

Securities Clarities Act Seeks Direction in Muddy Waters of Digital Asset Regulation

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On May 18, 2023, House Majority Whip Tom Emmer (R-MN) and Representative Darren Soto (D-FL) proposed the bipartisan Securities Clarities Act (the “Act”).^[1] The purpose of the Act is to “clarify and codify that an asset sold pursuant to an investment contract...including an asset in digital form..., that is not otherwise a security...does not become a security as a result of being sold or otherwise transferred pursuant to an investment contract.”^[2]

The Act responds to concerns that the U.S. Securities & Exchange Commission (SEC), in recent enforcement actions, has exercised jurisdiction by taking the erroneous position that if a digital asset is initially sold as part of a securities offering, the underlying digital asset itself is forever a security. For example, the SEC has argued that digital assets sold for fundraising purposes years ago remain securities today, even after the network is fully functional and the assets serve a useful function.

While many digital asset businesses are defending themselves in pending SEC enforcement actions and private party civil lawsuits by arguing that the SEC’s position is ahistorical and flawed, congressional intervention would bring much-needed clarity and consistency in this technical and unsettled area of law.

1. The Act Supports *Howey* Test Critiques

Although there is no federal law or regulation in the United States that specifically addresses the circumstances under which a digital asset is a security, the SEC has examined and applied the four-part *Howey* Test, first announced in *SEC v. W.J. Howey Co.*^[3] These four elements of the *Howey Test* surrounding the offer and issuance of an asset ask whether there is

(i) an investment of money; (ii) in a common enterprise; (iii) with a reasonable expectation of profits; and (iv) the expectation of profits is based upon the entrepreneurial or managerial efforts of others.

For years, through its enforcement actions and guidance documents, the SEC has utilized the *Howey* Test to assert that various “crypto assets” are being “offered and sold as investment contracts, and thus as securities.”^[4] However, the applicability of the *Howey* Test to digital assets has come under criticism. Industry participants, litigants, government officials, and at least one SEC commissioner^[5] have questioned whether the *Howey* Test is the appropriate test for secondary-market transactions. These critiques distinguish between an investment contract

transaction, which may be a securities offering, and the underlying investment contract asset, which may not be a security. Even SEC officials have acknowledged if a token became sufficiently decentralized, where “purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts,” the “assets may not represent an investment contract.”^[6]

The Act addresses these recent critiques surrounding the use of the *Howey* Test for digital assets. Specifically, the Act amends the Securities Act of 1933 to:

1. state that the term “security does not include an “investment contract asset,” and
2. define an “investment contract asset” to be “an asset, whether tangible or intangible, including assets in digital form” (a) sold or otherwise transferred, pursuant to an investment contract,” and (b) “that is not otherwise a security.”^[7]

In addition, the Act proposes similar amendments to the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Securities Exchange Act of 1934, and the Securities Investor Protection Act of 1970.

Thus, the Act explicitly recognizes that “although certain...fundraising arrangements may be deemed to be ‘investment contracts’” and thus categorized as securities, “the underlying assets sold pursuant to these arrangements are frequently not themselves inherently securities...[and] do not become securities...merely because they are sold pursuant to an investment contract.”^[8]

2. The Act Provides Necessary Clarity to the Digital Asset Industry

The Act also provides necessary clarity to the digital asset industry. Players in the digital asset space have sought regulatory guidance and rulemaking to guide compliance.^[9] In its release, the Act expresses the views of digital asset leaders who support further clarity, stating that “[t]he industry needs clear rules of the road,” [e]stablishing a predictable legal environment for tokens is one of the most pressing issues facing the digital marketplace today,” and “[t]he lack of clarity...continues to be a major challenge for companies operating in the United States.”^[10]

Importantly, the Act has support from the digital assets industry and is a bipartisan measure. Representative Emmer is a Republican and House Majority Whip, and Representative Soto is a Democrat who currently serves on the Committee on Energy and Commerce. In addition, the Act has support from the Coin Center, Blockchain Association, Chamber of Digital Commerce, and Crypto Council for Innovation.

We will continue to monitor developments in the digital assets and blockchain technology industry and provide friends of the firm with updates as they become available.

^[1] *Emmer and Soto Introduce Bipartisan Bill to Provide Regulatory Clarity for Digital Assets* (May 18, 2023), <https://emmer.house.gov/2023/5/emmer-and-soto-introduce-bipartisan-bill-to-provide-regulatory-clarity-for-digital-assets>; “Securities Clarity Act,” available at chrome-extension://efaidnbnmnibpcjpcglclefindmkaj/https://emmer.house.gov/_cache/files/4/4/44640083-8c24-432d-964e-b0dad3570b6f/A4BFD808D87EF1A7EAB1C7C00FD811C4.signed-bill-text.pdf.

^[2] “Securities Clarity Act,” *supra* note 1 at 3.

^[3] *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946)

^[4] *E.g.*, SEC, Framework for “Investment Contract” Analysis of Digital Assets, available at <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets> (last visited Sept 28, 2021).

^[5] See Commissioner Hester M. Peirce, *How We Howey*, SEC (May 9, 2019), available at <https://www.sec.gov/news/speech/peirce-how-we-howey-050919> (demonstrating Commissioner Peirce’s skepticism toward the applicability of the *Howey* Test in all digital asset offerings).

⁹⁹ William Hinman, Director, Div. of Corp. Fin., “Digital Asset Transactions: When Howey Met Gary (Plastic),” Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018), available at <https://www.sec.gov/news/speech/speech-hinman-061418> (last visited June 8, 2023).

¹⁰⁰ See “Securities Clarities Act,” *supra* note 1 at 4.

¹⁰¹ *Id.* at 2.

¹⁰² See, e.g., Nina Bambysheva and Steven Ehrlich, *Circle Begs Congress: Please Regulate Us*, Forbes Digital Assets (June 7, 2023), <https://www.forbes.com/sites/ninabambysheva/2023/06/07/circle-begs-congress-please-regulate-us/?sh=12436ecf4e2>

¹⁰³ See *Emmer*, *supra* note 1.

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[Carl Fornaris](#)

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Daniel T. Stabile

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