

SEC Staff Doubles Down on Howey for Digital Assets

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Last week, the SEC staff published new detailed guidance on its views of when a digital asset may be considered a security, in the form of two documents: a guidance “framework” issued by the SEC’s Strategic Hub for Innovation and Financial Technology and a no-action letter from the SEC’s Division of Corporation Finance. The [Framework for “Investment Contract” Analysis of Digital Assets](#) sets out “a framework for analyzing whether a digital asset is an investment contract” under the Supreme Court’s *Howey* decision,¹ and thus a security under federal securities laws, and “whether offers and sales of a digital asset are securities transactions.” At the same time, the SEC’s Division of Corporation Finance granted [no-action relief](#) for the offer and sale, without registration under the Securities Act of 1933, of a particular digital asset that is part of a proposed program for prepaid on-demand air charter services.

The guidance is not what many in the digital asset industry were likely hoping for—it reaffirms the staff’s position that digital assets sold to investors to raise capital are generally securities, regardless of potential utility, and charts a narrow path for the sorts of digital assets that the staff would not consider a security. With that said, as acknowledged by the staff, the Framework is intended to be instructive only, and none of the factors and considerations it identifies are determinative. Therefore, the analysis of whether a particular digital asset constitutes an investment contract, or is otherwise a security, under the federal securities laws will continue to require a careful facts and circumstances analysis.

Key Takeaways

Investment Contract Analysis Framework

- The Framework and the no-action letter represent a reaffirmation by the SEC staff of the positions the SEC and the staff have taken to date regarding the treatment of digital assets as securities. From its [Section 21\(a\) report on The DAO in 2017](#), [Director Bill Hinman’s speech in 2018](#), and various enforcement actions, the SEC and its staff have consistently taken the position that digital assets may be securities and should generally be evaluated under existing case law, including the *Howey*
- The Framework focuses on two particular factors under the *Howey* analysis, whether there is a “reasonable expectation of profits derived from efforts of others” (**REPDEO**), after concluding that the other two factors—the investment of money and the existence of a common enterprise—are generally met for digital asset offerings. The Framework includes lists of factors or considerations that the SEC staff believes indicate that a digital asset may be a security. These factors are extensive and, in our experience, many of these factors are met by many digital assets available today (although by Bitcoin and Ether to a lesser degree).
- The Framework identifies a key concept that the SEC staff focuses on in assessing whether the REPDEO factors are met—efforts of an “Active Participant.”
 - Under the Framework, an Active Participant, or AP, is a person or group that “provides essential managerial efforts that affect the success of the enterprise.” In the staff’s view, where an investor relies on the efforts of the AP, or may be expected to rely on the efforts of an AP, the REPDEO factors would generally be met.
 - An Active Participant is not limited to the promoter or sponsor of a digital asset. Instead, the Framework describes an AP as potentially also including a third party or group of third parties unaffiliated with the promoter or sponsor of a digital currency and lists a broad range of activities in which an AP may engage beyond those of a promoter or

sponsor.

- The Framework refers, for example, to APs that play a lead or central role in deciding governance issues, code updates, or how third parties participate in transaction validation; that determine where a digital asset will trade; that create or support a market for a digital asset; or that play a leading role in the validation or confirmation of transactions. Additionally, the Framework refers to successor APs, indicating that the person or entity to whom purchasers look for essential managerial efforts may well change over time.
 - This guidance includes a broader interpretation of who the “other” may be under the REPDEO factors and, accordingly, raises questions about the degree of decentralization that would be required in the operation of a digital asset or its underlying blockchain for the SEC staff to consider these factors are not met.
- The Framework focuses on a number of other important indicia of whether the REPDEO factors would be met, including marketing emphasis, existing use case functionality, and the consistency of token value, size of purchases, and trading volume with consumptive usage. The Framework also notes that the extent to which a digital asset is transferable and tradeable would be considered as contributing to a view that the REPDEO factors are met for the digital asset (although it may not be dispositive).
 - The Framework also supports the view, first expressed by Director Bill Hinman, that a digital asset sold as a security may not always continue to be a security, based upon reevaluation of the digital asset subsequent to its initial sale.

Turnkey Jet No-Action Letter

- The no-action relief is narrow and is unlikely to provide meaningful guidance or practical utility for many types of currently available digital assets or firms considering issuing digital assets.
- The no-action letter relates to a proposed digital asset program by TurnKey Jet, Inc. The proposed program would employ a private, permissioned, centralized blockchain network and smart contract infrastructure to allow the transfer and exchange of pre-paid non-refundable U.S. dollar-backed tokens redeemable for air charter services. In indicating it would not recommend enforcement action for offering and selling the tokens without registration under the Securities Act and the Exchange Act, the SEC staff emphasized the following characteristics of the proposed program:
 - TurnKey Jet’s platform and tokens will be fully developed and operational at the time any tokens are sold, and tokens will be immediately useable for purchasing air charter services at the time they are sold;
 - the high degree of correlation between the token’s value and the value of the air charter services—the tokens would be sold at a price of one U.S. dollar each, and each token would represent an obligation for an air charter service to supply one U.S. dollar of charter services;
 - the token would be marketed in such a manner as to emphasize its function, as opposed to any increase in market value; and
 - TurnKey Jet will restrict transfers of tokens, so that they are transferable only to other TurnKey Jet wallets and not to wallets external to the platform.

Law clerk Adam Fovent contributed to this post.

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¹ SEC v. W.J. Howey Co., 328 U.S. 293 (1946)