Shirzad, 'The Crypto Securities Market Is Waiting to Be Unlocked. But First We Need Workable Rules.' (*coinbase.com*, 21 July 2022) <https://www.coinbase.com/blog/the-crypto-securities-market-is-waiting-to-be-unlocked-but-first-we-need-workable-rules> accessed 12 June 2023.

[67] Paul Grewal, 'RE: Petition for Rulemaking – "Proof-of-Stake" Blockchain Staking Services' (*assets.ctfassets.net*, 20 March 2023) <https://assets.ctfassets.net/c5bd0wqjc7v0/37LaXLBCdgLHa7GE4TPnmw/7824df367e12f4136951db794a5df63d/Staking_Comment_Letter_3-20-2023_FINAL.pdf> accessed 12 June 2023.

[68] Brief of Amicus Curiae Coinbase, Inc. Case No. 2:22-cv-01009-TL.

above. The unclear and uncertain approach of the SEC towards crypto assets not only leaves investors in limbo as they do not know the future fate of their investments but also might drive innovation away and reduce the market competitiveness of the US.

CONCLUSION

In conclusion, investors in crypto assets in the US have received active protection from the laws. Such protection has seen the majority of enforcement actions come from the SEC. As protecting investors has been a key objective of the US federal securities laws, the SEC has actively taken the lead and attempted to regulate crypto assets by applying existing securities laws. However, the enforcement approach of the SEC, which is said to lack clarity, has been criticized for its harshness, leading some crypto businesses to seek more friendly jurisdictions. This harshness can drive away innovation, diminish the market competitiveness of the US, and put investors at risk due to uncertain legal requirements. Nevertheless, the attention given to crypto assets by US regulators is undeniable and the need for a comprehensive and clear regulation is apparent. Regardless of which agency and regulatory system will oversee the sector, crypto assets will hardly escape regulatory oversight. It is crucial for the US Congress to address the regulatory gaps and determine which authority will be in charge for overseeing crypto assets. By doing so, Congress can provide a more stable environment for investors and market participants, ensuring that adequate safeguards are in place. This comprehensive regulation will contribute to better protecting investors, enhancing their confidence in the market, and fostering the development of technological innovation while preserving the market competitiveness of the US in the global landscape.

BIBLIOGRAPHY

FEDERAL SECURITIES LAWS

1. The Securities Act of 1933
2. The Securities and Exchange Act of 1934
3. The Securities Enforcement Remedies and Penny Reform Act of 1990

CASELAW

1. *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946)
2. *United Housing Found., Inc. v. Forman*, 421 U.S. 837 (1975)
3. *Reves v. Ernst & Young*, 494 U.S. 56 (1990)
4. *Miller v. Cent. Chinchilla Grp., Inc.*, 494 F.2d 414 (8th Cir. 1974)
5. *Uselton v. Comm. Lovelace Motor Freight, Inc.*, 940 F.2d 564, 574 (10th Cir. 1991)
6. *SEC v. Shavers*, No. 4:13-CV-416, 2014 WL 4652121, at *1 (E.D. Tex. Sept. 18, 2014)
7. *Long v. Shultz Cattle Co., Inc.*, 881 F.2d 129, 140-41 (5th Cir. 1989)
8. *Securities & Exchange Commission v. Glenn W. Turner Enterprises Inc.*, 474 F.2d 476 (9th Cir. 1973)
9. *Warfield v. Alaniz*, 569 F.3d 1015, 1020 (9th Cir. 2009)
10. *In the Matter of Munchee Inc.*, SEC Admin Proc. File No. 3-18304 (Dec. 11, 2017)
11. *SEC vs Manor Nursing Centers, Inc.*, 458 F.2d, 1104 (2d Cir. 1972)
12. *Securities and Exchange Commission v. Telegram Group Inc.* et al., No. 1:2019cv09439 - Document 227 (S.D.N.Y. 2020)
13. *U.S. Securities Exchange v. the Infinity GP*, 212 F.3d 180, 197 (3d Cir. 2000)
14. *S.E.C. v. UNIFUND SAL*, 910 F.2d 1028, 1041 (2d Cir. 1990)
15. *SEC v. PlexCorps, Dominic LaCroix, and Sabrina Paradis-Royer* Case No. 17-cv-7007 (CBA) (RML) (E.D.N.Y.)

BOOKS

1. Coffee JC, Sale HA and Whitehead CK, *Securities regulation cases and materials* (14th edn, Foundation Press 2021)

AGENCY PUBLICATIONS

1. The U.S. Securities and Exchange Commission, 'SEC Proposes to Enhance Private Fund Reporting' (*SEC.gov*, 10 August 2022) <https://www.sec.gov/news/press-release/2022-141> accessed 1 June 2023
2. The SEC's Office of Investor Education and Advocacy, 'Blue Sky Laws' (*Investor.gov*) <https://www.investor.gov/introduction-investing/investing-basics/glossary/blue-sky-laws> accessed 15 June 2023
3. The U.S. Securities and Exchange Commission, 'Framework for "Investment Contract" Analysis of Digital Assets' (*SEC.gov*, 3 April 2019) <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets#_ednref10> accessed 14 April 2023
4. The U.S. Securities and Exchange Commission's (SEC) Investor Advisory Committee, 'IAC Views on Crypto Assets' (*SEC.gov*, 6 April 2023) <https://www.sec.gov/files/20230406-iac-letter-cryptocurrency.pdf> accessed 14 April 2023
5. The U.S. Securities and Exchange Commission, 'About the SEC' (*SEC.gov*, 25 June 2018) <https://www.sec.gov/strategic-plan/about> accessed 10 June 2023
6. The U.S. Securities and Exchange Commission, 'About the SEC' (*SEC.gov*, 22 November 2016) <https://www.sec.gov/about> accessed 5 June 2023
7. The U.S. Securities and Exchange Commission, 'Frequently Asked Questions about Exempt Offerings' (*SEC.gov*, 6 April 2023)

<https://www.sec.gov/education/smallbusiness/exemptofferings/faq> accessed 12 June 2023

8. The SEC's Office of Investor Education and Advocacy, 'Registration Under the Securities Act of 1933' (*Investor.gov*) <https://www.investor.gov/introduction-investing/investing-basics/glossary/registration-under-securities-act-1933> accessed 7 June 2023
9. The U.S. Securities and Exchange Commission, 'Exchange Act Reporting and Registration' (*SEC.gov*, 6 April 2023) <https://www.sec.gov/education/smallbusiness/goingpublic/exchangeactreporting> accessed 9 June 2023
10. The Financial Action Task Force, 'Virtual Currencies: Key Definitions and Potential AML/CFT Risks' (*fatf-gafi.org*, June 2014) <https://www.fatf-gafi.org/en/publications/Methodsandtrends/Virtual-currency-definitions-aml-cft-risk.html> accessed 8 June 2023
11. The U.S. Securities and Exchange Commission, 'Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO' (*SEC.gov*, 25 July 2017) <https://www.sec.gov/litigation/investreport/34-81207.pdf> accessed 11 June 2023
12. The SEC's Office of Investor Education and Advocacy, 'HoweyCoins' (*Investor.gov*) <https://www.investor.gov/ico-howeycoins> accessed 9 June 2023
13. The U.S. Securities and Exchange Commission, 'The SEC Has an Opportunity You Won't Want to Miss: Act Now!' (*SEC.gov*, 16 May 2018) <https://www.sec.gov/news/press-release/2018-88> accessed 9 June 2023
14. Thomsen LC, '2005 PROGRAM' (*SEC.gov*) <https://www.sec.gov/about/offices/oia/oia_enforce/overviewenfor.pdf> accessed 12 June 2023

15. U.S. Department of Justice, 'The Report of the Attorney General Pursuant to Section 8(b)(Iv) of Executive Order 14067: How To Strengthen International Law Enforcement Cooperation For Detecting, Investigating, And Prosecuting Criminal Activity Related To Digital Assets' (*justice.gov*, 6 June 2022) <https://www.justice.gov/ag/page/file/1510931/download> accessed 11 June 2023
16. The U.S. Securities and Exchange Commission, 'Telegram to Return $1.2 Billion to Investors and Pay $18.5 Million Penalty to Settle SEC Charges' (*SEC.gov*, 26 June 2020) <https://www.sec.gov/news/press-release/2020-146> accessed 11 June 2023
17. The U.S. Senate Committee on Banking, Housing & Urban Affairs, 'Toomey: Gensler's Refusal to Give Crypto Regulatory Clarity Hurt Consumers' (*banking.senate.gov*, 27 July 2022) <https://www.banking.senate.gov/newsroom/minority/toomey-genslers-refusal-to-give-crypto-regulatory-clarity-hurt-consumers> accessed 12 June 2023
18. The U.S. Securities and Exchange Commission, 'SEC Charges Coinbase for Operating as an Unregistered Securities Exchange, Broker, and Clearing Agency' (*SEC.gov*, 6 June 2023) <https://www.sec.gov/news/press-release/2023-102> accessed 12 June 2023

PUBLICATIONS BY SECTOR AND OTHERS

1. Brief of Amicus Curiae Coinbase, Inc. Case No. 2:22-cv-01009-TL
2. Deloitte, 'ICOs – The New IPOs? How to Fund Innovation in the Crypto Age' (*deloitte.com*) <https://www2.deloitte.com/content/dam/Deloitte/de/Documents/Innovation/ICOs-the-new-IPOs.pdf> accessed 11 June 2023
3. Global Shares, 'IPO Process, Pros & Cons & FAQs' (*GlobalShares.com*, 27 April 2021) <https://www.globalshares.com/academy/step-by-step-guide-ipo/> accessed 9 June 2023

4. Goswami R and Sigalos M, 'Coinbase Offers a Fiery Response to the SEC's Threat of Enforcement Action' (*cnbc.com*, 27 April 2023) <https://www.cnbc.com/2023/04/27/coinbase-offers-fiery-response-to-sec-wells-notice-.html> accessed 12 June 2023
5. Grewal P, 'We Asked the SEC for Reasonable Crypto Rules for Americans. We Got Legal Threats Instead.' (*coinbase.com*, 22 March 2023) <https://www.coinbase.com/blog/we-asked-the-sec-for-reasonable-crypto-rules-for-americans-we-got-legal> accessed 12 June 2023
6. Grewal P, 'RE: Petition for Rulemaking – "Proof-of-Stake" Blockchain Staking Services' (*assets.ctfassets.net*, 20 March 2023) <https://assets.ctfassets.net/c5bd0wqjc7v0/37LaXLBCdgLHa7GE4TPnmw/7824df367e12f4136951db794a5df63d/Staking_Comment_Letter_3-20-2023_FINAL.pdf> accessed 12 June 2023
7. Hammond S and Ehret T, 'Cryptocurrency Regulations by Country' (*thomsonreuters.com*, 2022) <https://www.thomsonreuters.com/en-us/posts/wp-content/uploads/sites/20/2022/04/Cryptos-Report-Compendium-2022.pdf> accessed 16 April 2023
8. Hirshberg BD and others, 'Equity Capital Markets in United States: Regulatory Overview' (*uk.practicallaw.thomsonreuters.com*, 1 January 2022) <https://uk.practicallaw.thomsonreuters.com/9-501-3333?contextData=(sc.Default)> accessed 9 June 2023
9. Mola S, 'SEC Cryptocurrency Enforcement: 2022 Update' (*cornerstone.com*, 2023) <https://www.cornerstone.com/wp-content/uploads/2023/01/SEC-Cryptocurrency-Enforcement-2021-Update.pdf> accessed 11 June 2023

10. Nakamoto S, 'Bitcoin: A Peer-to-Peer Electronic Cash System' (*bitcoin.org*, 2008) <https://bitcoin.org/bitcoin.pdf> accessed 16 April 2023
11. Shirzad F, 'The Crypto Securities Market Is Waiting to Be Unlocked. But First We Need Workable Rules.' (*coinbase.com*, 21 July 2022) <https://www.coinbase.com/blog/the-crypto-securities-market-is-waiting-to-be-unlocked-but-first-we-need-workable-rules> accessed 12 June 2023
12. The Chamber of Commerce of the United States of America, 'In Re: Coinbase Inc (23-1779) - Brief of Amicus Curiae the Chamber of Commerce of the United States of America in Support of Petitioner' (*uschamber.com*, 9 May 2023) <https://www.uschamber.com/assets/documents/U.S.-Chamber-Amicus-Brief-In-re-Coinbase-Third-Circuit.pdf> accessed 12 June 2023
13. Verma S, Bui N and Lam C, 'Munchee Token: A Decentralized Blockchain Based Food Review/Rating Social Media Platform'