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United States Senate
COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS
WASHINGTON, DC 20510-6075

July 26, 2022

The Honorable Gary Gensler
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairman Gensler:

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

In recent weeks, several companies whose crypto lending services were arguably within the SEC's purview have collapsed. These firms often promised enormous, seemingly unsustainable interest rates to depositors,¹ and at least one business allegedly engaged in risky practices.² One of these enterprises, Celsius, reportedly had nearly \$12 billion in assets under management,³ using funds from thousands of Americans to make loans to entities making short-term crypto investments. Customer funds have been frozen since mid-June, leaving in question the status of billions of dollars worth of deposits.⁴

Had the SEC responded to calls for clarity on how it would apply existing securities laws to novel digital assets and services, things might have been different. Companies could have adjusted product offerings accordingly, preventing investor losses today, and the SEC would have been free to focus enforcement efforts on the worst actors. For instance, the SEC could have clarified how the *Howey* and *Reves* tests applied to crypto lending platform products that paid interest to customers making crypto deposits. It is known the SEC already had an opinion

¹ Television Interview with Senator Pat Toomey, Sen. Pat Toomey on the need for clarity on crypto regulations, CNBC, Sept. 15, 2021 ("I think it is a little bit of the wild west and there's no doubt some of these projects are going to end badly. Some of these projects are offering returns that don't make sense to me, it's hard for me to imagine they are sustainable."), <https://www.cnbc.com/video/2021/09/15/sen-pat-toomey-on-the-need-for-clarity-on-crypto-regulations.html>.

² Kadhim Shubber & Joshua Oliver, *Inside Celsius: how one of crypto's biggest lenders ground to a halt*, Financial Times, Jul. 13, 2022, <https://www.ft.com/content/4fa06516-119b-4722-946b-944e38b02f45>.

³ Kate Rooney, *Embattled crypto lender Celsius files for bankruptcy protection*, CNBC.com, July 13, 2022, <https://www.cnbc.com/2022/07/13/embattled-crypto-lender-celsius-informs-state-regulators-that-its-filing-for-bankruptcy-imminently-source-says-.html>.

⁴ Steven Zeitchik & Rachel Lerman, *Crypto's frozen mystery: The fate of billions in Celsius deposits*, Washington Post, June 21, 2022, <https://www.washingtonpost.com/technology/2022/06/21/celsius-withdrawal-freeze-explained/>.

on this matter. Three months before Celsius and Voyager ended up freezing customer accounts (and ultimately declaring bankruptcy), the SEC had already concluded that another crypto lending company, BlockFi, offered a similar product that fell under the *Howey* test, which determines when something is an investment contract, and thus, a security. As the SEC states, this test consists of whether “there is the investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others.”⁵ Furthermore, the SEC could have shared its view on how it thought digital asset lending products met the *Reves* test, which generally considers notes to be securities if used as investments and not as part of commercial transactions like a secured business loan or automobile purchase.⁶

Instead, the SEC is choosing to regulate by enforcement, selectively deciding to apply its opaque position on when digital assets and services are securities. For example, on July 21st, the SEC announced insider trading charges against a former employee of cryptocurrency exchange Coinbase and two other persons, claiming they illegally traded nine digital asset securities.⁷ In this circumstance and elsewhere, the SEC ostensibly had a clear opinion on why it thinks these digital assets are securities, yet it did not disclose that view publicly before launching an enforcement action. There are many reasons to be skeptical of the SEC’s view that most digital assets are securities. Among those reasons is that an associated token may not give its owner any claim to the profits or assets of an enterprise, potentially calling into question whether there could be a reasonable expectation of profits or an investment in a common enterprise under the *Howey* test. Similarly, there may be other reasons why a token may not have all the features of a common enterprise. By contrast, a security typically has both of these features. Hence, regulatory clarity is needed to resolve these questions and many others involving digital assets and services.

Even as this regulatory uncertainty makes it difficult for well-intentioned companies to comply with SEC regulation, the capricious nature of regulation-by-enforcement is of limited utility for protecting consumers. As early as January of this year, press reports indicated the SEC was investigating whether Celsius and Voyager were in compliance with securities laws.

Unfortunately, the SEC failed to act before these two companies went bankrupt.⁸ In the face of SEC inaction, states have taken it upon themselves to act, citing securities laws violations. For example, in September 2021, New Jersey issued a cease-and-desist order for Celsius’s operations within its state, saying, “Celsius’s website fails to disclose to investors that [it] is not currently registered with any federal or state securities regulator even though, as a security, it is subject to such requirements.”⁹

⁵ U.S. Securities and Exchange Commission, *Framework for “Investment Contract” Analysis of Digital Assets*, https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets#_ednref5.

⁶ U.S. Securities and Exchange Commission, *BlockFi Agrees to Pay \$100 Million in Penalties and Pursue Registration of its Crypto Lending Product*, Feb. 14, 2022, <https://www.sec.gov/news/press-release/2022-26>.

⁷ U.S. Securities and Exchange Commission, *SEC Charges Former Coinbase Manager, Two Others in Crypto Asset Insider Trading Action*, July 21, 2022, <https://www.sec.gov/news/press-release/2022-127>.

⁸ Joe Light, Matt Robinson, & Zeke Faux, *Crypto Lending Firms Celsius Network, Gemini Face SEC Scrutiny*, Bloomberg, Jan. 26, 2022, <https://www.bloomberg.com/news/articles/2022-01-26/crypto-lending-firms-celsius-network-gemini-face-sec-scrutiny>.

⁹ New Jersey Bureau of Securities, *New Jersey Bureau of Securities Orders Cryptocurrency Firm Celsius to Halt the Offer and Sale of Unregistered Interest-Bearing Investments*, Sept. 17, 2021, <https://www.njoag.gov/new-jersey-bureau-of-securities-orders-cryptocurrency-firm-celsius-to-halt-the-offer-and-sale-of-unregistered-interest-bearing-investments/>.

Regardless of the merit to any specific SEC or state-based enforcement action, the SEC's continued refusal to give regulatory clarity to the crypto community, combined with a haphazard and an apparently sluggish enforcement pace harms not only investors, but also innovation. It poses a serious challenge for any developer or company striving to comply with existing laws and regulations. Market participants who lack the benefit of the SEC's thinking prior to designing a product may never create something that uses emerging technologies to solve a previously unsolvable problem.

To better understand how the SEC viewed the circumstances of the aforementioned crypto lending companies, please provide written answers to the following questions no later than August 9, 2022:

1. Are there other major crypto lending companies besides BlockFi that have not registered their services with the SEC? If so, please identify them.
2. After the SEC determined that BlockFi's lending product was a security, did the SEC determine whether any other companies, including Celsius and Voyager, were offering similar services that the SEC believed were securities?
 - a. If so, for what companies did the SEC make those determinations and on what date were those determinations made?
3. What material differences has the SEC identified between BlockFi and other crypto lending companies?
4. Did Celsius, Voyager, BlockFi, or any similar crypto lending company ever ask the SEC for guidance as to whether their crypto lending services were securities? If so, when were those inquiries first made and what did the SEC say in response?
5. Did the SEC determine whether to pursue an enforcement action against Celsius or Voyager? If so, when did the SEC make those determinations?
6. The SEC's insider trading charges against a former Coinbase employee and two other persons allege that they illegally traded nine digital asset securities, yet the U.S. Department of Justice's criminal charges against those defendants claim they made illegal trades in at least 25 digital assets. What distinguishable features do these nine digital assets have that the SEC determined were securities, compared to the other 16 digital assets the SEC did not include in its charges?
 - a. What guidance does the SEC plan to provide for these 16 digital assets?
7. In the absence of a commitment by the issuer of a digital asset to provide an investor a specific return or a claim against the issuer, how would an investor have a sufficiently well-founded expectation of profits to pass *Howey*'s "expectation of profits" and "investment in a common enterprise" prongs?

8. How does a decentralized open-source network comprised solely of software code meet the “common enterprise” and “efforts of others” prongs of the *Howey* test?

I hope when you urge crypto firms to “come in and talk to us,” you will have the SEC provide clear and useful feedback.¹⁰ The public, both crypto enthusiasts and skeptics alike, would benefit, too. A regulation-by-enforcement approach simply fails to provide the regulatory clarity that is needed.

Sincerely,



Pat Toomey
Ranking Member

cc: The Honorable Sherrod Brown, Chairman, Senate Committee on Banking, Housing, and Urban Affairs
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner

¹⁰ Testimony of SEC Chairman Gary Gensler Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, Sept. 14, 2021, <https://www.banking.senate.gov/imo/media/doc/Gensler%20Testimony%209-14-21.pdf>.