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The Clarity Act Advances Slowly, and The SEC and CFTC Anticipate Passage With A New Interpretation: Some Crypto Offerings Facilitated

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There has been movement forward on the Clarity Act, and the SEC and CFTC have anticipated its passage by pre-emptively completing a "memorandum of understanding" that would be required by the Act, and by beginning the "rulemaking" process with a joint interpretive release distinguishing between "investment contract assets" regulated by the SEC and "digital commodities" regulated by the CFTC. The legislation will also require that both agencies write rules, but they cannot publish proposals until the Act actually becomes law.

The Clarity Act is expected to become law this year, but of course there is no absolute assurance (see our prior post discussing the proposed SEC–CFTC regulatory split and recent legislative momentum).

The Clarity Act

As a reminder, the House passed the Clarity Act last Summer and it awaits Senate approval. The legislation did not pass last month principally due to one contested issue: The ability to pay rewards on passive stablecoin balances as traditional banks reportedly feared it would result in deposit outflows into accounts held at non-banks.

There are reports that the issue on the payment of rewards has been resolved, and the legislation is now moving forward, slowed somewhat by other matters, but expected to become law. The reported resolution of the "rewards on stablecoins" issue is as follows: Rewards on passive stablecoin balances will be prohibited, but activity-based rewards tied to payments, transfers, and platform-use will be allowed. Although expected to proceed toward passage, if the legislation is not approved by May, there reportedly is significant risk it will be paused for several months pending the mid-term Congressional elections.

The Clarity Act will provide the overarching structure within which the SEC and/or CFTC will regulate crypto-related assets, with the SEC regulating digital securities and the CFTC regulating digital commodities. Among other things, the Act as currently drafted would provide a conditional exemption for the issuance of digital assets associated with mature blockchains even if they involve "investment contracts" at inception. It would mandate coordinate regulation of hybrid instruments that have elements of both digital commodities and securities. There would also be coordinated regulation of brokers and other intermediaries, as well as of trading markets, when both securities and commodities are involved. It would broaden the custodians qualified to hold digital assets, including for example non-depositary trust companies affiliated with crypto trading platforms.

The SEC's traditional jurisdiction remains intact. Even in the form of digital assets, ownership interests in business enterprises, and a larger variety of "investment contracts," remain fully regulated by the SEC.

The SEC Gets Ahead of the Game: Its New Interpretation

Last week, the SEC issued a new interpretation – joined by the CFTC — that anticipates the passage of the Clarity Act by aligning the agency's position with the underlying logic of the legislation. That logic is that digital assets which are securities can also have components that are not securities – digital commodities in the Act's lingo – and that the securities and commodity components of such hybrid instruments can over time evolve into solely digital commodities that are no longer regulated by the Securities Act or Exchange Act. The existence of such a transformation appears to be a factual question, and we would speculate that the bright-line relief if eventually provided by the Clarity Act will be more practical than the SEC's interpretive approach. Nonetheless, the recent interpretive release confirms a fundamental shift. According to the new SEC release, the Commission under the last Administration deemed a digital asset that was at any time associated with a security (or investment contract) to be entirely and forever a security regulated by the SEC. In other words, it's association with an investment contact could not fall away.

The SEC's new interpretation addresses airdrops of digital commodity assets that recipients receive for free, indicated that they generally will be unregulated under the Securities Act or Exchange Act. The interpretation also addresses protocol staking and protocol mining in a manner generally consistent with the agency's prior public positions.

The interpretation can operate independently of the Clarity Act if the latter is delayed or fails to pass.

Proskauer's Experience With Crypto Assets

Proskauer has many years of experience with public and private offerings, including cross-border offerings, as well as with a variety of other types of commercial transactions, and we look forward to answering questions and providing guidance on these new developments.

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