



September 20, 2021

Hon. Gary Gensler, Chair
Securities and Exchange Commission
100 F St NE
Washington, DC 20549

Re: Commission Protection of Certain Digital Asset Investors and Market Participants

Dear Chair Gensler:

We write to urge you to urgently review certain digital assets and related activities for compliance with the federal securities laws and related rules, and take all appropriate action to ensure compliance with the requirements for offers, trading, custody and other activities involving securities. We appreciated the Commission staff's recent Investor Alert regarding digital asset scams,^[1] as well as enforcement activity that has recently been made public, but much remains to be done.

We welcomed your August 3, 2021 remarks to the Aspen Security Forum, and agree with your declaration that “[i]t doesn’t matter whether it’s a stock token, a stable value token backed by securities, or any other virtual product that provides synthetic exposure to underlying securities. These products are subject to the securities laws and must work within our securities regime.”^[2]

Since the federal securities laws were adopted, the Commission and courts have guided companies and their lawyers as to what is, and what is not, a security. For decades, companies, investors, federal and state regulators, and their lawyers have relied upon the clear and yet flexible tests set forth by the Supreme Court. While individual products and technologies have changed over time, these Supreme Court standards protect investors, and focus the markets and regulators on the economic realities of investment products. The value, trading rules, and rights of different market participants for trillions of dollars in investment products now rest on these tests.

We encourage you to vigorously enforce these rules, and we urge lawmakers and regulators alike to avoid perhaps well-intentioned, but ill-advised effort to design more customized rules to promote digital assets determined to be securities. In short, we urge the SEC not to undermine securities regulation and its investor protections by creating new carve-outs or exemptions for digital asset offerings that are in reality securities warranting regulation as such.

It appears as though many existing digital assets meet the definition of a “security” under these longstanding Supreme Court standards,^[3] and yet:

1. those securities are offered without registration with the Commission,^[4]
2. those acting as brokers, custodians, exchanges, and providing other products or services related to those securities are not registering with the Commission, and
3. those acting as brokers, custodians, exchanges, and providing other products or services related to those securities are not complying with the basic investor and consumer protections that are ensured by the federal securities regulatory regime.

Two particularly concerning examples of digital assets that appear to be securities are the two largest stablecoins: USD Coin and Tether. Circle Internet Financial, LLC voluntarily disclosed the July 2021 holdings of USD Coin, the second-largest stablecoin. According to that report, the “reserves” for the digital asset included:

- \$13.0 billion in cash, but also “cash equivalent” securities with maturities up to 90 days;
- \$4.5 billion in corporate bonds, which included “unsecured debt obligations of corporations and financial institutions with a maturity of less than or equal to 3 years” and a “[m]inimum S&P rating of BBB+”;
- \$4.1 billion in Yankee CDs, which included “USD denominated Certificates of Deposit issued in the US by branch(es) of Foreign Banking Organizations” with “[m]inimum S&P rating of S/T A1” and a “maximum maturity of 13 months”;
- \$3.4 billion in “treasury bills, notes and bonds with maximum maturity of 3 years”;
- \$2.2 billion in commercial paper, which included “[u]nsecured debt obligations of corporations and financial institutions with maturities between 91 days and 13 months” with “[m]inimum S&P rating of S/T A1” and “maximum maturity of 13 months”; and
- \$0.2 billion in municipal & US agency bonds.^[5]

These holdings look remarkably similar to a class of pooled investment products with which the Commission is intimately familiar -- money market funds.^[6] In fact, the holdings, marketing, and purported uses of USD Coin appear to draw parallels to both money market funds and bank deposits, and yet neither the product nor those involved in offering, trading, providing custody, or providing other services related to it appear to be complying with the federal securities or banking laws.^[7]

In addition, unlike money market mutual funds that primarily hold very short-term and low-risk investments, USD Coin held as much in corporate bonds as several hedge funds, and such debt, despite being rated “investment-grade”, may still be subject to sharp losses in price or subject to ratings downgrades.^[8]

The limited disclosures regarding Tether are similarly alarming in that the stablecoin appears to have large holdings of commercial paper, secured loans, corporate bonds, funds, and even precious metals.^[1] Historically, the company’s lack of disclosure and aggressive legal maneuvering have given rise to speculation that Tether’s “reserves” may

not be tied “one-to-one” with the dollar value of Tether outstanding and that the “reserves” may be invested in assets that are not cash or cash equivalents.

Clearly, both products may create significant risks to investors and consumers.

Beyond just the digital assets themselves, market participants have begun offering lending services, which are marketed as offering often very attractive yields. Digital asset exchange Coinbase recently disclosed that the Commission’s Division of Enforcement staff is reviewing and considering recommending an enforcement action against the company regarding its proposed digital asset lending product, Lend.^[9] Coinbase was marketing the product as permitting USD Coin investors to “Earn 4% APY on USDC” by allowing Coinbase to administer lending the investors’ USD Coin to other parties.^[10] Here, too, we wonder whether these products may also meet the definition of securities.^[11] If Commission action is warranted in one instance, it is likely warranted in several others.

While the Commission has recently settled an action against one digital asset exchange for trading securities,^[12] much more must be done. It seems clear that many digital asset exchanges are indeed trading securities. As specific digital assets are identified as securities, the Commission staff should be directed to move quickly to identify market participants who are providing products and services related to those securities, and bring them into the federal securities regulatory environment. This may include not only enforcing registration requirements, but also rules related to market participants’ governance and operations, and the antifraud rules.

Further, recent press reports and studies have established that several foreign brokers, custodians, and exchanges for digital assets are permitting trading activity by US investors and customers, again without complying with the federal securities regulatory regime.^[13] While digital asset exchange FTX was identified as likely illegally providing trading services to US customers, the company is aggressively seeking to expand its US investor footprint. For example, the company has already bought the naming rights to the arena for the National Basketball Association team Miami Heat, and is currently engaged in a massive marketing campaign involving numerous high profile celebrities, such as Tom Brady, Giselle Bündchen, Stephen Curry, and others.^[14] How are these advertisements impacting digital asset investors? Are these new investors trading in prohibited assets?

To the extent that some investor and consumer facing digital asset companies are affiliated with registered entities (such as broker-dealers), investors may be unaware of the differences in their level of protections and rights depending on what party they are engaging with. If certain digital assets and the products and services provided are not currently within the Commission’s clear authority, we urge you to ensure that investors and consumers are well informed that they are not working with SEC-regulated entities and are not generally protected by the federal securities regulatory regime.

For example, investors in such digital assets should know that their service providers may not be subject to the fiduciary duties that accompany securities-related activities,

including brokers' duty of "best execution." Similarly, digital assets may not be subjected to the same custody and capital safeguards as securities, thus subjecting the investors to potentially much greater risk of loss if a service provider experiences financial strains. Further, digital asset service providers are not subject to conflicts of interest and self-dealing protections, or to disclosure requirements mandated by securities regulation.

Additionally, the registration process ensures that issuers provide investors with crucial information necessary to make informed investment decisions, and that even in the circumstances where digital assets are deemed securities, issuers of those digital assets have the option of registering offerings with the Commission or seeking one of multiple existing transaction and resale exemptions—a process that several firms are already utilizing.

Lastly, none of these actions preclude other regulators, including bank regulators, from exercising their statutory authority with respect to stablecoins and other digital assets. At the same time, the fact that many of these digital assets raise concerns under banking and other laws should not slow the Commission in fulfilling its statutory mandates to protect investors in securities.

Without significant regulatory guidance, the digital asset marketplace has been born and grown into a Wild West. It is urgent for the Commission and other federal financial regulators to enforce the law to better protect investors and improve the integrity and stability of the digital asset markets.

Sincerely,

Americans for Financial Reform Education Fund

Arthur E. Wilmarth, Jr. Professor Emeritus of Law, George Washington University

Better Markets

Consumer Federation of America

Public Citizen

Revolving Door Project