

COIN RUSH IN THE VIRTUAL WILD WEST: THE SEC AS THE NEW SHERIFF IN TOWN

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I. INTRODUCTION

Following the financial crisis of 2008, blockchain-based technology fostered the development of cryptocurrencies and other digital assets.¹ Consumer interest in these technologies burgeoned during the pandemic, forcing regulators to take notice.² Stamping their deserved space in the financial industry, the combined market capitalization for all cryptocurrencies surpassed 3 trillion dollars during a surge in late 2021—far surpassing silver’s market cap, at the time, of 1.14 trillion.³ The current cryptocurrency market cap is hovering just above 1 trillion.⁴

While the future of cryptocurrencies remains unknown, one thing is guaranteed—where consumer interest journeys, regulators are quick to follow. For example, in 2019, the Securities and Exchange Commission’s (SEC) Strategic Hub for Innovation and Financial Technology (“FinHub”) released a framework (“Framework”) for when digital assets—“asset[s] that [are] issued and transferred using distributed ledger or blockchain technology”—may classify as investment contracts under the *Howey* test, and, therefore, securities

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¹ See *Stablecoins Come with Bank-Like Risks*, FIN. TIMES (July 26, 2021), <https://www.ft.com/content/096b9080-cbcc-413d-8053-3d9964db8c5e>.

² See Shalini Nagarajan, *The SEC Is Taking a Hard Line on Stablecoins Right Now*, BUS. INSIDER: MKTS. (Oct. 9, 2021, 07:01 AM), <https://markets.businessinsider.com/news/currencies/stablecoin-regulation-sec-federal-reserve-gary-gensler-jerome-powell-cowen-2021-10>.

³ See *Top Assets by Market Cap*, COS. MKT. CAP, <https://companiesmarketcap.com/assets-by-market-cap> (last visited July 31, 2022); see also Joanna Ossinger, *Crypto World Hits \$3 Trillion Market Cap as Ether, Bitcoin Gain*, BLOOMBERG: MKTS. (Nov. 8, 2021, 4:06 AM), <https://www.bloomberg.com/news/articles/2021-11-08/crypto-world-hits-3-trillion-market-cap-as-ether-bitcoin-gain#xj4y7vzkg>.

⁴ See *Today’s Cryptocurrency Prices by Market Cap*, COIN MKT. CAP, <https://coinmarketcap.com> (last visited July 31, 2022).

subject to SEC governance.⁵ Other agencies similarly discussed releasing “crypto asset” regulations in the near future.⁶

One group of digital assets drawing its fair share of regulatory attention is stablecoins. In fact, a prolonged struggle between the SEC and the Federal Reserve over which would govern stablecoins,⁷ combined with the obvious need to regulate such a prominent financial instrument, compelled the President’s Working Group to release a report on stablecoins.⁸ While the President’s Working Group clarified that stablecoins may fall under both the SEC’s and the Commodity Futures Trading Commission’s (CFTC) jurisdictions, they requested Congress to quickly enact legislation to ensure that stablecoins are “subject to a federal prudential framework on a consistent and comprehensive basis.”⁹

The chief purpose of this Comment is to highlight why stablecoins classify as investment contracts under the SEC’s Framework. It is imperative that those seeking to issue, as well as those seeking to invest in, stablecoins are aware of when they may be dealing with securities—for issuers, to abide by their filing and disclosure duties; for investors, to know the risks involved in their investment.¹⁰ This Comment focuses on why stablecoins classify as securities, rather than on how they should be regulated.¹¹

⁵ See *Framework for “Investment Contract” Analysis of Digital Assets*, U.S. SEC. & EXCH. COMM’N (Apr. 3, 2019) [hereinafter *Framework*], <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>; see also Edward Baer et al., SEC FRAMEWORK FOR DETERMINING WHETHER A DIGITAL ASSET IS A SECURITY: FIRST ANALYSIS I (2019), Lexis: Prac. Guidance (clarifying that “[w]hile the Framework is not a rule, regulation, or statement of the SEC and is not binding on the SEC or its divisions, it is an important signal of the SEC’s position on the application of securities law to digital assets.”).

⁶ See Peter D. Hardy, *Federal Banking Agencies Issue “Crypto Asset Roadmap” for 2022 Guidance*, BALLARD SPAHR LLP (Nov. 29, 2021), <https://www.consumerfinancemonitor.com/2021/11/29/federal-banking-agencies-issue-crypto-asset-roadmap-for-2022-guidance-occ-confirms-prior-interpretive-letters-on-crypto-but-adds-no-objection-requirement>.

⁷ See Nagarajan, *supra* note 2.

⁸ See generally PRESIDENT’S WORKING GRP. ON FIN. MKTS., REPORT ON STABLECOINS (2021), https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

⁹ *Id.* at 1–2.

¹⁰ See *Framework*, *supra* note 5.

¹¹ While this Comment will point to various Acts that stablecoins are subject to as securities, more specific requirements imposed by these regulations are beyond the scope of this Comment.

Part II will detail the recent boom—and a few of the noteworthy busts—in cryptocurrency, focusing on stablecoins in particular. Part III will discuss the background to the SEC’s Framework and explicate the various elements of the *Howey* test, which the SEC uses as the basis for analyzing whether digital assets are investment contracts subject to securities regulation. Part IV will not only show how stablecoins can qualify as investment contracts under *Howey*, but also analogize stablecoins to various types of mutual funds that currently fall under SEC regulation. The Conclusion will propose that Congress and the SEC release further guidance on stablecoins to provide a uniform federal framework for dealing with these complex financial instruments.

II. AMBIGUITY IN A BUDDING INDUSTRY

A. *The Craze*

The explosion in blockchain-based technologies in recent years continues to captivate the attention of consumers and regulators alike.¹² Cryptocurrency’s current trillion-dollar market cap dwarfs the \$200 billion average over recent years.¹³ Furthermore, the previous pinnacle amidst the 2018 “crypto bubble” only peaked just below \$800 billion, whereas the latest boom surpassed \$3 trillion.¹⁴

In the early months of 2017, the total market capitalization of all stablecoins fluctuated around \$20 million.¹⁵ Fast forward five years to the summer of 2022, and that market cap erupts to over \$150 billion—an increase more than 7,500 times over.¹⁶ As of July 2022, there are six stablecoins with a market cap exceeding \$1 billion.¹⁷ While

¹² See, e.g., Ryan Harr, *U.S. Officials Send Mixed Messages on Crypto Regulation. Here’s What It All Means for Investors*, NEXT ADVISOR (Apr. 18, 2022), <https://time.com/nextadvisor/investing/cryptocurrency/crypto-regulation-talks-heat-up>.

¹³ *Total Cryptocurrency Market Cap*, COIN MKT. CAP, <https://coinmarketcap.com/charts/> (last visited Sept. 19, 2022).

¹⁴ *Id.*; Ossinger, *supra* note 3.

¹⁵ Raynor de Best, *Market Capitalization of the 10 Biggest Stablecoins from January 2017 to June 19, 2022*, STATISTA: FIN. INSTRUMENTS & INVS. (June 29, 2022), <https://www.statista.com/statistics/1255835/stablecoin-market-capitalization>.

¹⁶ *Stablecoins by Market Capitalization*, COINGECKO: STABLECOINS, <https://www.coingecko.com/en/categories/stablecoins> (last visited July 31, 2022).

¹⁷ See *Top Stablecoin Tokens by Market Capitalization*, COIN MKT. CAP, <https://coinmarketcap.com/view/stablecoin> (last visited July 31, 2022).

globalization and the need for liquidity continue to grow, it is difficult to imagine this infatuation slowing down anytime soon.¹⁸

With regard to trading activity, Tether—the markets' predominate stablecoin—has nearly 70 billion coins in circulation, while its daily trading volume generally fluctuates between 70 and 100 billion, and often beyond.¹⁹ At one point in May of 2021, its daily trading volume reached nearly \$290 billion.²⁰ In comparison, Apple—one of the most desirable stocks today—has nearly 16.2 *billion* shares outstanding, but its average volume over the last three months is just above 90 *million*.²¹ While less than half-a-percent of the outstanding shares are traded each day for one of the most sought-after stocks, more Tether coins are trading each day than are in circulation—a bewildering amount of volume for an individual asset.²² Such a significant amount of money tied up in an asset class with little-to-no regulation raises genuine concerns over consumer protection and the legitimacy of these ventures.

B. *The Concern*

The primary attraction to stablecoins lies in their promise of maintaining a fixed price relative to a particular asset.²³ Such a task is undeniably no easy feat and contains a wide margin of error. As mentioned previously, Tether's daily trading volume often exceeds the number of coins in circulation, thus complicating the maintenance of a steady value with such a highly liquid secondary market.²⁴ Far larger

¹⁸ See Marco Quiroz-Gutierrez, *Bitcoin—Not Gold—Is the New Inflation Hedge*, Says JPMorgan, FORTUNE: FIN. (Oct. 8, 2021, 2:16 PM), <https://fortune.com/2021/10/08/bitcoin-not-gold-is-the-new-inflation-hedge-says-jp-morgan> (explaining how institutional investors seem to be replacing gold with Bitcoin as their hedge against inflation).

¹⁹ See *Top Stablecoin Tokens by Market Capitalization*, *supra* note 17.

²⁰ *Tether Sees \$2.3T in Monthly Trading Volume, More than Bitcoin and Ethereum*, ANALYTICS INSIGHT (July 1, 2021), <https://www.analyticsinsight.net/tether-sees-2-3t-in-monthly-trading-volume-more-than-bitcoin-and-ethereum>.

²¹ *Apple Inc. (AAPL), Statistics*, YAHOO! FIN., <https://finance.yahoo.com/quote/AAPL/key-statistics> (last visited July 31, 2022).

²² See *Top Stablecoin Tokens by Market Capitalization*, *supra* note 17; see also *Tether Sees \$2.3T in Monthly Trading Volume*, *supra* note 20; *Apple Inc., Statistics*, *supra* note 21.

²³ See generally Julian Dossett, *What Are Stablecoins and Are They Less Risky? The Details Crypto Investors Should Know*, CNET: MONEY (Sept. 26, 2022, 7:01 PM), <https://www.cnet.com/personal-finance/crypto/stablecoins-what-they-are-how-they-work-and-how-to-buy-them>. For a quick primer on stablecoins, see *infra* notes 92–94.

²⁴ See *Top Stablecoin Tokens by Market Capitalization*, *supra* note 17; see also *Tether Sees \$2.3T in Monthly Trading Volume*, *supra* note 20; *Apple Inc., Statistics*, *supra* note 21.

of a concern, however, is the collateral backing the nearly 70 billion coins Tether has in circulation.²⁵ In 2021, Tether came under fire after disclosing that they held \$30 billion dollars of reserves in short-term commercial paper, making them “the seventh-largest holder of such debt.”²⁶ For a venture that prides itself on stability, its uncanny reliance on a less-than-perfectly-stable form of debt is alarming. Because each Tether coin is not directly backed by its respective dollar, many have feared the possibility of a bank run.²⁷

The prospect of this nightmare became all too real when Titan—a governance token used as collateral to stabilize the value of the algorithmic stablecoin,²⁸ Iron²⁹—plummeted from sixty dollars to virtually nothing in a matter of hours when “whale accounts” offloaded massive amounts of shares.³⁰ With the underlying collateral pulled out from under it, the smart contract—a self-executing contract with the terms” written directly into lines of code³¹—temporarily froze coin holders’ ability to redeem coins,³² causing a phenomenon synonymous

²⁵ See Zeke Faux, *Anyone Seen Tether’s Billions?*, BLOOMBERG: BUSINESSWEEK (Oct. 7, 2021, 2:25 PM), <https://www.bloomberg.com/news/features/2021-10-07/crypto-mystery-where-s-the-69-billion-backing-the-stablecoin-tether>. Those reserve breakdowns have since changed. See TETHER: TRANSPARENCY, RESERVES BREAKDOWN (2022), <https://tether.to/en/transparency/#reports>.

²⁶ Faux, *supra* note 25.

²⁷ See *Stablecoins Come with Bank-Like Risks*, *supra* note 1 (emphasizing that stablecoins “combine the potential for bank runs . . . with the all but non-existent regulation of cryptocurrency”); see also Camomile Shumba, *IMF Warns of the Danger to the Financial System from ‘Disappearing’ Crypto Coins and the Instability of Stablecoins*, YAHOO! FIN. (Oct. 13, 2021), <https://finance.yahoo.com/news/imf-warns-danger-financial-system-115144109.html> (“The International Monetary Fund (IMF) has issued a warning about the growing risks in the expanding cryptocurrency space, including . . . potential ‘runs’ on seemingly more stable assets . . .”); Faux, *supra* note 25 (noting a lack of reassurance that Tether always had enough cash to pay out the requests of a single day because “[b]ank runs can last longer than 24 hours”).

²⁸ For an explanation of algorithmic stablecoins, see discussion *infra* Part IV.

²⁹ See *Analysis of the TITAN Token Collapse: Iron.Finance Rugpull or DeFi Bank Run?*, CIPHER TRACE (June 21, 2021), <https://ciphertrace.com/analysis-of-the-titan-token-collapse-iron-finance-rugpull-or-defi-bank-run>.

³⁰ See Shumba, *supra* note 27.

³¹ See Jake Frankenfield, *Smart Contracts*, INVESTOPEDIA: BLOCKCHAIN (Mar. 24, 2022), <https://www.investopedia.com/terms/s/smart-contracts.asp>.

³² *Id.* “A smart contract is a self-executing contract with the terms of the agreement between buyer and seller being directly written into lines of code” that exist on a blockchain network. *Id.*

to a bank run.³³ It seems Iron Finance overestimated their ability to “remove bank run risks . . . and ensure[] FULL redeemability.”³⁴

Fortunately, the Iron debacle drew a disproportionate amount of attention because investor Mark Cuban got “hit like everyone else” and subsequently called on regulators to take initiative in defining stablecoins and imposing regulations.³⁵ If a prominent investor as savvy as Mark Cuban could fall victim to the ambiguity surrounding stablecoins, it is expected that the lack of clarity regarding the collateral backing various stablecoin schemes has the potential to wreak havoc on uninformed retail investors. Unfortunately, however, the Iron fracture proved an insufficient warning to stablecoin issuers.

Fast forward less than a year later and the chilling downfall of Terra exposes that retail investors are far from the only ones to fear. While a comprehensive analysis into Terra’s deterioration is beyond the scope of this Comment, the basic explanation can be broken down as follows: When the value of Terra’s stablecoin, UST, slipped from its peg by just over a cent, fear sparked, and a bank run—combined with massive and unrelenting short positions on UST’s stabilizing token, Luna—pulverized the price to fractions of a cent.³⁶ This time, however, the \$18 billion stablecoin giant left a gaping hole in the crypto community at large, dragging down hedge funds and exchanges alike.³⁷ While the repercussions are still weighing on the industry, regulators, among others, noticed these concerns and are beginning

³³ See *Iron Finance Post-Mortem*, IRON FIN. (June 17, 2021), <https://ironfinance.medium.com/iron-finance-post-mortem-17-june-2021-6a4e9ccf23f5>.

³⁴ See *IRON Stablecoin v2 Design*, IRON FIN. (Aug. 10, 2021), <https://ironfinance.medium.com/iron-stablecoin-v2-design-44a006b5b8b> (emphasis in original).

³⁵ See Emily Graffeo, *Mark Cuban Says He Lost Money Trading a DeFi Token Called Titan that Crashed from \$60 to Zero in One Day*, BUS. INSIDER: MKTS. (June 17, 2021, 3:29 PM), <https://markets.businessinsider.com/news/stocks/mark-cuban-says-he-lost-money-trading-defi-token-titan-that-crashed-to-zero-2021-6>; see also Kevin Reynolds, *In Token Crash Postmortem, Iron Finance Says It Suffered Crypto’s First Large-Scale Bank Run*, YAHOO! (June 17, 2021), <https://www.yahoo.com/now/iron-finance-says-suffered-crypto-170918275.html>.

³⁶ Krisztian Sandor & Ekin Genç, *The Fall of Terra: A Timeline of the Meteoric Rise and Crash of UST and LUNA*, COINDESK (June 1, 2022), <https://www.coindesk.com/learn/the-fall-of-terra-a-timeline-of-the-meteoric-rise-and-crash-of-ust-and-luna>.

³⁷ MacKenzie Sigalos, *From \$10 Billion to Zero: How a Crypto Hedge Fund Collapsed and Dragged Many Investors Down with It*, CNBC: CRYPTO WORLD (July 11, 2022, 3:30 PM), <https://www.cnbc.com/2022/07/11/how-the-fall-of-three-arrows-or-3ac-dragged-down-crypto-investors.html>.

to sort out where exactly stablecoins fit within the existing regulatory framework.³⁸

III. THE NEED FOR REGULATION AND THE SEC'S RESPONSE

A. *Howey: The Original*

With a proliferation of digital assets entering the market, the SEC quickly realized the need to issue guidance for those seeking to create and offer digital assets.³⁹ Both the SEC and federal courts utilize the analysis of an “investment contract” to ascertain when “unique or novel instruments or arrangements, such as digital assets,” qualify as securities subject to SEC jurisdiction.⁴⁰ Because of the novelty and complexity of digital assets, the SEC found it essential to release guidance on the governance of these assets to provide consumers with greater knowledge concerning their investments.⁴¹

The Framework centers around the analysis spelled out in *SEC v. W. J. Howey Co.*, which involved “the application of § 2(1) of the Securities Act of 1933 to an offering of units of a citrus grove development coupled with a contract for cultivating, marketing and remitting the net proceeds to the investor.”⁴² In this infamous case, the Supreme Court held that the scheme constituted an investment contract because purchasers contributed money with the goal of sharing the profits derived from the management and ownership of a large citrus operation, rather than derived through their own occupation and development.⁴³ In short, the buyers were investors rather than farmers. *Howey* and its progeny consistently define “investment contracts” as “the investment of money in a common

³⁸ See PRESIDENT'S WORKING GRP. ON FIN. MKTS., *supra* note 8, at 15; see, e.g., Christina Pazzanese, *Regulators Put Cryptocurrency in Crosshairs*, HARV. GAZETTE: BUS. & ECON. (Sept. 29, 2021), https://news.harvard.edu/gazette/story/2021/09/regulating-the-unregulated-cryptocurrency-market (“SEC Chairman Gary Gensler called cryptocurrency an asset class “rife with fraud, scams, and abuse” and said investors don’t have enough regulatory protection from the swarms jumping into crypto finance, issuance, trading, and lending.”).

³⁹ See *Framework*, *supra* note 5.

⁴⁰ *Id.* SEC regulation imposes certain filing requirements and requires various disclosures. The SEC also prescribes that the information be complete and not materially misleading. *Id.*

⁴¹ *Id.*

⁴² See *SEC v. W. J. Howey Co.*, 328 U.S. 293, 294 (1946).

⁴³ *Id.* at 299–300.

enterprise with a reasonable expectation of profits to be derived from the efforts of others.”⁴⁴

Because individuals purchased these contracts from the company itself, the Court had no problem finding “an investment of money in a common enterprise.”⁴⁵ Further, the Howey Company’s promise to share the profits from the respectively owned tracts of land permitted the Court to establish that purchasers had a reasonable expectation of profits.⁴⁶ The Court focused on the essential efforts of the citrus operation to deliver returns and a lack of effort on behalf of the purchasers, noting that “the promoters manage, control and operate the enterprise,” while investors simply “provide the capital and share in the earnings.”⁴⁷ Emphasizing the difficulty individual purchasers faced when seeking to earn a profit themselves due to a “lack [of] equipment and experience requisite to the cultivation,” the Court stressed that Howey’s “personnel and equipment” were imperative “if the investors [were] to achieve their paramount aim of a return on their investments.”⁴⁸ The Court further noted that users had no intention of exerting their own efforts but rather were “attracted solely by the prospects of a return on their investment.”⁴⁹ Thus, the Court unambiguously held that the Howey Company offered investment contracts that should have been registered with the SEC.⁵⁰

B. *Howey in the Digital Age*

FinHub’s Framework breaks the *Howey* test down into four parts: (1) the investment of money (2) in a common enterprise (3) with a reasonable expectation of profits (4) derived from the efforts of others.⁵¹ The Framework immediately clarifies that the first two prongs are generally satisfied when a digital asset is offered and primarily focuses on the latter two elements.⁵² The Framework explains that the investment of money typically exists “in an offer and sale of a digital

⁴⁴ *Framework*, *supra* note 5; *Howey*, 328 U.S. at 298; *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 848 (1975); *SEC v. Telegram Grp.*, 448 F. Supp. 3d 352, 365 (S.D.N.Y. 2020).

⁴⁵ *See Howey*, 328 U.S. at 299–300.

⁴⁶ *Id.* at 299.

⁴⁷ *Id.* at 300.

⁴⁸ *Id.* at 299–300.

⁴⁹ *Id.* at 300.

⁵⁰ *Id.* at 301.

⁵¹ *See generally Framework*, *supra* note 5.

⁵² *Id.*

asset because the digital asset is purchased or otherwise acquired in exchange for value”—regardless of the form the consideration takes.⁵³ Similarly conclusive is their finding “that a ‘common enterprise’ typically exists” in the offering of a digital asset.⁵⁴ Because of the Framework’s emphasis on the last two prongs, this analysis will likewise narrow its focus to the reasonable expectation of profits derived from the efforts of others.⁵⁵

1. Reliance on the Efforts of Others

In determining when a purchaser is relying on the efforts of others, two questions must be asked. First, “[d]oes the purchaser reasonably expect to rely on the efforts of an” Active Participant (AP)?⁵⁶ If so, the next question is whether those efforts are “the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise,” as opposed to efforts that are more ministerial in nature?⁵⁷ If the answer to both questions is “yes,” then a purchaser is relying on the efforts of others. To help answer the second question, the SEC provides a list of characteristics that indicate a reliance on the efforts of others, carefully noting that “[a]lthough no one of the following characteristics is necessarily determinative, the stronger their presence, the more likely it is that a purchaser of a digital asset is relying on the ‘efforts of others.’”⁵⁸

According to the Framework, consumers are more likely to rely on the efforts of others when an AP manages “the development, [] operation, or promotion of the network” or digital asset.⁵⁹ This is particularly true when users “expect an AP to be performing or overseeing tasks that are necessary for the . . . digital asset to achieve or retain its intended purpose or functionality.”⁶⁰ Reliance on the efforts of others is also more likely to exist when these tasks are

⁵³ *Id.*

⁵⁴ *Id.* Although it can be argued that there are many instances where a common enterprise may not exist, such as in certain decentralized currencies, because this Comment focuses on centralized stablecoins, the common enterprise section is beyond the scope of this Comment.

⁵⁵ See SEC v. W. J. Howey Co., 328 U.S. 293, 298 (1946).

⁵⁶ See *Framework*, *supra* note 5. The Framework defines an AP as a “promoter, sponsor, or other third party (or affiliated group of third parties).” *Id.*

⁵⁷ *Id.* (quoting SEC v. Glenn W. Turner Enters., 474 F.2d 476, 482 (9th Cir. 1973)).

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

“expected to be performed by an AP, rather than an unaffiliated, dispersed community of network users.”⁶¹ Further, when an AP plays a key role in “deciding governance issues, code updates, or how third parties participate in the validation of transactions” involving the digital asset, reliance is more likely to be found.⁶² The key with each of these factors is that a third party must be responsible for maintaining the functionality of the network or digital asset rather than the consumers themselves. Contrarily, if the digital asset is self-sustainable and an AP no longer affects its success, consumers are not relying on the efforts of others.⁶³

When an AP establishes or otherwise embraces a market for the digital asset, including by “control[ing] the creation and issuance of the digital asset; or [by] tak[ing] other actions to support a market price of the digital asset,” these actions weigh towards finding a reliance on the efforts of others.⁶⁴ Actions that support a market price include “limiting supply or ensuring scarcity, through, for example, buybacks, ‘burning,’ or other activities.”⁶⁵ Reliance on the efforts of others is also more likely to exist when an AP has an ongoing managerial role in deciding “whether and where the digital asset will trade.”⁶⁶ This is even more true when the “AP has arranged, or promised to arrange for, the trading of the digital asset on a secondary market or platform.”⁶⁷

2. Reasonable Expectation of Profits

The final prong of the Framework considers whether the purchaser has a reasonable expectation of profits.⁶⁸ The Framework notes—in reference to the Supreme Court’s definition in *United Housing Found., Inc. v. Forman*⁶⁹—that “[p]rofits can be, among other things, capital appreciation resulting from the development of the initial investment or business enterprise or a participation in earnings resulting from the use of purchasers’ funds.”⁷⁰ The Framework goes

⁶¹ *Id.*

⁶² *Framework, supra* note 5.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Framework, supra* note 5.

⁶⁹ *Id.*

⁷⁰ *Id.* (citing *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 852 (1975)).

on to observe that purchasers can also reasonably expect to earn a profit when “[t]he digital asset is transferable or traded on or through a secondary market or platform.”⁷¹ Thus, by specifying “among other things,” it seems clear that the SEC was not restricting profits to just “capital appreciation” or “a participation in earnings,” but that profits may also derive from trading or transferring on a secondary market.⁷² The Framework was quick to clarify, however, that “[p]rice appreciation resulting solely from external market forces (such as general inflationary trends or the economy) impacting the supply and demand for an underlying asset” does not qualify as “profit” under *Howey*.⁷³

In addition to the potential profit a secondary exchange promises when the AP markets the digital asset—“directly or indirectly”—in ways that emphasize its ability to earn a profit, the SEC is more inclined to find a reasonable expectation of profits on behalf of the purchaser.⁷⁴ In particular, when the AP emphasizes “[t]he availability of a market” where the digital asset can be traded, the SEC finds a reasonable expectation of profits is more likely to exist.⁷⁵ This is “particularly [true] where the AP implicitly or explicitly promises to create or otherwise support a trading market for the digital asset.”⁷⁶ Further, the Framework makes clear that when “[t]he ready transferability of the digital asset is a key selling feature,” the SEC is more willing to find an expectation of profits.⁷⁷

The Framework finishes its discussion on the expectation of profits by noting various circumstances in which a purchaser may no longer expect to derive profits from the digital asset. Digital assets that have proved “a direct and stable correlation to the value of the good or service for which it may be exchanged or redeemed[,]” are less likely to provide consumers with a reasonable expectation of profits.⁷⁸ Further, when “holders are then able to use the digital asset for its intended functionality,” the attraction likely lies in its consumptive use rather than its prospect for appreciation.⁷⁹

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Framework, supra* note 5.

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

3. Other Relevant Considerations

When determining whether the elements of *Howey* are satisfied, “federal courts look to the economic reality of the transaction.”⁸⁰ To be clear, the focal point of the Framework is not just on the structure and terms of the digital asset, “but also [] the circumstances surrounding the digital asset and the manner in which it is offered, sold, or resold.”⁸¹ This inquiry characterizes the instrument according to “the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.”⁸² The analysis is objective and “depends on the specific facts and circumstances” surrounding each digital asset.⁸³

The Framework ends by enumerating various other considerations the SEC deems relevant, though not determinative, to the analysis of an investment contract. The more prominent these characteristics are, “the less likely the *Howey* test is met.”⁸⁴ The SEC struggles to find a reliance on the efforts of others when the network or digital asset is “fully developed and operational.”⁸⁵ Fully developed and operational networks, while rare, are those that no longer need improvement and can instantly be used for their designated purpose.⁸⁶ This is particularly true when the digital asset’s use is restricted to the network and can only “be held or transferred [] in amounts that correspond to a purchaser’s expected use” of the asset.⁸⁷ In this respect, the Framework observes that when the digital asset in question is a virtual currency, its immediate ability “to make payments in a wide variety of contexts [] or act[] as a substitute for real (or fiat) currency” decreases the likelihood that a digital asset is an investment contract.⁸⁸

⁸⁰ *Framework*, *supra* note 5.

⁸¹ *Id.*

⁸² *Id.* (citing *SEC v. C.M. Joinder Leasing Corp.*, 320 U.S. 344, 352–53 (1943)).

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Framework*, *supra* note 5.

⁸⁷ *Id.*

⁸⁸ *Id.* In addition, virtual currencies that effectively act “as a store of value” are less suitable to classification as a security under *Howey*. Something that qualifies “as a store of value” is capable of being “saved, retrieved, and exchanged for something of value at a later time.” *Id.*

IV. STABLECOINS AS SECURITIES

This Part first provides a brief background on stablecoins. It will then illustrate how stablecoins satisfy the Framework by providing a reasonable expectation of profits derived from the efforts of others and, consequently, classify as securities subject to SEC regulation. It will also analogize stablecoins to money market mutual funds, which also fall under the SEC's jurisdiction. Because stablecoins are potentially classified as different types of securities, the SEC should release further guidance to clarify which set of regulations stablecoin issuers must abide by and under what circumstances. Similarly, because stablecoins may resemble other assets—such as commodities—in various circumstances, it is important for Congress to encourage the implementation of a cohesive federal framework surrounding stablecoins.

Public skepticism in financial institutions—both centralized and private—following the 2008 financial crisis catalyzed the development of blockchain-based currencies.⁸⁹ While cryptocurrencies such as Bitcoin and Ethereum were early pioneers in alternative currency, cryptocurrency's instability and constant price fluctuation ultimately remained a barrier to many consumers entering the blockchain sphere.⁹⁰ Recognizing a market for consumers wary of both institutional finance as well as volatile cryptocurrency, companies began issuing stablecoins.⁹¹

Stablecoins sustain a stable price by tying (also known as “pegging” or “tethering”) their value to an underlying asset or bundle of assets.⁹² The underlying asset can be virtually anything, from fiat currencies such as the U.S. dollar and the Chinese yuan, to commodities, such as oil and gold.⁹³ Pegging to another asset can be achieved through (1) holding various forms of collateral, such as fiat currencies or physical gold, in reserve and issuing coins as the

⁸⁹ See *Stablecoins Come with Bank-Like Risks*, *supra* note 1.

⁹⁰ Usman W. Chohan, *Are Stable Coins Stable?*, *Notes on the 21st Century*, CRITICAL BLOCKCHAIN RSCH. INITIATIVE, Mar. 29, 2020, at 1, 2.

⁹¹ The process of creating a stablecoin on blockchain is commonly referred to as “minting.” See *What Are Stablecoins?*, GEMINI: CRYPTOPEDIA, (June 28, 2022), <https://www.gemini.com/cryptopedia/what-are-stablecoins-how-do-they-work>.

⁹² See EVA SU, CONG. RSCH. SERV., DIGITAL ASSETS AND SEC REGULATION 16 (2021).

⁹³ See, e.g., *Gemini Dollar*, GEMINI, <https://www.gemini.com/dollar> (last visited July 31, 2022); *GOLD COIN*, <https://goldcoin.com> (last visited July 31, 2022); Jake Frankfield, *Petro (PTR)*, INVESTOPEDIA: ALTCOINS (Feb. 26, 2022), <https://www.investopedia.com/terms/p/petro-cryptocurrency.asp>.

collateral comes in; (2) carefully calculating arrangements with other assets, such as investing in money market accounts or short-term corporate debt; or (3) utilizing an algorithm designed to maintain the stablecoins' value by buying and selling as needed.⁹⁴ When companies rely exclusively on the first method of pegging—issuing a coin every time the corresponding collateral is received and maintaining that collateral in a secure vault or savings account—the argument for treating stablecoins as securities becomes more attenuated.⁹⁵ As will be discussed below, however, holding the underlying asset in reserve in an amount equal to the number of outstanding coins is rarely the exclusive method stablecoin issuers utilize.⁹⁶

This Part will focus on currency-pegged stablecoins⁹⁷ and show how they independently satisfy the *Howey* test due to the complex efforts stablecoin issuers endure to maintain a stable value and the reasonable expectation of profits from earned interest. It will also analogize stablecoins to SEC-registered mutual funds and exchange-traded funds (ETFs) due to their overwhelming similarities in management.⁹⁸ While there are many different types of mutual funds,

⁹⁴ See Chohan, *supra* note 90, at 2–3, 6.

⁹⁵ *Id.* at 2–4.

⁹⁶ See, e.g., *Reserves Breakdown*, *supra* note 25; CAMERON WINKLEVOSS, INDEPENDENT ACCOUNTANTS' REPORT: GEMINI DOLLAR AND CASH BALANCES AS OF AUGUST 31ST, 2021 3 (2021), https://assets.ctfassets.net/jg6lo9a2ukvr/3U43d7IUPmunUNLa0f9xui/24e439e3040c92179245485ebd1b5ba1/Gemini_Dollar_Examination_Report_08-31-21.pdf.

⁹⁷ Commodity-pegged and crypto-pegged stablecoins are the other two most prominent types of stablecoins and attempt to track the value of a specific commodity or cryptocurrency, respectively. See *What Are Stablecoins?*, *supra* note 91. These stablecoin classes are beyond the scope of this Comment.

⁹⁸ Mutual funds and ETFs are “investment compan[ies] that pool[] money from many investors and invest[] the money in stocks, bonds, short-term money-market instruments, other securities or assets, or some combination of these investments.” See *Mutual Funds and Exchange-Traded Funds (ETFs) — A Guide for Investors*, U.S. SEC. & EXCH. COMM'N. (Jan. 26, 2017), <https://www.sec.gov/reportspubs/investorpublications/investorpubsinwsmfhtm.html>. Because stablecoins are both offered directly from the minting company (e.g., Tether) as well as traded on secondary exchanges, this Comment will ignore this difference between mutual funds and ETFs. Stablecoins regulated as mutual funds would be subject to the Investment Act of 1940, just as mutual funds are. See generally Investment Company Act of 1940, 15 U.S.C. §§ 80a-1–80a-64.

this analysis focuses primarily on bond funds,⁹⁹ alternative funds,¹⁰⁰ and money-market funds.¹⁰¹ Again, because of their resemblance to several securities within the SEC's jurisdiction, it is imperative that the SEC release further guidance on stablecoins. Alongside a more stablecoin-specific framework from the SEC, Congress should release a complementary federal framework detailing the interplay between agencies such as the SEC and CFTC.

A. *When Howey Met Currency-Pegged Stablecoins*

Currency-pegged stablecoins are exactly that—stablecoins whose underlying value is tied to a traditional fiat currency.¹⁰² This Section will highlight how these stablecoins meet the Framework's definition of an investment contract due to the elaborate efforts coin issuers exert to preserve a stable value and their endorsement of high interest rates available on primary and secondary lending platforms that allow consumers to reasonably expect a profit. Because stablecoins also resemble money market mutual funds, however, the SEC must clarify which regulations they will subject stablecoins to.

1. *Howey*: Reliance on the Efforts of Others

Stablecoin purchasers rely on the efforts of others because an AP—rather than the purchaser or a dispersed network—manages the “development, [] operation, [and] promotion” of stablecoins, and those efforts are the “undeniably significant ones” controlling the fate of the stablecoin.¹⁰³

As mentioned previously, stablecoins—particularly, currency-pegged stablecoins—rarely rely exclusively on the first method of pegging but, instead, employ a combination of strategies designed to perpetuate stability.¹⁰⁴ These strategies, in turn, amplify the difficulty in maintaining a consistent value and require “undeniably significant” efforts on behalf of the coin issuers. Gemini, a blockchain-focused

⁹⁹ *Mutual Funds and Exchange-Traded Funds (ETFs) — A Guide for Investors*, *supra* note 98. (“Bond funds invest primarily in bonds or other types of debt securities.”).

¹⁰⁰ *Id.* (“Alternative funds are funds that invest in alternative investments such as non-traditional asset classes (e.g., global real estate or currencies) and illiquid assets (e.g., private debt) and/or employ non-traditional trading strategies (e.g., selling short).”).

¹⁰¹ *Id.* (“[M]oney market funds try to keep their NAV at a stable \$1.00 per share.”).

¹⁰² See *What Are Stablecoins?*, *supra* note 91.

¹⁰³ See *Framework*, *supra* note 5.

¹⁰⁴ See, e.g., WINKLEVOSS, *supra* note 96, at 4; *Reserves Breakdown*, *supra* note 25.

financial platform, for example, pegs its stablecoin one-to-one to the U.S. dollar and embodies the most common structure for a stablecoin,¹⁰⁵ not only in terms of its exchange ratio but also in its method of pegging.¹⁰⁶ Gemini asserts that “[f]or [every] Gemini dollar issued, the Company has received one corresponding U.S. dollar,” which they hold in “one or more omnibus bank accounts” and/or “one or more money market accounts.”¹⁰⁷ Thus, although Gemini holds some of their reserves in secure bank accounts, they also have exposure to money market accounts, which are inherently riskier than cash—albeit by a modest amount.¹⁰⁸

Other companies, including Tether, similarly invest their reserves in “cash equivalent” forms of collateral but are slightly more liberal in their definitions of “cash equivalent.”¹⁰⁹ Tether, pegged one-to-one with the U.S. dollar, admits in their whitepaper that their “[r]eserves include traditional currency, cash equivalents and, from time to time, may include other assets and receivables from loans.”¹¹⁰ These “cash equivalents” include various types of “secure” debt, such as short-term commercial paper, Treasury bills, and reverse repo notes.¹¹¹

Creating a diverse portfolio of assets in an attempt to maintain a stable value is no easy feat and requires constant attention and adjustments as market forces drive interest rates in circles. This system, requiring persistent maintenance, is far from a self-sustaining asset no longer affected by an AP.¹¹² Because the price of any stablecoin would waver in the wake of so many moving parts without continuous surveillance and restructuring, the efforts of the coin issuer are “those essential managerial efforts which affect the failure or success of the

¹⁰⁵ A one-to-one peg to the U.S. dollar means that one coin is exchangeable for one U.S. dollar. *Gemini Dollar*, *supra* note 93.

¹⁰⁶ See generally *Top Stablecoin Tokens by Market Capitalization*, *supra* note 17 (illustrating that a vast majority of large-cap coins are exchangeable one-to-one with the U.S. dollar); *Gemini Dollar*, *supra* note 93.

¹⁰⁷ See WINKLEVOSS, *supra* note 96, at 3.

¹⁰⁸ See, e.g., James McWhinney, *Money Market Mayhem: The Reserve Fund Meltdown*, INVESTOPEDIA: BANKING (Oct. 31, 2021), <https://www.investopedia.com/articles/economics/09/money-market-reserve-fund-meltdown.asp> (detailing the “run” on money market funds following the Lehman Brothers bankruptcy, where the Reserve Primary Fund “broke the buck” and fell to ninety-seven cents per share).

¹⁰⁹ See *Reserves Breakdown*, *supra* note 25.

¹¹⁰ TETHER GOLD—A DIGITAL TOKEN BACKED BY PHYSICAL GOLD 4 n.8 (2022), <https://gold.tether.to/Tether%20Gold%20Whitepaper.pdf>.

¹¹¹ See *Reserves Breakdown*, *supra* note 25.

¹¹² See *Framework*, *supra* note 5.

enterprise” and are mandatory for the stablecoin to “retain its intended purpose or functionality”—namely, maintaining a stable value.¹¹³

Just like the consumers in *Howey* lacked the equipment and experience needed to cultivate the citrus grove,¹¹⁴ consumers similarly lack the equipment and knowledge required to create and maintain an asset with a stable value. Minting a *single* stablecoin poses equipment and coding challenges by itself, let alone raising the requisite capital to maintain a diverse portfolio capable of sustaining an army of coins.¹¹⁵ Accordingly, “an AP, rather than an unaffiliated, dispersed community,”¹¹⁶ oversees essential tasks, such as creating the token and “deciding governance issues [and] code updates.”¹¹⁷

Because consumers have no impact on maintaining the stablecoin’s value (nor does a dispersed group of network users) and because the price of the coin would swing without someone overseeing it, consumers must rely on the efforts of others.

2. *Howey*: Reasonable Expectation of Profits

The reasonable expectation of profits for currency-pegged stablecoins lies in the emphasis stablecoin issuers place on the high interest rates available to consumers.¹¹⁸ As recognized in the Framework, when a digital asset is “transferable or traded on . . . a secondary market,” a reasonable expectation of profit is more likely to exist.¹¹⁹ This is particularly true when an “AP implicitly or explicitly promises to create or otherwise support a trading market for the digital asset.”¹²⁰ Gemini, a crypto-based company founded by the Winklevoss twins,¹²¹ created a secondary trading and lending platform called Gemini Earn, which touts up to 8 percent interest when users lend its

¹¹³ *Id.*

¹¹⁴ See SEC v. W. J. Howey Co., 328 U.S. 293, 299–300 (1946).

¹¹⁵ Creating a single stablecoin will not give it the necessary utility to be able to be lent at such high interest rates. It is only when there are billions of coins that have consistently maintained their peg that institutions trust the coin enough to be willing to pay abnormally steep interest rates.

¹¹⁶ *Framework*, *supra* note 5.

¹¹⁷ *Id.*

¹¹⁸ See, e.g., *Gemini Earn*, GEMINI, <https://www.gemini.com/earn> (last visited July 31, 2022); *Where You Can Trade*, BINANCE, <https://www.binance.com/en/busd> (last visited July 31, 2022).

¹¹⁹ See *Framework*, *supra* note 5.

¹²⁰ *Id.*

¹²¹ Shobhit Seth, *Gemini*, INVESTOPEDIA: CRYPTOCURRENCY (July 21, 2022), <https://www.investopedia.com/tech/gemini-winklevoss-bitcoin-exchange>.

stablecoin Gemini dollar.¹²² When consumers purchase Gemini dollar—or any stablecoin for that matter—on Gemini Earn, Gemini can automatically lend their coins for them, earning them interest without any further affirmative action on their part beyond purchasing the coins. Binance also spotlights—as one of only two uses—its stablecoin’s ability to earn interest through lending and directs users to over twenty-five secondary trading platforms.¹²³ Similar marketing appears on nearly every stablecoin’s website—whether the company employs their own lending platform or points users to secondary platforms.¹²⁴ These secondary platforms offer even higher interest rates—upwards of 12 percent.¹²⁵

While the expectation of profits clearly derives from the efforts of an AP when the same company that issues the stablecoin also maintains its lending platform, the connection is only slightly more difficult when stablecoin companies rely on third parties for the same. The Framework clarifies, however, that creating the secondary market is not mandatory so long as the issuer “otherwise support[s] a trading market for the digital asset.”¹²⁶ Additionally, the SEC considers the “economic reality” of the transaction and the investment scheme as a whole, rather than whether the isolated asset is inherently a security.¹²⁷ Minting stablecoins on blockchain makes them tradable on decentralized, peer-to-peer exchanges—even if a centralized lending platform is unavailable—and by not only permitting, but encouraging, users to trade on these secondary exchanges, stablecoin issuers sufficiently support a trading market for their coin.

¹²² See *Gemini Earn*, *supra* note 118.

¹²³ See *Where You Can Trade*, *supra* note 118.

¹²⁴ See, e.g., *Circle Yield*, CIRCLE, <https://www.circle.com/en/products/yield> (last visited July 31, 2022) (advertising Circle Yield, a new product that is built with USDC and will allow users to earn nearly 7 percent interest annually by lending their USDC and other digital currencies); *Why Use Tether?*, TETHER, <https://tether.to/en/why-tether> (last visited July 31, 2022) (advertising Tether’s liquidity and widespread adoption across exchanges).

¹²⁵ *Best Stablecoin Interest Rates*, COIN MKT. EXPERT, <https://coinmarketexpert.com/crypto-savings-account/stablecoin-savings-account> (last visited July 31, 2022); *Stablecoin Interest Rates*, COIN INT. RATE, <https://www.coininterestrate.com/stablecoin-interest-rates> (last visited July 31, 2022); Jean Galea, *How to Earn 12% Returns on Stablecoins—Best Platforms*, JEAN GALEA (Aug. 11, 2022), <https://jeangalea.com/stablecoins-interest>.

¹²⁶ See *Framework*, *supra* note 5.

¹²⁷ *Id.*

Further evidence that stablecoins trading on secondary exchanges constitute securities for regulatory purposes is the Wells Notice—a formal notice from the SEC informing a recipient that the agency is planning to bring enforcement actions against them¹²⁸—Coinbase received for its proposed program Lend, which would allow consumers to earn up to 4 percent interest by lending the stablecoin USD Coin.¹²⁹ The SEC warned Coinbase that, after analyzing Lend through the lens of *Howey*, “they consider Lend to involve a security.”¹³⁰

Although it may be argued that lending programs, but not stablecoins, are securities, the focus of the *Howey* analysis is on the economic reality of the transaction, and the reality is that consumers purchase stablecoins expecting to passively earn a profit.¹³¹ Further, the Framework focuses not only on the structure and terms of the digital asset itself, “but also on the circumstances surrounding the digital asset and the manner in which it is offered, sold, or resold.”¹³² Thus, the SEC would likely view the lending programs in conjunction with the stablecoins themselves. While the attraction lies in the “consumptive” use of lending the stablecoin, consumers are still relying on the efforts of an AP to uphold the coin’s integrity and, consequently, retain its ability to be lent profitably. Further, this is only one factor in a totality-of-the-circumstances analysis focusing on the economic reality, which ultimately shows consumers are relying on third parties to maintain a coin’s value so that it can be lent profitably.

The ability to earn a higher interest rate on these platforms is only possible because of the company’s efforts to maintain a coin’s consistent value. This is not the case where “solely . . . external market forces . . . [are] impacting the supply and demand” of the coin, causing its price to appreciate.¹³³ In fact, stablecoins are *designed* to prevent appreciation—particularly appreciation caused by the supply and demand on a secondary exchange.¹³⁴ Rather, the coin’s value—and,

¹²⁸ Adam Hayes, *Wells Notice*, INVESTOPEDIA: SEC & REGUL. BODIES (Apr. 26, 2022), <https://www.investopedia.com/terms/w/wellsnotice.asp>.

¹²⁹ See Paul Grewal, *The SEC Has Told Us It Wants to Sue Us over Lend. We Don’t Know Why*, COINBASE: COINBASE BLOG (Sept. 7, 2021), <https://blog.coinbase.com/the-sec-has-told-us-it-wants-to-sue-us-over-lend-we-have-no-idea-why-a3a1b6507009>.

¹³⁰ *Id.*

¹³¹ *Framework*, *supra* note 5.

¹³² *Id.*

¹³³ *Id.*

¹³⁴ See *On Supply and Demand for Stablecoins*, DANKRAD FEIST (Sept. 27, 2021), <https://dankradfeist.de/ethereum/2021/09/27/stablecoins-supply-demand.html>.

consequently, profit—derives from its ability to be lent at such high interest rates on secondary exchanges.¹³⁵ And because stablecoins can only be lent at such high interest rates if the company successfully promotes its coin and consistently maintains a fixed value, “external market forces” are not exclusively what give consumers an expectation of profit, but, alternatively, the *internal* efforts of the stablecoin issuer itself matter.¹³⁶ If the company’s efforts fail and the price of the coin fluctuates, as do many traditional cryptocurrencies, it becomes hard to imagine anyone would be willing to pay such an exorbitant interest rate to borrow an unstable asset. Further, by including the word “solely,” the SEC likely wished to exclude from the definition of profit cases where a digital asset is created and then left untouched—with its price to be bound between the struggles of supply and demand. Due to the complex efforts of APs mentioned above, if stablecoins were left untouched and subject exclusively to the influences of market forces, the intrinsic properties that give them value would vanish.¹³⁷ Thus, the reasonable expectation of profits can only exist when the AP exerts reasonable efforts to maintain a consistent value, and, therefore, the profits can be said to derive from those efforts.

The Framework further notes that when “[t]he ready transferability of the digital asset is a key selling feature,” a reasonable expectation of profits is more likely to exist.¹³⁸ Thus, because stablecoin issuers are quick to point to an abundance of secondary exchanges where their coins can be traded and lent, it is hard to deny that immediate transferability is a principal selling point.¹³⁹ The fact that stablecoins’ primary method of earning profit is through these exchanges, an AP’s emphasis on these secondary exchanges further supports an expectation of profits.¹⁴⁰ Since, when held in a wallet, there is otherwise little difference between traditional currency and the digital representation of such on blockchain, if the consumer was not looking to lend the stablecoin for a profit, they would presumably keep their money in traditional fiat currency to avoid the possibility of the stablecoin losing its peg. Thus, while possible that one purchases

¹³⁵ See discussion *supra* note 125.

¹³⁶ *Framework*, *supra* note 5.

¹³⁷ See discussion *supra* Part IV.A.1.

¹³⁸ See *Framework*, *supra* note 5.

¹³⁹ See, e.g., *Where You Can Trade*, *supra* note 118.

¹⁴⁰ See Paulina Likos, *What Are Stablecoins and How Can I Invest in Them?*, U.S. NEWS: CRYPTOCURRENCY (May 21, 2021, 3:09 PM), <https://money.usnews.com/investing/cryptocurrency/articles/what-are-stablecoins-and-how-can-i-invest-in-them>.

stablecoins without the intention of lending them, the economic reality of an overwhelming majority of cases will reveal that consumers are purchasing these coins with the expectation of earning high interest.

Because stablecoin issuers market their stablecoin's ability to be transferred on a secondary platform and further emphasize its ability to earn high interest rates, consumers reasonably expect to earn a profit.

3. Other Relevant Considerations

Finally, balancing all the other relevant considerations—the economic reality of the transaction and the manner in which stablecoins are offered, sold, and resold—supports the finding that stablecoins are investment contracts. Although the overwhelming presence of these factors leads one to believe that stablecoins are securities, the *Howey* test is still fact-specific, focusing on the specific circumstances surrounding each digital asset.¹⁴¹

The economic reality of stablecoins is that investors purchase these coins expecting the issuer to endure significant efforts to maintain their value so that the investors can earn astronomical interest rates on secondary exchanges. Thus, consumers reasonably expect to earn a profit, and those profits can only be derived from the complex efforts of an AP. Looking at “the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect,”¹⁴² stablecoins check all the boxes for securities. Not only can stablecoins be bought, sold, and transferred on secondary exchanges, but issuers actually *encourage* stablecoin holders to do so.¹⁴³ Thus, the economic inducement held out to consumers is the prospect of earning exceptional yield simply by lending their coins.¹⁴⁴

The SEC also has trouble finding an investment contract when the digital asset is “fully developed and operational[.]” as investors would not expect the AP to engage in any efforts to promote the digital asset at that point.¹⁴⁵ Stablecoins, however, are never fully developed but, rather, are constantly adjusting to the demands of the market in

¹⁴¹ *Framework*, *supra* note 5.

¹⁴² *Id.* (footnote omitted).

¹⁴³ See *Gemini Earn*, *supra* note 118 (emphasis added).

¹⁴⁴ See discussion *supra* note 125.

¹⁴⁵ See *Framework*, *supra* note 5.

order to hold their peg.¹⁴⁶ Maintaining a fixed price relative to another asset, *without* respect to market forces on the derivative asset, prevents stablecoins from fully developing because of the underlying asset's constant price fluctuation. Supply and demand therefore prevent stablecoins from developing to a point beyond that which requires constant attention. In an effort to mitigate the effects of market forces, stablecoin issuers regularly engage in “minting” and “burning” stablecoins and are always developing the ecosystem of stablecoins they have in circulation.¹⁴⁷

Finally, when a digital asset can instantly be used for its designated purpose, it requires no further development, and the SEC is unlikely to find an investment contract.¹⁴⁸ Further, virtual currencies that can be used as “payments in a wide variety of contexts, or act[] as a substitute for real (or fiat) currency” are unlikely to be securities.¹⁴⁹ Stablecoins can be thought of as virtual currencies, so this section of the Framework is of particular importance. Stablecoins, however, cannot be used as a form of payment in any major context, let alone “in a wide variety of contexts.”¹⁵⁰ One cannot walk into their local coffee shop and buy a cappuccino with stablecoins, nor can one pay for a book on Amazon with stablecoins. Stablecoins are not a substitute for real money because they provide different utility and are non-fungible with traditional currency.¹⁵¹ Evidence of their non-fungibility lies in end-users' willingness to pay extreme interest rates for stablecoins.¹⁵² While the Framework notes that virtual currencies acting as a store of value are less suitable to classification as investment contracts, the Framework does not automatically disqualify such classification—particularly when there are significant, continuing

¹⁴⁶ See *infra* note 147.

¹⁴⁷ Minting is the process of creating a stablecoin, while burning is the process of destroying a stablecoin—effectively removing it from the market. See Harper Li, *Examining the Status of Stablecoin Minting and Burning Activities*, COINTELEGRAPH (June 12, 2020), <https://cointelegraph.com/news/examining-the-status-of-stablecoin-minting-and-burning-activities>, for a look into the minting and burning activities of the major stablecoin issuers.

¹⁴⁸ *Framework*, *supra* note 5.

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ Whereas fiat currency can be used as a universal form of payment, stablecoins cannot be used to purchase goods or services in the traditional marketplace.

¹⁵² Were these assets fungible, they would demand the same interest rates. See discussion *supra* note 125.

efforts on behalf of an AP to maintain that store of value.¹⁵³ Because of the plethora of factors weighing towards an investment contract, it is unlikely that this single factor will be dispositive.

Even though an asset deriving its value through use looks like a commodity, the totality of the circumstances and the economic reality of the transaction show that consumers purchase stablecoins in hopes of earning a profit, and that profit is contingent on the active efforts of a third party. This is exactly the type of situation the SEC seeks to encompass in its Framework.

B. *Currency-Pegged Stablecoins as Mutual Funds*

While currency-pegged stablecoins satisfy the analysis for an investment contract, they can also be likened to mutual funds since they similarly “pool[] money from many investors and invest[] the money in stocks, bonds, short-term money-market instruments, other securities or assets, or some combination of these investments.”¹⁵⁴ Money market funds aim to maintain a stable value of one dollar per share and are required by law to invest only in “certain high-quality, short-term investments issued by the U.S. Government, U.S. corporations, and state and local governments.”¹⁵⁵ Because money market funds similarly strive to maintain a consistent value, they are substantively the most similar to stablecoins.¹⁵⁶ Not only do both currency-pegged stablecoins and money market mutual funds attempt to maintain a consistent value, but they both strive to maintain a value of one dollar per share or coin.¹⁵⁷

Bond funds and alternative funds also mirror stablecoins in their underlying investment strategies.¹⁵⁸ Just as bond funds invest in bonds and other debt securities, stablecoins often invest in various forms of debt, such as treasury-bills and commercial paper.¹⁵⁹ Similarly, when stablecoins use traditional currency as collateral, they begin to resemble alternative funds. The similarities become even more salient

¹⁵³ See *Framework*, *supra* note 5. Something that qualifies “as a store of value” is capable of being “saved, retrieved, and exchanged for something of value at a later time.” *Id.*

¹⁵⁴ See *Mutual Funds and Exchange-Traded Funds (ETFs) — A Guide for Investors*, *supra* note 98.

¹⁵⁵ *Id.*

¹⁵⁶ See *id.*

¹⁵⁷ *Id.*

¹⁵⁸ See *id.*

¹⁵⁹ See, e.g., *Reserves Breakdown*, *supra* note 25.

when stablecoins “employ non-traditional trading strategies,”¹⁶⁰ such as algorithms, designed to buy and sell as needed to counter the effects of supply and demand on the coin’s price.

Because of the wide variety of strategies stablecoins utilize to maintain their peg, stablecoins currently resemble a hybrid of the various mutual funds discussed above. Since stablecoins’ attraction lies in their promise of keeping a value equivalent to one dollar, however, imposing the same regulations as money market funds may be necessary for consumer protection. Consumers purchase both money market mutual funds and stablecoins expecting their value to remain consistent. Because of consumer reliance on this promise, the SEC has imposed tight restrictions on money market mutual funds regarding the types of assets they can invest in.¹⁶¹ Restricting the permissible assets to high-quality investments prevents spontaneous fluctuations from the target price, and ultimately helps these funds meet consumers’ expectations.¹⁶² Imposing these same restrictions on stablecoins would not only ensure that the investment is free from the dangers that riskier asset classes pose, but also drive consumer demand by providing investors with transparency and peace of mind.

Due to the similarities to both investment contracts and mutual funds, the SEC should release a stablecoin-oriented framework detailing how they plan to regulate this emerging asset class without stifling its growth.

V. CONCLUSION

Stablecoins are subject to SEC regulation because of both their qualification as investment contracts and their resemblance to money market mutual funds. Stablecoins satisfy the SEC’s Framework for an investment contract because consumers have a reasonable expectation of profits derived from the efforts of others.¹⁶³ Consumers reasonably expect to profit because the stablecoin issuer advertises the coin’s ability to earn high interest rates on primary and secondary exchanges. Further, this profit derives from the efforts of others because an AP employs significant, complex efforts to maintain the coin’s stable

¹⁶⁰ See *Mutual Funds and Exchange-Traded Funds (ETFs) — A Guide for Investors*, *supra* note 98.

¹⁶¹ See Troy Segal, *Money Market Funds: What They Are, How They Work, Pros and Cons*, INVESTOPEDIA (Apr. 7, 2022), <https://www.investopedia.com/terms/m/money-marketfund.asp>.

¹⁶² See *id.*

¹⁶³ See *SEC v. W. J. Howey Co.*, 328 U.S. 293, 298 (1946).

value. Without those efforts, the coin's stability would falter, and institutions would be unwilling to pay the high interest rates consumers have otherwise come to expect.

Stablecoins, however, also resemble money market mutual funds in their promise of maintaining a stable value of one dollar per "share" or "coin."¹⁶⁴ Many stablecoins also employ strategies similar to money market funds by investing in high-quality, short-term debt.¹⁶⁵ Because stablecoins mirror both investment contracts and money market mutual funds, the SEC should release further guidance to clarify which set of regulations stablecoin issuers must abide by and under what circumstances. Congress should also release a federal framework detailing the interplay between the agencies so that stablecoin creators and issuers understand all the various guidelines they must adhere to.

¹⁶⁴ See discussion *supra* Part IV.B.

¹⁶⁵ See discussion *supra* Part IV.B.

