# Essential Revisions to Strengthen Digital Asset Market Structure Proposals, Prevent Market Failure, and Ensure Securities Law Consistency

**By: Teresa Goody Guillén**

## Introduction[1]

The rapid development of Distributed Ledger Technology ("DLT") and associated digital assets demands a timely and precise regulatory approach. Delay stifles innovation and weakens U.S. competitiveness, while overreach or missteps could trigger market failure. The legislative goal is not to construct a sprawling regime, but to chart a correct course and empower executive agencies with flexible tools to respond as markets evolve. We do not need perfection, but we must avoid steering in the wrong direction.

Current legislative proposals—the House Clarity Act[2] and the Senate Discussion Draft II[3]— would benefit from being scaled back to simple, smart guardrails and nimble agency oversight. A rulebook that takes years to write will be outpaced by the market it seeks to govern. These proposals are myopic in their reliance on decentralization as the key factor in classifying an asset. Further, the Senate draft's re-labeling of the "subject" of an investment contract as an "ancillary asset" is doctrinally incorrect and confusing. The resulting classification based on intangibility is arbitrary, lacks grounding in economic reality, and will result in inconsistent application of securities laws. Procedural requirements, such as agency auto-approvals resulting from resource constraints, are impractical and create misaligned incentives, improperly transferring accountability from private market participants to the government. Additional unintended consequences that will negatively impact the digital asset market and/or create inconsistent or absurd results in the securities law regime are also discussed.

This proposal revises and synthesizes these competing frameworks. It advances an alternative approach to asset classification and proportionate regulation based on: (i) economic property rights (or interests) and the abstraction thereof—the separation of ownership and control over the economic property; (ii) the modularized economic property made possible by DLT—the unbundling of rights and obligations that previously were inextricably combined; and (iii) the

---

[1] This paper builds on the prior paper co-authored by the same author. Goody Guillen, Teresa and Corbett Sterling, Isabelle, *Paving the Path for Crypto Clarity: A Framework for Digital Asset Regulatory Structure* (Discussion Draft) (February 17, 2025), https://ssrn.com/abstract=5156725.

[2] The Clarity Act seeks to provide a regulatory system for the offer and sale of digital asset commodities. Digital Asset Market Clarity Act of 2025 or Clarity Act of 2025 ("Clarity Act"), H.R. 3633, https://www.congress.gov/bill/119th-congress/house-bill/3633/text.

[3] The Senate Discussion Draft II seeks to differentiate digital asset securities and commodities, and create a disclosure regime for newly-created "ancillary assets." Chairman Tim Scott (R-SC), Senators Cynthia Lummis (R-WY), Bill Hagerty (R-TN), and Bernie Moreno (R-OH), Discussion Draft of the Responsible Financial Innovation Act of 2025 (Senate Discussion Draft II") (Sept. 5 2025), https://cdn.sanity.io/files/ifn0l6bs/production/c0fd5849c0fa5f8f591d3825a17a4eaa44db8c9b.pdf. A prior version of the discussion draft ("Senate Discussion Draft I") is available at https://www.banking.senate.gov/imo/media/doc/senate_banking_committee_digital_asset_market_structure_legislation_discussion_draft.pdf.

various risks created by economic abstraction factors (discussed below) and particular modular stacking—risks of ownership of the specific economic property rights without effective control thereof. The approach builds on both longstanding regulatory principles and the thoughtful work of the House and Senate proposals.

**Executive Summary**

To delineate between a security and non-security, or to more precisely identify what constitutes "any interest or instrument commonly known as a 'security,'"[4] it is necessary to identify the *sine qua non* of a security—or the essential element necessary for a security to exist. The more than 30 types of securities enumerated by federal statute all involve economic property interests and the separation of ownership from control (e.g., voting trust certificates, passive partnership interests). Accordingly, this proposal advocates for a framework centered on two core concepts: ***Economic Abstraction*** and ***Modular Ownership***.

***Economic Abstraction*** exists when an economic interest's value depends on an enterprise's[5] success, but the holder lacks meaningful control and direct, enforceable rights. This concept is assessed through five "Economic Abstraction Factors":

1. **Transferability**: The instrument can be freely traded in secondary markets.
2. **Passive Economic Interest**: The holder bears the enterprise's risk or reward without meaningful operational control.
3. **Limited Enforceability**: The holder lacks direct contractual rights to compel performance or obtain meaningful redress for operational failures.
4. **Systemic Dependency**: The instrument's value depends on enterprise-wide performance or managerial execution by an identifiable group rather than external market forces or individual use.
5. **Limited Collective Action**: Holders cannot meaningfully coordinate to exercise collective supervision over the enterprise.

***Modular ownership*** recognizes that DLT allows the unbundling of traditional ownership rights—such as voting, economic interest, and enforceability—into distinct components. This modular approach clarifies the classification of tokens and distinguishes securities from commodities based on structural economic realities.

A central premise of this proposal is that ***capital raising marks the critical trigger for securities market regulation***. It is at this moment—when an enterprise sells financial claims to outsiders to fund its operations or growth—that investor protection and disclosure obligations attach. Outside investors become exposed to financial risk without direct managerial control or internal enterprise information, heightening the risk of information asymmetry and agency conflicts.

[4] The definition of a security includes this as one of its components. 15 U.S.C. § 77b(a)(1).
[5] An "enterprise" is broadly construed generally refers to a venture or undertaking. It is purposeful in its existence in that there is some sort of organized activity with the intent to achieve certain objectives (economic, operational, strategic, etc.), but it does not require any specific structure or scale.

Where these factors do not warrant the application of securities laws, the same risk-based principles can determine the appropriate non-securities regulatory intervention, if any. By leveraging DLT's inherent capabilities—such as transparency and programmability—regulation can be made proportionate to the specific risks an asset presents. For example, digital assets functioning as bearer instruments can be treated as such with modifications. DLT enhances transparency, reduces theft risk, and enables programmable legal compliance, mitigating the concerns associated with traditional bearer bonds. This framework proposes safe harbors for digital bearer instruments that meet specified transparency, antifraud, and AML standards.

A proposed **18-Month Legislative Timeline** would include statutory amendments to direct the U.S. Securities and Exchange Commission ("SEC") to define a "digital asset security" using the Economic Abstraction Factors, broaden the Commodity Futures Trading Commission's ("CFTC") exemptive authority, and grant the CFTC commodity spot market regulatory authority.

## I. Foundational Principles and Theoretical Framework

### A. Core Regulatory Philosophy

This proposed structure builds on the House and Senate bills, offering modifications to avert the critical market failures their current forms might precipitate. While cognizant of the apparent appeal for behavioral tests like decentralization,[6] this proposal advocates for an additional functional approach, based on economic property interests and market structure analysis.[7] This philosophy applies to both securities and non-securities. Central to the securities approach is the recognition that capital raising establishes the basis for regulatory intervention. At this point, the core purposes of securities regulation—capital formation, investor protection, and market efficiency—are most implicated and should be implemented ***through the least intrusive means necessary to achieve these objectives***. This fourth pillar to "protect . . . with as little interference with business as possible" was a main theme of Securities Act of 1933 ("Securities Act"),[8] but it has since been forgotten. The "least intrusive means" is a required and integral element to the development and implementation of the regulatory regime.

This approach is anchored in foundational economic and legal theories, designed to avoid over-regulating markets while instituting safeguards when information asymmetry and moral hazard

[6] While I do not believe that decentralization is an appropriate approach for legislation defining a digital asset security, I am cognizant that this is one method that legislators wish to apply. Accordingly, rather than eliminate the decentralization approach and return to other doctrinal approaches altogether, I propose modifications and alternatives to avoid critical market failure that would ensue if decentralization is a requirement for a digital asset to be a non-security.

[7] *See* Posner, Richard A., *Economic Analysis of Law*, Boston: Little, Brown and Company (1973).

[8] Federal Securities Act, Hearings Before the House Interstate and Foreign Commerce Committee, 1st Session, on H.R. 4314 (Mar. 31, 1933) (Hon. Huston Thompson, former member of the FTC who helped develop the federal securities legislation, stated: "The purpose and policy here is to protect . . . with as little interference with business as possible. This is the main theme upon which we played in building up this bill."); *see* 77 Cong. Rec. 937 (1933) (President Franklin D. Roosevelt observed that federal securities legislative proposals did not pursue investor protection at all costs and were designed to impose "the least possible interference to honest business."); 77 Cong. Rec. 3801- 2 (May 20, 1933) (On H.R. 5480, Fletcher stated: "The country justly demands that the public have some protection . . . and honest business a legitimate chance.").

exist.[9] The framework is rooted in rights/interests, obligations, and risks rather than subjective factors such as profit motive or decentralization.[10] The framework's philosophical foundation rests on four principles:

1. **Economic Abstraction as the Defining Characteristic**: Regulation should apply when economic exposure to enterprise value is separated from meaningful control, creating information asymmetries, agency costs, and collective action difficulties.
2. **Modularized Ownership Recognition**: Regulation must acknowledge that DLT enables the disaggregation of traditional ownership bundles into distinct, transferable modules, each requiring tailored treatment.
3. **Functional Market Structure Analysis**: Regulatory treatment should be determined by the actual economic relationships not formulaic categorizations.
4. **Proportionate Regulation to Specific Risks**: Regulation must be proportionate to the actual risks posed, leveraging an asset's technological capabilities to reduce the regulatory burdens where appropriate.

## B. Inadequacies of Current Proposed Models

### ***The Dangers of Over-Relying on Howey and Decentralization***

The current legislative proposals reduce the security test to a single variable: decentralization. This factor, which may influence one element of the *Howey* test for one type of security (investment contract), is being elevated to the overarching test for all 30+ securities named by statute. This produces an incoherent and contradictory framework that engenders market instability.[11]

---

[9] *See* Smith, Adam, *The Wealth of Nations*, Oxford, England: Bibliomania.com Ltd. (2002). The framework also incorporates Adolf Berle's insight that securities holders possess rights or interests that are economic in nature, divorced from control, and held by individuals who require protection from those who do exercise control. *See* Adolf A. Berle, Gardiner C. Means, *The Modern Corporation and Private Property*, New York: The Macmillan Company (1933, revised ed. 1970).

[10] There are numerous decentralization metrics and indicators, generally falling into the categories of political, economic, and administrative decentralization. If a comprehensive framework is universally adopted, this would reduce subjectivity and enable decentralization to be meaningfully compared across DLT networks. *See* Ovezik, C., Karakostas, D., Milad, M., Woods, D.W., Kiayias, A. (2025). SoK: Measuring Blockchain Decentralization. In: Fischlin, M., Moonsamy, V. (eds) Applied Cryptography and Network Security. ACNS 2025. Lecture Notes in Computer Science, vol 15825. Springer, Cham. https://doi.org/10.1007/978-3-031-95761-1_7.

[11] The Securities Act defines as a security as follows:

> [U]nless the context otherwise requires—(1) [t]he 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.

Over-reliance on the *Howey* test and decentralization leads to two primary problems:

1. **False Negatives**: Instruments that function as securities escape regulation, leaving investors unprotected.
2. **False Positives**: Tokens with genuine utility or functionality are incorrectly classified as securities due to superficial factors like initial fundraising. Examples of non-securities in centralized systems:
   - Prepaid Functional/Utility Token: Redeemable only for services, not transferable
   - Enforceable Royalty NFT: Embedded contract rights tied to IP
   - Cooperative Governance Token: Voting and usage without economic abstraction

This myopic approach will lead to critical failures, including stifled innovation, as projects contort themselves to an amorphous decentralization standard, and increased investor harm from premature project abandonment. Consequently, the proposals fail to address the actual risks, which prevents effective investor/consumer protection (including technological integrity), transparency, and market fairness. Additionally, the proposals create ambiguity regarding the application of specific securities laws, including various anti-fraud provisions and private rights of action. It is also unclear whether, and to what extent, Congress intends to attempt to preempt state statutory and common law (*e.g.*, tort and contract law), and other legal regimes, such as the Uniform Commercial Code.

## ***Why the "Ancillary Asset" Concept is Doctrinally Misguided***

The Senate Discussion Draft II introduces the notion of an "ancillary asset"—"an intangible asset, including a digital commodity, that is offered, sold, or otherwise distributed to a person pursuant to the purchase and sale of a security through . . . an investment contract[,]" which may or may not itself a security. This concept inverts longstanding doctrine. An investment contract is the mechanism for an investment opportunity; the token is the subject of that opportunity.[12] Labeling the token "ancillary" misstates both economic reality and legal substance, producing absurd results. Its definition arbitrarily distinguishes between tangible and intangible assets and creates inconsistent treatment across federal securities laws. To the extent the goal is to reach digital assets on a DLT network, there are more precise distinctions than intangibility, which extends to intellectual property, business-related property (e.g., goodwill), and many financial and contractual claims. It also ignores the other securities instruments and transactions that are capable of involving a digital asset beyond investment contracts and profit-sharing agreements. While the safe harbor provisions for ancillary assets offer a thoughtful framework, anchoring the analysis in economic abstraction—not decentralization—provides a more functional comprehensive approach.

15 U.S.C. § 77b(a)(1). While the foregoing definition from the Securities Act is slightly different in the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(10)), these definitions are typically interpreted consistently. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 847 n.12 (1975).

[12] *Paving the Path for Crypto Clarity* at 15, 29-30.

### C. The Core Concepts: Economic Abstraction and Modularized Ownership

Under § 2(a)(1) of the Securities Act, a "security" encompasses a range of instruments including stocks, bonds, notes, debentures, voting trust certificates, evidence of indebtedness, profit-sharing agreements, and more. These instruments share structural DNA: they are transferable, passive, and represent abstracted economic interests in an enterprise. Enterprise generally refers to a venture or undertaking (regardless of its structure or scale). The fundamental element of a security is essentially economic abstraction in a capital raising context—the condition when an individual bears economic exposure (i.e., risk or reward) to the outcome of an enterprise without having enforceable rights to control or secure that outcome. This condition, where control and risk are separated, is a hallmark of many securities and one reason why regulatory oversight is often needed to mitigate information asymmetry and agency problems. Risk/control separation is not determinative on its own, but its presence across traditional instruments (e.g., voting trust certificates, passive partnership interests, debt notes) suggests it may serve as a foundational diagnostic feature in a functional taxonomy of securities.[13]

Digital assets magnify these issues. ***Economic Abstraction*** manifests as detached exposure to value generation by others, with potentially limited participation but lacking meaningful control, and for which direct enforceable rights are insufficient or structurally limited. [14] ***Modularized Ownership*** allows for the unbundling of rights traditionally bundled in a single asset. By splitting these rights apart, each can be tokenized and sold independently, creating securities-like instruments. DLT enables this unbundling in unprecedented ways, which is why certain digital assets are more akin to securities than others. Digital assets, as modular rights to abstracted economic property, can be analyzed based on the elements that warrant regulation, considering the technological advancements that may mitigate the need for it.

## II. Agency Problems and Collective Action Challenges

Federal securities laws were designed to address two foundational market failures: (1) agency problems (and resulting information asymmetry), and (2) collective action and bargaining failures. These failures provided the structural rationale for mandatory disclosure regimes, fiduciary duties, and antifraud provisions.

---

[13] This approach bears some similarity to the *Howey* test, as the investment contract category has been used to capture nontraditional securities transactions that are ***not enumerated by statute***. However, this proposed regulatory approach differs in significant ways, as it identifies the fundamental requirement(s) of a security—meaning securities enumerated by statute (e.g., voting-trust certificate) and nontraditional investment arrangements that may be an investment contract. This approach identifies what is meant by the term in the definition of a security: "***any interest or instrument commonly known as a 'security,'***" 15 U.S.C. § 77b(a)(1), and is consistent with significant developments of the meaning of a security in federal securities jurisprudence, including: (i) applying a family resemblance test to determine the characterization of an instrument, *Reves v. Ernst & Young*, 494 U.S. 56, 64-65 (1990); (ii) whether the securities laws are necessary as a key factor in determining whether they should apply, *Marine Bank v. Weaver*, 455 U.S. 551 (1982); and (iii) whether the purpose of obtaining the asset is fundamentally consumptive or for speculative investment, only the latter of which requires the extra protection of the securities laws, *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).

[14] Notably, decentralized nature and pseudo-anonymity can make enforcement more difficult and people may incorrectly assume these features mean they have no liability under common law tort, contract, etc.

### A. Agency Problems

Agency costs arise from the separation of ownership and control, particularly when agents (issuers, developers) possess more information than principals (tokenholders). DLT can modify this relationship by aligning incentives and increasing transparency, but it also introduces new risks related to software integrity and cybersecurity.

### B. Collective Action Problems

Securities regulation addresses the difficulty dispersed securities holders face in coordinating oversight, such as to demand information, negotiate principal terms, or monitor management. DLT can either exacerbate this problem through pseudonymity or mitigate it through mechanisms like DAOs. In designing a risk-based approach, the more automated a system, the more critical the integrity of its underlying technology becomes.

### C. DLT as a Disclosure Substitute

DLT's inherent transparency can serve as a substitute for traditional disclosure. On-chain data on token supply, governance, and transactions is often immutable and immediately visible. Smart contracts can embed operational information directly into the asset, providing automated updates. This real-time access can significantly reduce information asymmetry. Consequently, where DLT achieves the core objectives of disclosure, mandatory requirements can be scaled back.

A ***DLT-Based Disclosure Exemption for Securities*** could be warranted when:

1. On-chain data is complete, reliable, and publicly accessible (on a venue and in a format easily accessible by the general public).
2. Tokenholder rights are programmatically enforced via smart contracts.
3. Information accessibility and symmetry exist by virtue of the protocol.
4. Active governance systems allow for effective, coordinated oversight.

This approach prioritizes regulation that is justified by persistent market failures, not rigid adherence to legacy frameworks. It operationalizes the principle that securities regulation must be justified by the persistence of agency costs or collective action problems. Where DLT remedies these market failures, regulatory intervention can step back, resulting in a flexible, cost-effective framework that leverages the benefits of DLT systems. As discussed above, regulatory safeguards may be warranted for technological integrity and cybersecurity to ensure proper functioning of the DLT-based tools.

## III. Digital Assets as Bearer Instruments and DLT Advantages

Many digital assets function as bearer instruments, where control depends on possessing a private key. While traditional bearer bonds were phased out due to risks of money laundering and tax evasion, DLT addresses these concerns through:

1. ***Transparency***: Unlike physical bearer bonds, digital assets on public ledgers provide an immutable transaction history.
2. ***Reduced Theft Risk***: While digital assets face cybersecurity risks, cryptography and multi-signature mechanisms provide security generally superior to physical instruments.
3. ***Audit Trail***: DLT creates comprehensive, tamper-evident audit trails that facilitate regulatory oversight.
4. ***Programmable Compliance***: Smart contracts can embed regulatory requirements directly into digital assets.
5. ***Real-Time Settlement***: DLT enables near-instantaneous settlement and clearing, and reduces counterparty risk and operational inefficiencies.

Given these advantages, the prohibitions on traditional bearer securities can be re-evaluated for DLT-based "smart" bearer instruments.

### A. Safe Harbor Provisions for Digital Bearer Instruments

A safe harbor could deem a digital bearer instrument lawful if it meets certain requirements, such as immutable public recording of transfers, built-in anti-fraud measures, and AML compliance at trading venues. This would provide legal certainty for issuers and developers without precluding necessary disclosures or liability for misconduct.

### B. Modernization of Section 12(g) for DLT Assets

Securities and Exchange Act of 1934 ("Exchange Act") §12(g) requires issuers with widely held equity securities to register their securities and become subject to periodic reporting and disclosure requirements. The triggers for an issuer to register its equity securities are:

1. The issuer has total assets greater than $10 million; and
2. The issuer exceeds 2000 "holders of record,"[15] or if there are 500 or more non-accredited investors among the holders of record (employee compensation-related holders are excluded, and collective investment vehicles and securities held in street name are counted as one holder).

This trigger applies to any class of equity security,[16] which recognizes that equity holders often have a long-term stake in the issuer and bear the issuer's ultimate risk. Debt holders, on the other

[15] A holder of record is "each person who is identified as the owner of such securities on records of security holders maintained by or on behalf of the issuer, subject to" several provisions, two of which are more notable here: (1) when the records of security holders are not properly maintained then holder of record includes any person who would be counted if records were kept in a generally accepted practice; (2) outstanding unregistered or bearer certificates are each counted as being held of record by a separate person unless the issuer can establish that, if registered, the securities would be held by less people. 17 CFR § 240.12g5-1.

[16] For purposes of this section, the term "equity security" is defined as follows:

> to include any stock or similar security, certificate of interest or participation in any profit sharing agreement, preorganization certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, limited partnership interest, interest in a joint venture, or certificate of interest in a business trust; any security future on any such security; or any security convertible, with or without consideration into such a security, or carrying any warrant or right to

hand, are often more concerned with creditworthiness and repayment, as opposed to governance, or a claim on profits or capital appreciation.

Applying this to decentralized networks requires modification. Potential amendments to § 12(g) include:

- Redefine "holders of record" to count unique beneficial owners with freely transferable, economically exposed tokens, omitting custodial or protocol-controlled accounts.
- Registration and disclosure duties could be triggered based not on raw headcounts but market conditions: free transferability, thresholds for retail trading, liquidity, and depth.
- A safe harbor could also exempt issuers from duplicative SEC reporting when all material information is public, reliable, and verifiable on-chain, and is on a venue and in a format making it generally available to the public.

## IV. The Economic Abstraction Framework

### A. Framework Development

The Economic Abstraction Factors provide an analytic framework for determining when an asset should be subject to securities regulation, and are additionally informative to develop regulatory frameworks for non-security digital assets. These factors focus on the risks arising from the separation of economic exposure from meaningful control. Crucially, this framework recognizes that DLT's transparent, programmable infrastructure can mitigate the need for traditional mandatory disclosure. Where DLT provides equivalent or greater market transparency and enforceability, duplicative disclosure requirements are unnecessary.

### B. The Economic Abstraction Factors

An instrument may constitute a security if it exhibits a sufficient clustering of the following characteristics ***in a capital-raising context***. These factors should be considered on a sliding scale in which no single factor is determinative:

1. ***Transferability***: The instrument is capable of being transferred, assigned, or traded in secondary markets without operational involvement in the underlying enterprise.
2. ***Passive Economic Property Right/Interest***: The holder possesses an economic property right or interest such that the holder bears risk or reward of the enterprise (project or venture) without meaningfully participating in operational control. The inability to exercise meaningful control serves as a key indicator that some level of protection may be needed, and may exist due to the: (a) lack of legal control due to agreement or technological restrictions; (b) absence of capacity to control due to requisite expertise; or (c) lack of

---

subscribe to or purchase such a security; or any such warrant or right; or any put, call, straddle, or other option or privilege of buying such a security from or selling such a security to another without being bound to do so.

17 CFR § 240.3a11-1.

practical control due to over-reliance on an identifiable group with unique abilities, including expertise or access.

3. ***Limited Enforceability***: The holder lacks direct, enforceable contractual rights to compel enterprise performance or obtain meaningful redress for operational failures. When economic rights/interests are insufficiently enforceable by private contract, regulation can compensate for the lack of ex ante bargaining power, ex post remedies, etc. This requires someone to be accountable for operational failures, which could include an insurance-like feature, or certain assumptions of risk.[17]
4. ***Systemic Dependency***: The value of the instrument depends on enterprise-wide performance or managerial execution by an identifiable group,[18] rather than individual usage, consumption activities, traditional market forces, and similar factors external to the enterprise.
5. ***Limited Collective Action***: The holders lack the meaningful ability to coordinate with one another to exercise collective responsibility and supervision over the enterprise.

### C. Interplay Between Economic and Governance Rights

An instrument granting both economic exposure and effective governance control may not be a security in the conventional sense. However, nominal governance rights do not equate to meaningful control. If voting rights are practically ineffective due to holder dispersion, information asymmetry, or insider dominance, the holder remains in a state of economic abstraction, and the Economic Abstraction Factors should be considered.

### D. Liability Nuances

Liability for fraud remains, with criminal statutes and common law rights of action fully applicable. Federal securities laws provide enhanced protection, such as relaxed reliance requirements for plaintiffs in certain fraud cases.[19] The regulatory framework must distinguish between ***exempt securities*** and ***exempt transactions***, as they carry different liability standards. The

[17] Notably, digital assets that are goods are subject to express and implied warranties (such as merchantability and fitness for a particular purpose), and certain public policy limitations on the enforceability of disclaimers for strict liability in tort, unconscionability, and fraud/misrepresentation. And those assets or activities that are classified as services are also subject to common law, including contract and tort law, such as principles of implied covenants of good faith and fair dealing, workmanlike performance, professional duty standards, negligence, etc. In most U.S. jurisdictions, one cannot waive liability for gross negligence or willful misconduct as it is against public policy to protect conduct approaching bad faith. The doctrine of unconscionability also serves as a non-waivable backstop: procedurally, it protects from unequal bargaining power and unfair surprise, and substantively it invalidates contract terms that are unreasonably harsh or one-sided. It is worth noting that a smart contract (computer program that automatically executes predefined actions when coded conditions are met) is not the same as a contract (a legally binding agreement between parties formed through offer, acceptance, and consideration), but a smart contract may be used as the performance mechanism. The enforceable contract obligations are rooted in law, not code.

[18] This paper applies a common sense, reasonable interpretation of words. For example, a "an identifiable group" intends to mean an articulable group of persons who coordinate in some manner and are capable of being identified even if they evade or make it difficult to identify them.

[19] Generally, common law fraud requires the plaintiff to prove the elements: (1) material misrepresentation (false statement or omission), (2) defendant know the statement was false or acted with reckless disregard for the truth, (3) defendant made the statement with the purpose of causing the plaintiff to act/not act, (4) plaintiff justifiably relied on the misrepresentation, and (5) plaintiff suffered actual harm as a result of the reliance.

SEC may also exercise its broad exemptive authority under Securities Act § 28 and Exchange Act § 36, which offer flexibility to exempt—conditionally or unconditionally—any person, transaction, or instrument from all provisions of the respective Act.

### E. The Decentralization Puzzle

A sophisticated framework must also account for varying network control structures.

1. ***No Identifiable Control Group, But Economic Rights/Interests Exist.*** When tokenholders have economic exposure, such as price appreciation aligned with increased network usage, but there is no centralized managerial group, the traditional securities law rationale is weaker because there is no identifiable "other" managing the enterprise. Nonetheless, the absence of a control group does not render regulation unnecessary. Systemic risks, including fraud, manipulation, and persistent collective action problems, may still be present, particularly as market-based triggers such as broad retail accessibility and deep liquidity emerge. Thus, regulatory intervention (not necessarily within the securities regime) may still be warranted based on these market characteristics, recognizing that governance failures and regulatory gaps can arise even in the absence of a centralized agent. In addition, technological integrity (e.g., bugs) and cyber risks (e.g., hacking) may warrant different types of regulatory considerations.
2. ***No Identifiable Control Group, and Only Consumptive Use Rights*.** If the instrument confers purely consumptive utility—such as a non-transferable subway card—without any exposure to the enterprise's economic value, it falls outside the scope of securities regulation. The functional token operates solely as a voucher or payment method. A fluctuation in value based on demand for the functional token does not change its non-security characteristics, and does not create the information or agency asymmetries that justify securities law intervention. However, other consumer protections are warranted.
3. ***Diffuse or Fragmented Control.*** When control is so widely dispersed that, while governance rights exist in theory, practical collective action is infeasible. The separation between formal governance entitlements and actual decision-making power results in a persistent economic abstraction: the token holder cannot meaningfully participate in management due to coordination challenges, expertise gaps, or information asymmetry. Regulatory intervention may be warranted to ensure the effectiveness, not simply the formal existence, of governance mechanisms.

This framework encourages regulation that tailors oversight to genuine risks arising from abstraction and control dynamics in digital asset markets.

## V. Market Structure Triggers

Regulatory oversight should be calibrated to market structure characteristics that indicate heightened risk of manipulation, fraud, information asymmetry, or collective action difficulties. These triggers can apply in both securities and non-securities contexts:

1. ***Retail Market Access***: Assets available for trading by retail investors through centralized or decentralized exchanges trigger disclosure requirements if information asymmetry exists and market surveillance to ensure fair and efficient markets.
2. ***Market Depth and Volume***: Significant trading volume, market capitalization, or liquidity metrics above specified thresholds could require more comprehensive market structure oversight and manipulation prevention measures. While large volumes and deep liquidity indicate healthy trading environments, they also increase market susceptibility to manipulation and fraud if left unchecked.
3. ***Ecosystem Interdependence and Significance***: Assets integral to broader digital asset ecosystems or serving as infrastructure for other tokenized instruments may warrant systemic risk assessment and potentially regulatory requirements narrowly tailored and proportionate to the specific risks.

## VI. Registration and Disclosure Framework

***Proportionate Registration***: The regulatory requirements should be scaled to market capitalization, with streamlined procedures for smaller offerings and exemptions for instruments meeting specified criteria related to reduced agency costs and collective action difficulties.

***Proportionate and Flexible Disclosure***: Ongoing disclosure requirements should be calibrated to the degree of information asymmetry, with a focus on materiality. Lighter-touch disclosures, such as something inspired by Form D or Form CF, may be more appropriate.

***Technical Implementation***: Regulatory reporting should leverage DLT technology and standardized data formats to minimize compliance costs while enhancing regulatory visibility and market transparency.

## VII. Legislative Language and Implementation

### A. Proposed Statutory Amendments

***Definition of Digital Asset Security***: One option is to create a new term, "digital asset security," meaning any digital representation of rights or interests in economic property that, in the context of a capital-raising activity, exhibits economic abstraction, as determined by the Economic Abstraction Test, to be established by Commission rule. An alternative is to request that the Commission undergo rulemaking to formalize that "any interest or instrument commonly known as a 'security'" includes any representation of rights or interests in economic property that, in the context of a capital-raising activity, exhibits economic abstraction, as determined by the Economic Abstraction Test, to be established by Commission rule. Under either approach, the Commission would be required to develop an objective test that creates a rebuttable presumption of a security.

***Broad Exemptive Authority for the CFTC***: Extend broad authority to the CFTC to exempt any transaction or instrument from the CEA, similar to the SEC's authority.

***Broad Spot Market Regulatory Authority for the CFTC***: Provide the CFTC with regulatory authority (not only enforcement authority) over the commodity spot markets.

### B. Implementation Timeline

***Phase I (Months 1-6)***: Establish a digital asset regulatory coordination council and develop initial guidance on the Economic Abstraction Test.

***Phase II (Months 7-12)***: Promulgate rules implementing the proportionate regulation framework and streamlined registration procedures.

***Phase III (Months 13-18)***: Implement market infrastructure requirements for trading platforms and custody providers.

***Phase IV (Ongoing)***: Continuously monitor and refine the framework based on market developments and technological evolution.

## VIII. Specific Comments to Senate Discussion Draft II

The following non-exhaustive list highlights issues, in addition to those discussed elsewhere in this proposal, that require particular attention.

1. **Over-reliance on Investment Contract Analysis**: The proposals' focus on investment contracts is doctrinally incorrect. The SEC's historical analysis of analogous assets, such as trading stamps in 1958, is instructive. The Commission correctly refrained from exercising jurisdiction over items like trading stamps, meal tickets, and gift certificates, that may be evidence of indebtedness securities, recognizing they were not what Congress intended to regulate as securities.[20] There are other securities and transactions that are capable of involving digital assets.
2. **Definition of Digital Asset**: The definition requires cryptographic security, but not all DLT assets are cryptographically secured. Permissioned or enterprise DLT systems may use other control mechanisms.
3. **Gratuitous Distributions**: The draft's position that a gratuitous distribution is not an offer or sale must be consistent across the securities laws such as Rule 144 and mindful of long-established securities law precedent that a "gift" intended to create a public market constitutes a sale for "value."[21]

---

[20] SEC Interpretative Rel., The Commission's Statement Regarding Trading Stamps, 17 C.F.R. § 231.3890 (Jan. 24, 1958), https://www.govinfo.gov/content/pkg/FR-1958-01-25/pdf/FR-1958-01-25.pdf ("SEC Stamps Rel."). The SEC concluded that trading stamps were not securities in 1958, which was 12 years after the *Howey* decision and 25 years after the Securities Act was enacted. Trading stamps were small, colorful coupons with adhesive backings provided to customers as a reward mechanism and were a widely used marketing tool used by merchants. 43 Individually, each stamp held minimal monetary value— typically just a few pennies. In 1956, over 168 billion trading stamps were distributed, and there was a significant trading stamps market, including a secondary market. Merchants purchased these stamps from issuers and distributed them to customers, who could collect and redeem them for cash or valuable items such as furniture or toys. In the stamp ecosystem, merchants controlled the distribution, which they significantly altered by offering promotions like "double" or "triple" stamp days, and stamp issuers determined the value of the merchandise for which stamps could be redeemed. Notably, the SEC did not even consider the investment contract analysis potentially applicable here, and only considered whether the stamps were evidence of indebtedness.

[21] The Commission has repeatedly taken the position for over 50 years that the lack of monetary consideration does not mean that there was not an offer or sale for purpose of Section 5; for example, a gift of stock is a sale when the

4. **Consistent Definitions Across Existing Securities Laws**: The concept of ***common control*** must be applied consistently with existing statutes, rules, and precedents. The proposals' new standards and definitions of common control need to be clarified to the extent they are inconsistent with already-existing definitions and thresholds. The use of ***equity interest***, versus ***equity stock***, versus ***share***, need to be adequately defined and in a manner consistent with the already-existing definitions of these terms.
5. **Self-Certification Impracticality**: The Commission lacks the resources to review all self-certifications. This system would transfer liability to the government and create perverse incentives and free-riding, likely leading to a flood of automatic approvals or denials without substantive review due to resource limitations.
6. **Voluntary Disclosure and Liability**: The provisions for opting into securities laws must clarify which liability provisions apply, and how long they apply, if not indefinite, to provide predictability for issuers and purchasers.
7. **Furnished vs. Filed**: The distinction between filed certifications (with heightened liability) and furnished materials should be consistent with the disclosure requirements across the federal securities laws.
8. **Investment Contract Rulemaking**: The proposed rulemaking does not correct existing problems with judicially created tests and introduces new issues. The definition should be revised to require a clear quid pro quo exchange. First, there must be the provision of capital or other assets—this constitutes the investment ("quid"). Second, there must be a legally recognized right or contractual claim to both another party's future efforts to manage a venture on behalf of the investor, and the proceeds of those obligated efforts (e.g., income, revenue, profit)—this represents legal entitlement ("quo").[22]
9. **Conflation of Instruments**: Profit-sharing agreements and investment contracts are distinct instruments and should not be collapsed. Similarly, passive interests in partnerships, limited liability companies, or trusts should not be automatically construed as investment contracts.
10. **Bank Custody and Basel III**: Legislative carve-outs are needed for banks engaging in digital asset services to avoid the prohibitively high capital requirements under Basel III for Group 2 crypto-assets.[23]
11. **Regulatory Sandbox Prohibition**: A permanent prohibition from the sandbox for a fraud conviction, without a time limit, appears improperly targeted.

---

purpose of the "gift" is to advance the donor's economic objectives rather than to make a gift for simple reasons of generosity. *See, e.g.*, Capital General Corporation, 54 SEC Docket 1714, 1728-29 (July 23, 1993) (Capital General's "gifting" of securities constituted a sale because it was a disposition for value, the "value" arising "by virtue of the creation of a public market for the issuer's securities."); *see also SEC v. Harwyn Industries Corp.*, 326 F. Supp. 943 (S.D.N.Y. 1971). SEC, *SEC Brings First Actions to Halt Unregistered Online Offerings of So-Called 'Free Stock*,' SEC Rel. 99-88 (July 22, 1999) (By gifting stock and in some cases receiving additional shares for linking to the issuer's website or soliciting additional investors, the issuers "received value by spawning a fledgling public market for their shares, increasing their business, creating publicity, increasing traffic to their websites.").

[22] Further discussion of proposed changes to the test of an investment contract are discussed in our prior paper. *Paving the Path for Crypto Clarity* at 15, 29-30.

[23] Basel III requires banks to classify crypto assets into two groups, with much different capital requirements, and most crypto exposures are capital-inefficient. Group 2 covers all unbacked crypto (e.g., bitcoin) and requires prohibitively high risk weights (upwards of 1,250%).

12. **Tokenized Real-World Assets**: These assets should continue to be regulated similarly to their underlying counterparts, with the underlying asset's regulator involved in marketplace rulemaking.
13. **DeFi Protocol Regulation**: The draft places too much weight on decentralization and fails to address the actual risks, including information accessibility, cybersecurity, and the enforcement of common law rights and duties, as discussed in footnote 17 *supra*.
14. **Undefined Terms**: Key terms, such as what constitutes a "mass-minted" NFT series, require clear definition.
15. **Failure to Address Accredited Investor Definition**: The antiquated and paternalistic wealth thresholds to access investment opportunities results in arbitrary exclusion from our markets. Intermediation and exclusion from financial markets are significant drivers of DLT and decentralized finance, as well as the creation of alternative economic property structures that fall outside securities regulations. To democratize our financial markets and enable fair access to digital asset securities, the accredited investor definition must be changed contemporaneously, to require no more than basic financial literacy or access to expert advice.[24]

## IX. Conclusion

This proposal's alternative approach—focused on economic abstraction, modularized ownership, and proportionate regulation—addresses the fundamental inadequacies of current legislative proposals. By focusing on the purposes underlying regulatory intervention and leveraging DLT's inherent capabilities, this principle-based approach can better facilitate capital formation, ensure fair and efficient markets, and protect investors without imposing undue burdens on legitimate business activities.

[24] Discission of potential changes to the accredited investor definition are discussed in our prior paper. *See Paving the Path for Crypto Clarity* at 35-36.

**Appendix: DA-K Lite – Disclosure Checklist**

To operationalize this framework, the "DA-K Lite" offers a principles-based disclosure standard tailored to DLT-based enterprises. It is a practical, cost-effective alternative to legacy reporting, focused on materiality and feasibility. Many projects already make this information publicly available.

***Core Protocol Information***

1. **Protocol Description:** Plain-English explanation of the protocol's function and key technical dependencies.
2. **Tokenomics & Supply Schedule:** Disclosure of total supply, issuance/burn schedule, vesting arrangements, and token distribution.

***Governance & Control***

3. **Governance Structure:** Description of voting mechanisms, quorum thresholds, and proposal procedures.
4. **Material Participants:** Identification of core developers, holders with ≥10% governance rights or token supply, and operators of critical infrastructure.

***Financial & Risk Profile***

5. **Treasury & Financials:** DAO treasury balance, major holdings, and spending policies.
6. **Conflicts of Interest:** Disclosure of related-party transactions and governance capture risks.
7. **Known Risks & Dependencies:** Smart contract audit status, legal/regulatory risks, and critical operational dependencies.

***Market Activity***

8. **Trading & Liquidity:** Platforms where the token trades, approximate volume, and any transferability restrictions.

***Ongoing Updates (Event-Driven)***

9. **Material Code Changes**: Major protocol upgrades or forks with economic impact.
10. **Material Governance Events**: Significant votes on treasury allocations or token supply.

***Key Features of the DA-K Lite***

- **Lean**: A principles-based checklist focused on materiality.
- **Machine-Readable**: Encourages reporting in machine-readable formats.
- **Event-Driven**: Emphasizes timely updates rather than rigid quarterly filings.
- **Enforced Access**: Disclosures may be required by trading platforms as a condition for listing.