

Professional Perspective

Securities Law and Digital Asset Products

Frantz Jacques

**Bloomberg
Law**

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Securities Law and Digital Asset Products

Contributed by [Frantz Jacques](#), [Jordan Guydon](#)

Blockchain technology has the potential to revolutionize the world economy, from the financial service industry, smart contracts, and identity authentication to supply chain management.

As blockchain technology continues to take root, countries are jostling to create an enabling environment for blockchain technology to develop within their borders.

Invariably, the developing regulatory regime of digital assets in the U.S. will affect this nascent technology. "Digital asset" refers to an asset that is issued and transferred using distributed ledger or blockchain technology, including, but not limited to, so-called "virtual currencies," "coins," and "tokens."

Because Bitcoin, a cryptocurrency, was the first to bring blockchain technology to the mainstream, the Securities and Exchange Commission (SEC) became a leading regulator of the industry. A recent [safe harbor proposal](#) for digital asset projects by Commissioner Hester Peirce of the SEC provides a felicitous backdrop to analyze some of the complex legal and regulatory issues stemming from this burgeoning area of the law.

Commissioner Peirce's proposal helps highlight a critical distinction between public and private securities as it relates to liability exposure for issuers. As regulators continue to build the regulatory framework for digital assets, two key questions become significant and have broad-reaching implications.

First, are there characteristics inherently unique to digital assets and blockchain technology that make current securities laws ill-suited to regulate the new asset class, or is the securities law regulatory framework sufficiently flexible to handle this new paradigm? Second, is the potential innovative power of blockchain technology worth diluting the investor protection provided by the current securities law regulatory regime? This article explores a range of securities law issues pertinent to the digital asset products ecosystem. It provides a useful framework for lawyers to analyze potential liability exposure to digital asset projects' sponsors under federal securities laws.

Howey Test

At the onset, as digital currencies started to capture the attention of regulators in the U.S., the SEC applied the flexible, principle-based definition of an investment contract, a type of security listed in Section 2(a)(1) of the Securities Act of 1933, [15 U.S.C § 77a](#) and defined in *SEC v. W.J. Howey Co.* [328 U.S. 293](#) (1946) to stake out the position that federal securities laws apply to the new paradigm of distributed ledger technology, cryptocurrencies, and other digital assets.

Under the broad principles of the Howey Test, a transaction or investment scheme meets the definition of an investment contract and thereby is a security if there is an investment of money in a common enterprise with a reasonable expectation of profit from the efforts of others. As such, issuers engaged in the offer, sale, or distribution of a digital asset, or an initial coin offering (ICO) that met the four prongs of the Howey Test have to either register under the provisions of the [Securities Act](#) and the [Exchange Act](#) or qualify for an exemption from registration. The SEC has made it clear that the facts and circumstances will dictate whether securities law will apply to a venture using distributive ledger technology to access the capital markets, without regard to form.

To further this point, on June 14, 2018, William Hinman, the director of the Division of Corporation Finance of the SEC, stated that the discussion on the application of federal securities laws to digital assets should focus on the circumstances surrounding the digital asset and how it is sold, and not the digital asset itself. Hinman noted that often the economic substance of ventures using blockchain technology is the same as conventional securities offering:

Funds are raised with the expectation that the promoters will build their system and investors can earn a return on the investment—usually by selling their tokens in the secondary market once the promoters create something of value with the proceeds and the value of the digital enterprise increases.

Hinman outlined a series of contractual or technical ways to structure digital assets transactions so they are more akin to a utility or consumer item in the form of a token or a coin that function solely as a means of exchange on a decentralized network, which would then bring the digital asset outside of the purviews of U.S. securities laws. Although a digital asset,

which is merely a set of binary codes, in and of itself might not be a security, how the promoters sell the digital assets can create an economic reality that meets the elements of the Howey Test.

Mutable Characteristic of Digital Assets

Hinman's remarks and the subsequent release of the SEC [Framework for "Investment Contract" Analysis of Digital Assets](#) brought the mutable characteristic of digital assets a vanguard. The nuanced and fact-intensive "reasonable expectation of profits" and "from the efforts of others" prongs of the Howey Test are at the forefront of the mutable characteristic of digital assets.

Specifically, at what point is the digital asset merely a utility token to purchase goods or services on a digital platform, and not an investment reasonably driven by profit motives? Or what is the threshold for a network using blockchain technology to become sufficiently decentralized to no longer construe a central enterprise in which investors are relying on the efforts of an individual, entity or affiliates for success?

To add an extra layer of complexity to the notion of the mutable characteristic of digital assets, the implications of decoupling the underlying object from the investment scheme that created the investment contract gives rise to some fascinating legal issues. A detailed discussion on the mutable characteristic of digital assets is beyond the scope of this piece, but the concept gives rise to a plethora of interesting legal and regulatory questions.

To address this very issue, on Feb. 6, 2020, SEC Commissioner Peirce announced Proposed [Securities Act](#) Rule 195—Time-Limited Exemption for Tokens. The stated purpose of Rule 195 is to resolve a regulatory Catch-22 that has emerged in the securities law regulatory framework of digital assets. In broad terms, the proposed safe harbor provides network developers of tokens or digital assets with a three-year grace period during which they would be exempt from the registration provisions of the federal securities laws. Rule 195 exempts:

...(1) the offer and sale of tokens from the provisions of the [Securities Act of 1933](#) (Securities Act), other than the antifraud provisions, (2) the tokens from registration under the [Securities Exchange Act of 1934](#) (Exchange Act), and (3) persons engaged in certain token transactions from the definitions of "exchange," "broker," and "dealer" under the [Exchange Act](#).

The expressed rationale for Rule 195 is to remove the regulatory uncertainty, and dilemma entrepreneurs face when looking to build a utility token or a decentralized network using blockchain technology. In her speech outlining Rule 195, Peirce [stated](#),

...would-be networks cannot get their tokens out into people's hands because their tokens are potentially subject to the securities laws. However-would-be networks cannot mature into a functional or decentralized network that is not dependent upon a single person or group to carry out the essential managerial or entrepreneurial efforts unless the tokens are distributed to and freely transferable among potential users, developers, and participants of the network.

The metamorphosis process, during which a caterpillar morphs to a butterfly, aptly describes the regulatory Catch-22 outlined by Commissioner Peirce. An investment interest in a centralized network or digital assets that are not freely transferable will eventually evolve into a non-security provided that the network becomes sufficiently decentralized, or the digital asset becomes a medium of exchange. However, the venture cannot get to the butterfly state of being because while it is a caterpillar, the severe provisions of securities laws will effectively snuff out the project. Rule 195 aims to get digital asset projects past the metamorphosis period.

Although Rule 195 highlights regulatory friction points in the digital asset ecosystem, Rule 195 is likely to have minimal impact in the digital asset regulatory framework. First, Peirce introduced Rule 195 in a manner outside the norm of the SEC rulemaking process. Peirce's introduction of [Rule 195](#) does not comport with the provisions of the Administrative Procedure Act (APA), which governs the process by which a federal agency may promulgate rules and regulations.

The announcement of Rule 195 resembles the notice-and-comment rulemaking procedure of § [553](#) of the APA; however, the Commission did not approve Rule 195 as a body. As such, Rule 195 is not a "proposed rule" in the conventional sense under the APA, but rather a discussion point for a safe harbor for digital asset projects.

Substantively, in light of the various options currently available to securities lawyers to structure digital asset projects through private or public offerings outlined below, it is not entirely clear that a regulatory Catch-22 exists for digital assets sponsors under current federal securities laws. However, Rule 195 provides a useful framework to analyze the potential impact of securities law regulation on the metamorphous period of digital asset projects.

Capital Formation Framework

In the wake of the global financial crisis in 2007-2008, Congress enacted the Jumpstart Our Business Startups Act to spur capital formation for emerging growth companies and increase economic activity. In part, the JOBS Act lowered the regulatory burden for companies to access the capital market, and increasingly blurred the private and public line in securities law.

Among other things, the JOBS Act amended Section 12(g)(1)(A) of the [Exchange Act](#) to increase the threshold for mandatory registration from 500 to 2,000 shareholders of record, excluding employees; amended Rule 506 of Regulation D (Reg D), to permit general solicitation to accredited investors; and mandated the SEC to amend Regulation A.

The final rules adopted by the SEC amending Regulation A, commonly known as "Reg A+," has two tiers. Tier two allows issuers to offer and sell up to \$50 million over a 12 months period, permits general solicitation, and permits non-accredited investors to invest. [Securities Act of 1933, 15 U.S.C. §§ 77a-77mm](#) (1934). Additionally, the Fixing America's Surface Transportation Act (FAST Act) amended Section 5 of the Securities Act to add Section 4(a)(7), a new exemption from the registration requirement for private secondary sales of "restricted" and "control" securities to accredited investors. Section 4(a)(7) is a non-exclusive safe harbor and preempts state Blue Sky Laws.

To date, there have not been any public offerings of digital assets using Form S-1 in the U.S. However, issuers using Tier 2 Regulation A offerings are permitted to go public by filing a Form 8-A. Additionally, issuers entering [Exchange Act](#) reporting under a qualified Regulation A offering statement and Form 8-A are considered "emerging growth companies." The capital formation framework post the JOBS Act provides tremendous flexibility for entrepreneurs developing digital assets projects through private offerings.

Post the JOBS Act, Rule 506 of Reg D allows companies to raise an unlimited amount of capital and allows for general solicitation provided that all purchasers are accredited investors. And Section 4(a)(7) of the [Securities Act](#) partially opened up the secondary market for otherwise restricted securities of a private offering.

Additionally, tier 2 of Reg A+ permits companies to sell to an unlimited number of unaccredited investors up to \$50 million in a one-year period. Reg D and Reg. A+ are non-exclusionary. For the most part, with some transactional engineering, Reg D and Reg A+, in conjunction with the JOBS Act's other non-exclusionary provisions, provides a viable path for entrepreneurs to build a utility token or a decentralized network, without Rule 195.

Two Reg A+ token fillings approved by the SEC illustrates this point—BlockStack, Inc., and YouNow, Inc. It is helpful to overlay the capital formation options available to digital asset project sponsors to help grasp the interrelationship of the securities law regulatory framework. Particularly significant to our discussion is the varying liability exposure under federal securities law to sponsors of digital asset projects.

Figure 1

	Max Capital Raise	Max # of Investors	Blue Sky Laws	Liability Exposure	Resale Restrictions	Disclosure Vehicle
Proposed Rule 95	Unlimited	Unlimited, purchasers are not required to be accredited investors	Preempts state Blue Sky Laws	Presumed § 10(b) liability exposure (scienter pleading requirement)	No restrictions, unless the securities are held by an affiliate	Disclosure form (does not require SEC approval)

Reg. D	Unlimited	2000 not including employees, provided that all purchasers are accredited investors	Rule 504: Does not preempt state Blue Sky Laws Rule 506: Preempts state Blue Sky Laws	§ 10(b) liability exposure (scienter pleading requirement)	Time restrictions, and resale must be to an accredited investor	Form D (does not require SEC approval) Private placement memorandum
Tier 2 Reg. A+	\$50m in 12-month period	Unlimited, purchasers are not required to be accredited investors. However, Rule 501(a) limits the amount of money non-accredited investors are permitted to invest.	Preempts state Blue Sky Laws	§ 10(b) liability exposure (scienter pleading requirement) § 12 liability exposure (no scienter pleading requirement)	No restrictions, unless the securities are held by an affiliate	Form 1-A (requires SEC approval)
Public Offering	Unlimited	Unlimited, purchasers are not required to be accredited investors	Preempts state Blue Sky Laws	§ 10(b) liability exposure (scienter pleading requirement) § 11 liability exposure (no scienter pleading requirement) § 12 liability exposure (no scienter pleading requirement)	No restrictions, unless the securities are held by an affiliate	Form S-1 (requires SEC approval)

A close look at the similarities and differences between Reg A+ and Rule 195 helps bring some clarity to our discussion. Reg A+ provides a clear avenue for digital asset sponsors to circulate a utility token to a large number of people. Provided that the issuer meets certain conditions, Reg A+ exempts securities issued in a Tier 2 offering from the holders of record

threshold of Section 12(g) of the [Exchange Act](#), which in effect allows for a promoter to distribute tokens to an unlimited number of purchasers.

Both Reg A+ and Rule 195 have a set of disclosure requirements. Reg A+ disclosure requirements are filed with the SEC on Form 1-A, a scaled-down version of Form S-1, and requires Staff review to become effective. Conversely, Rule 195 disclosure requirements have to be “provided on a freely accessible public website,” and the issuers would have to file a notice of reliance on the safe harbor on EDGAR. Rule 195 filing requirements mirrors Form D, the notice [filing requirement](#) under Rule 504 or 506 of Regulation D or Section 4(a)(5) of the [Securities Act](#).

Antifraud Provisions and Digital Asset Projects

Setting aside the issues of the role that the SEC staff plays as a gatekeeper to bolster full and fair disclosure in SEC regulatory filings, and the proper disclosure requirements for an ICO, we reach the focal point of our query. In light of the current regulatory framework of securities laws, is there something inherently unique about digital assets and blockchain technology that warrants diluting investor protection, e.g., in the form of a safe harbor?

The language in Rule 195 makes it clear that the exemption does not apply to the antifraud provisions of the federal securities laws as it relates to the SEC's authority to bring antifraud actions. Rule 195 explicitly states that “the safe harbor would reserve the SEC antifraud authority with respect to token sales under the safe harbor” and “although the safe harbor would preempt state securities laws, it would not stand in the way of state antifraud actions.” However, a careful look at the developing landscape of liability for fraud under federal securities laws reveals some potential unintended or eschewed consequences of Rule 195.

The [Securities Act](#) and [Exchange Act](#) contain various interrelated antifraud provisions to promote honest and fair dealings in the securities market. To facilitate the discussion, this article separates the varying causes of actions under the federal securities law into two broad categories—scienter or strict liability based causes of actions, and private or public causes of action. The general liability provisions of federal securities law are §§ 11, 12, 15, and 17 of the [Securities Act](#), and §§ 10, 18 and 20 of the [Securities Exchange Act](#), Rule 10b-5 promulgated under Section 10(b) of the [Exchange Act](#), are the primary and most widely-used antifraud provisions of the federal securities laws.

Scienter-Based Causes of Action

Rule 10b-5 and Section 17 are scienter-based causes of action and are often analyzed together by the courts. Although there are nuanced distinguishing factors between §§ 10(b) and 17, as outlined in *Ernst & Ernst v. Hochfelder* 425 U.S. 185 (1976), this article analyzes the two causes of actions together.

Rule 10b(5)(b) requires a plaintiff to prove a false statement or omission of material fact made with scienter, in connection with the purchase or sale of a security, upon which the plaintiff justifiably relied, and the false statement or omission of material fact is the proximate cause of the plaintiff's injury. Of particular note, the plaintiff must show “a mental state embracing intent to deceive, manipulate, or defraud.”

A cause of action under Rule 10b(5)(c) is different than that under Rule 10b(5)(a) or 10b(5)(b) “scheme and liability” claims as it relates to primary and secondary liability. Specifically, in *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011), the Supreme Court narrowed the definition of “maker” of a false or misleading statement in securities antifraud provisions. Subsequently, in *Lorenzo v. Securities and Exchange Commission*, 139 S. Ct. 1094, 203 L. Ed.2d 484 (2019), in a rare reversal of recent trends, the Supreme court expanded the range of defendants that private plaintiffs can sue under 10b(5) “scheme and liability” provisions to include secondary actors who aid and abet primary actors in the fraudulent scheme.

However, 10b(5)(c) liability remains limited to primary actors who “make” the false statement. As such, sections 15 of the [Securities Act](#) and Section 20 of the [Exchange Act](#)—parallel statutes pertaining to secondary liability under the securities law have become increasingly important.

Overall, the scienter pleading requirement in § 10b(5) and § 17 has become increasingly difficult to establish, notably, since the Supreme Court added a plausibility standard in pleading requirements. *Ashcroft v. Iqbal*, 556 U.S. 662 (2009). As such, the door has closed significantly on the ability of the SEC and plaintiffs to bring lawsuits under § 10b and § 17.

Non-Scienter-Based Causes of Action

In light of the heightened pleading standard for scienter-based causes of action in securities litigation, non-scienter-based causes of action have become increasingly important. For instance, although § 10b of the [Exchange Act](#) and § 17 of the Securities Act are treated substantially similar by the courts, the SEC has increasingly brought claims under § 17(a)(2) of the [Securities Act](#) in Securities fraud cases. Notably, § 17(a)(2) does not have a scienter requirement...claims may be brought on negligent misconduct. However, § 17 is not a private right of action and is only available to the government.

Conversely, §§ 11 and 12 of the Securities Act and § 18 of the [Exchange Act](#) are private causes of action and do not have a scienter requirement. These antifraud provisions of the securities laws do not require a pleading of negligence; they are virtually strict liability causes of action. There are significant overlap and noteworthy differences between §§ 11 and 12 of the [Securities Act](#), and § 18 of the [Exchange Act](#). In broad terms, §§ 11 and 12 impose liability for false or misleading statements in a prospectus or registration statement filed with the SEC.

Similarly, § 18 of the [Exchange Act](#) imposes liability on any person that “make or causes to be made any false or misleading statements in any application, report, or document filed...” with the SEC. § 18 of the [Exchange Act](#) is a bit broader than its parallel provisions §§ 11 and 12 of the [Securities Act](#). Paramount to our discussion is the implications of Rule 195 on §§ 11 and 12 of the [Securities Act](#), and § 18 of the Exchange Act—the non-scienter based private causes of action of the securities law regime. Simply put, in its current form, Rule 195 would preclude digital asset projects from liability under both §§ 11 and 12 of the [Securities Act](#) and § 18 of the [Exchange Act](#).

In effect, Rule 195 would eliminate the only significant liability distinction between public and private securities by limiting private rights of actions of digital asset projects to the heightened pleading standard of scienter-based causes of action. To date, Several issuers of tokens have conducted ICOs under Reg A+. In contrast to “a registered offering, a Regulation A offering is not subject to liability under Section 11,” which may lower the cost of ICOs using Reg A+.

However, issuers in ICOs using Reg A+ have liability exposure to the non-scienter based civil liability provisions of section 12(a)(2) of the [Securities Act](#). An issuer raising capital under Reg A+ must file a Form 1-A for SEC Staff review and comments before the offering becomes qualified.

Broadly, the role of the SEC review and comment process in a new issuance is to ensure full and fair disclosure of material information before an issuer gains access to the general investing public, and not to opine on the quality or the merits of the venture. Similar to Form 1-A, Rule 195 has a set of disclosure requirements. However, Rule 195 does not require SEC Staff review and comments on the disclosure requirements.

Rule 195 makes clear that “none of the disclosures required by the safe harbor would be provided in the filing notice on EDGAR.” As mentioned earlier, the filing requirements of Rule 195 mirror the filing requirements of Regulation D, with the practical implication of putting Rule 195 outside the purviews of all the non-scienter-based causes of action under securities law. In *Gustafson v. Alloyd*, 513 U.S. 561 (1995), the Supreme Court held that the liability provisions of Section 12(a)(2) do not extend to Regulation D private transactions. As such, Rule 195 would force private litigants in fraudulent ICOs to pursue a 10b5 cause of action as the only recourse.

To be sure, Rule 195 has its advantages, primarily—time and money. The BlockStack Reg A+ SEC [review and comment process](#) lasted approximately one year and cost \$1.8 million. However, the BlockStack token Reg A+ offering was the first of its kind. Moving forward, the length of time for regulatory approval and the transactional cost should go down significantly for ICOs using Reg A+. The SEC estimates that Form 1-A will take approximately 750 burden hours per response for new issuers.

Nonetheless, even if the cost and time frame of Reg A+ offering goes down significantly, it is safe to assume that the cost and time frame of Rule 195 will still be less. The tradeoff, however, is less investor protection. Notably, investors will not have access to non-scienter based causes of action, nor the benefits of the SEC Staff review to facilitate full and fair disclosure of material information before the sales of the tokens to the general public.

The SEC review and comment process provides a prophylactic layer before securities in an issuance reach general circulation. In a sense, the SEC, as a government institution, bears the transactional cost of reducing the information asymmetry between the issuer and potential investors. Conversely, in Reg D offerings, the targeted investors, who are

mainly “accredited,” are better positioned to bear the transactional cost of reducing the information asymmetry between the investor and issuer than the general investing public.

Although Rule 195 does not exempt the issuer from the Securities Act's antifraud provisions, the SEC would retain its prerogative to bring enforcement actions in fraudulent sales of tokens. Rule 195 does abdicate a central pillar in protecting the general investing public during the critical period before tokens reach the general investing public. Generally, an enforcement action stemming from a false or misleading disclosure is limited in its effectiveness. Primarily because the defendants are often judgment proof, and the funds raised during the fraudulent ICO are usually long gone before any disgorgement or penalties can make the investors whole.

Intermediary Issues in Digital Asset Projects

Along with the cost associated with a Reg A+ ICO, Rule 195 attempts to address a salient issue that is somewhat unique to blockchain technology. Specifically, a core appeal of blockchain technology is non-reliance on intermediaries because users are able to transact on a peer to peer basis. Regardless of their appeal, however, tokens from Reg A+ ICOs have to trade as securities, and market intermediaries engaged in the process have to comply with applicable securities laws.

To address this issue, Rule 195 expressly exempts “persons engaged in certain token transactions from the definitions of “exchange,” “broker,” and “dealer” under the [1934 Act](#).” Although not directly, Reg A+ somewhat addresses the intermediary issue as it relates to blockchain technology. Specifically, in a Tier 2 offering under Reg A+, the annual, semiannual, and current event reports satisfy the broker-dealers obligation under [Exchange Act](#) Rule 15c2-11 “to review and maintain certain information about the issuer in order to initiate or continue quotation of the issuer's securities on OTC markets.”

However, ongoing Tier 2 reports do not satisfy the “adequate current public information requirement under Rule 144, because no quarterly filing is required. Issuers seeking to satisfy the Rule 144 information requirement may voluntarily file quarterly reports on Form 1-U.” In effect, Reg A+ allows an issuer to sell its securities without a broker-dealer in the traditional sense. If the issuer so chooses, it can act as the broker-dealer in a Reg A+ offering.

Additionally, Reg A+ permits general solicitation and advertising pre-filing, which further negates the need for traditional market intermediaries, such as an underwriter. To Peirce's point on market intermediaries in blockchain technology, Reg A+ does not exempt issuers from Section 17(a) of the [Exchange Act](#), which requires issuers to engage the services of a transfer agent in connection with the sales of securities.

However, Rule 195 does not include registered agents in the list of exempt persons engaged in certain token transactions. As such, Rule 195 does not solve the intermediary issue as it relates to registered agents in blockchain transactions in a manner that gives Rule 195 a clear advantage over Reg A+. Without expressly removing registered agents from the list of exempt intermediaries, Rule 195 undermines one of the central tenets for its rationale.

It is essential to be discerning when analyzing market intermediary issues in securities transactions involving blockchain technology. Specifically, it is vital to judiciously designate which economic actors, if any, in the blockchain ecosystem will be deemed an intermediary; thus, subjected to the regulatory burdens associated with the applicable designation.

In association with the disclosure under “Risk Factors” in the Blockstack Token filing, the issuer took the position that “miners are not broker-dealer” nor purchasers of tokens, and miners do not need to register as transfer agents or clearing agencies. Additionally, the issuer took the position that neither Blockstack network nor browser extensions are required to register as an exchange or ATS.”

It is crucial to keep these distinctions in mind to provide the nascent technology the regulatory space to flourish. Specifically, regulators should be mindful not to place undue regulatory burdens on miners—who are an indispensable part of the blockchain ecosystem. For instance, providing issuers the option to serve as the broker-dealer might create some friction; however, it is not a calamity to the blockchain ecosystem. Conversely, if miners were to be designated broker-dealers or registered agents, it would have a devastating effect on blockchain technology development..

Conclusion

After extensive debate and deliberation, Congress decided to adopt a system of full disclosure for federal securities law rather than a merit-based regulatory regime. Underlying Congress's design choice are fundamental free-market principles.

In essence, investors are optimally protected when all material information of securities being offered are fairly disclosed, allowing the market to drive investment decisions.

Ergo, securities law regulators are limited and restrained from picking winners and losers in the marketplace. Consequently, the SEC should remain technology-agnostic while carrying out its congressional mandate. Ideally, the role of securities law during the metamorphosis period of digital asset project should be to foster a product and technology-neutral environment that allows market forces to dictate outcomes.

Determining the right balance between protecting the investing public and facilitating capital formation to help foster innovation is a herculean task, particularly for highly technical and novel financial instruments. Ultimately, the decision will be subjective in nature and influenced by the decision-maker's proclivities. To the extent possible, as a matter of first principles, market forces should take precedence. Legislators, policymakers, and regulators should be reluctant to introduce technology or product-specific regulation to the securities law regime, e.g., a safe harbor for digital assets if the existing regulatory framework is suitable.

Digital assets have the potential to transform our financial system and increase efficiency in our digital payment infrastructure. However, as regulators continue to develop the regulatory framework of digital assets, it is worth pondering whether the current framework is well-suited and adequate for this new paradigm. For example, although the stated purpose of proposed Rule 195 is to resolve a Catch-22 that has emerged in the securities laws regulatory framework of digital assets, a careful analysis reveals that the Gordian Knot outlined in Rule 195 is not as stark as the rationale for the proposed rule suggests.

A combination of Reg D and Reg A+ illustrates that developers of digital asset projects have a clear pathway to develop a utility token or a decentralized network while maintaining important distinctions between public and private securities. However, Rule 195 does reveal some friction points in the securities laws regulatory framework of digital assets.

To reduce these regulatory friction points, Rule 195 reduces investors protection to the general investing public by precluding non-scienter-based causes of action in ICOs and inadvertently undermines the market-based ethos of federal securities law. In effect, Rule 195 imposes the light regulatory framework of Reg D designed for accredited investors to the general investing public, exclusively for digital assets.

Lawmakers, policymakers, and regulators should be extremely judicious before adopting a sweeping safe harbor to avoid unintended consequences. A safe harbor such as Rule 195 might inadvertently create an environment primed for regulatory arbitrage, especially since the concept of digital assets is nebulous, and the nomenclature surrounding blockchain technology is not well-defined.

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