

# The Director Talks Crypto and the Sun Shines (a Little)

June 15, 2018

On June 14, 2018, the Director of the SEC's Division of Corporation Finance, William Hinman, delivered a speech regarding crypto assets at the Yahoo Finance All Markets Summit: Crypto. The speech, "Digital Asset Transactions: When Howey Met Gary (Plastic)," was delivered against a backdrop of questions among market participants and their advisors as to how the U.S. federal securities laws apply to digital assets and, specifically, whether any crypto asset (other than Bitcoin, which SEC Chairman

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Clayton had previously indicated was not a security) could be deemed to not constitute a security subject to the registration and disclosure requirements of the U.S. federal securities laws.

**Certain digital assets are not, today, securities.** Director Hinman expressly noted during the speech that the virtual currencies Bitcoin and Ether, as offered and sold today, are not securities. This is the first time that an SEC official has publicly indicated that a virtual currency, other than Bitcoin, does not constitute a security and, importantly with respect to Ether, notwithstanding a history of fundraising that accompanied its creation. Underlying his view is the fact that applying the disclosure regime of the U.S. federal securities laws to current transactions in these virtual currencies would add little value because the underlying software platforms are sufficiently decentralized and sufficiently functional. In other words, there is no informational asymmetry between founder/sponsor/promoter, on the one hand, and investors, on the other, that puts investors at risk.

**Other digital assets may not, today, be securities.** Director Hinman covered three additional points during the speech that may help to bring additional virtual currencies and other digital assets out of the regulatory "shadows." First, he allowed that there may be other sufficiently decentralized networks and systems where regulating the tokens or coins that function on them as securities may not be required. Second, he made clear his view that "whether something is a security is not static and does not strictly inhere to the instrument." Consistent with relevant case law and the SEC's long-stated views, the economic substance of the transaction in question always determines the legal analysis, and this cuts both ways:

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- a digital asset that was originally distributed in a securities offering may later be sold in a manner that does not constitute an offering of a security; and
  - digital assets with utility that function solely as a means of exchange over a decentralized network could be packaged and sold as an investment strategy that can be a security.

Finally, Director Hinman laid out a framework containing two sets of non-exclusive factors that the SEC considers in assessing whether a digital asset is offered as an investment contract and is thus a security. The critical underpinnings of the *Hinman Factors* are: (i) the role that a third party, whether a person, entity or coordinated group of actors, plays in driving an expectation of an investment return and (ii) whether the economic substance of the transaction indicates that the digital asset truly functions more like a consumer item and less like a security.

**Final thoughts.** While Director Hinman's speech was accompanied by the standard SEC disclaimer that the remarks reflected his views only and not those of the Commission or the Staff of the SEC, the views outlined in the speech answer certain long-standing questions and generally represent positive momentum for participants in the crypto markets. It is also clear that the SEC remains quite open to engaging with members of the crypto market and helping promoters of this technology and their counsel navigate and comply with the U.S. federal securities laws. Director Hinman's speech may be found at <https://www.sec.gov/news/speech/speech-hinman-061418>.

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