August 5, 2025
Submitted via Email

Senate Banking Committee
United States Senate

DRC: Senate Banking Committee RFI Response (August 2025)

Response to the Senate Banking Committee's Request for Information on Digital Asset Market Structure

Dear Chairman Scott, Senator Lummis, Senator Hagerty, and Senator Moreno,

The Decentralization Research Center ("DRC") is grateful for the opportunity to answer questions posed in the Senate Banking Committee's Digital Asset Market Structure Request for Information ("RFI"), which were shared by the Senate Banking Committee ("Committee) alongside the market structure discussion draft ("Discussion Draft") on July 22, 2025.[1] The DRC appreciates the Committee's efforts to advance a bipartisan regulatory framework for digital assets in the United States, and applauds the Committee's willingness to engage the public.

Since its inception, the DRC has worked closely with leading academics, lawyers, researchers, developers, founders, legislative staff, and policymakers to inform rulemaking and legislative development in the digital asset space. Our status as a 501(c)(4) social welfare non-profit allows our work to be driven by the public interest, and not be constrained by market demands or investor returns. Our advocacy is grounded in the principles outlined in our April 2025 report, *Designing Policy for a Flourishing Blockchain Industry*, which translates decentralization into clear, administrable criteria based on control.[2]

Control is a common theme throughout the President's Working Group Report on Digital Assets ("White House Report"),[3] and is included as a factor in determining the applicability of securities laws,[4] money transmission obligations,[5] tax,[6] and other rules to crypto projects. Likewise, control is a central focus of our submission. We believe

[1] Majority Press Release, United States Committee on Banking, Housing, and Urban Affairs, Scott, Lummis, Colleagues Release Market Structure Discussion Draft, Issue Request for Information from Stakeholders (July 22, 2025), https://www.banking.senate.gov/imo/media/doc/market_structure_rfi.pdf.
[2] Designing Policy for a Flourishing Blockchain Industry (April 2025) ("DRC Report"), https://thedrcenter.org/wp-content/uploads/2025/04/DRC-Flourishing-v2.pdf.
[3] President's Working Group Report on Digital Asset Markets ("White House Report"), Strengthening American Leadership in Digital Financial Technology (July 30, 2025), https://www.whitehouse.gov/wp-content/uploads/2025/07/Digital-Assets-Report-EO14178.pdf.
[4] White House Report at 6, among others.
[5] White House Report at 57 and 58, among others.
[6] White House Report at 134, among others.

the appropriate regulatory treatment of network and application tokens should turn on whether meaningful control exists over the assets and network in question, as durable, technology-neutral rules must account for who can influence the functionality, distribution, and use of an asset and network over time. The control-based approach set out in the CLARITY Act has garnered significant industry support. Last month, we joined 50 other leading blockchain projects in sending a letter to House and Senate leadership endorsing the CLARITY Act's control framework.[7]

We have reviewed the Discussion Draft and applaud the significant effort that went into crafting a nuanced and forward-looking proposal. We hope our responses to the RFI contribute to the Committee's continued efforts to establish a clear and durable market structure framework, and we welcome any opportunity to further support the Committee's efforts.

Regulatory Clarity and Tailoring

Question 1: The proposed legislation aims to provide clarity on how to allocate jurisdiction over digital assets between the CFTC and the SEC. Does the legislation strike the right balance?

The Discussion Draft makes progress in clarifying the jurisdictional divide between the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC") in particular instances. However, we urge the Committee to ensure that the economic realities of each transaction remain central to determining regulator jurisdiction.

To strike the right balance, we recommend the Committee adopt many elements from the CLARITY Act, including its definition of "digital commodity"[8] and its comprehensive, control-based framework for determining blockchain maturity.[9] Under this approach, the SEC retains jurisdiction until objective network maturity thresholds are met, which ensures that securities law obligations remain in place until control-based risks have been meaningfully resolved, at which point regulatory oversight may shift to the CFTC.

a. **Should legislation rely on the concept of ancillary assets? If so, is the definition in proposed Section 4B(a) of the Securities Act appropriate? Does it exclude the right categories of assets?**

[7] Letter to Senate and House Leadership, https://x.com/TheDRC_/status/1944787470903603272.
[8] Digital Asset Market Clarity Act of 2025, H.R. 3633, 119th Congress (2025) ("CLARITY Act") § 103(a)(4)(F)(i): "The term 'digital commodity' means a digital asset that is intrinsically linked to a blockchain system, and the value of which is derived from or is reasonably expected to be derived from the use of the blockchain system."
[9] CLARITY Act § 205.

Legislation should not rely on the "ancillary asset" concept in its current form. While we appreciate the Committee's goal of simplifying the distinction between tradable digital assets and the investment contract schemes that may accompany them, the ancillary asset model, as currently drafted, rests on the problematic assumption that a token can be meaningfully separated from the circumstances of its issuance and the conduct of its issuer prior to maturity. We believe that assumption does not reflect the practical realities of how most blockchain projects operate today. As drafted, this concept allows a project to retain significant control through mechanisms such as token supply, governance rights, or upgrade authority, while still qualifying the token as an ancillary asset. This would allow issuers to receive an exemption from securities laws simply by adding a blockchain to their asset or offering, regardless of whether the offering still presents risks characteristic of securities.

In many cases, particularly among early-stage or centralized projects, the value of a digital asset remains inextricably tied to the managerial efforts, tokenomic design, and information asymmetries associated with its issuer. By treating ancillary assets as categorically distinct from securities, even when materially influenced by a promoter group, the framework risks prematurely stripping tokens of investor protections. It also invites regulatory arbitrage, rewards superficial structuring over economic substance, and diminishes the SEC's ability to address misconduct in digital markets.

Further, adoption of the ancillary asset concept will disincentivize decentralization while incentivizing surface-level structuring that retains core control mechanisms. Decentralization is the critical feature of innovative blockchain technology. If properly incentivized, blockchain projects will commit to decentralization, giving users greater control over their finances and digital assets, reducing reliance on overreaching institutions. Beyond financial use cases, decentralized blockchain networks function as infrastructure for a variety of applications that provide users with more autonomy over their lives, including, for example: social media platforms that allow users to own and control their data, community owned platforms that leverage decentralized governance to increase competition in the market, and digital identity protocols necessary for users to protect their identity online from sophisticated AI-enabled bots. For further details on the importance of decentralization, please see our report *Designing Policy for a Flourishing Blockchain Industry*.[10]

Although the ancillary asset concept may appear to offer simplicity, that perceived simplicity comes at a cost. The vague and subjective nature of Section 4B(a) introduces legal uncertainty and opens the door to inconsistent interpretation. Such a framework does not clarify the law; it injects the law with ambiguity that courts and regulators will be forced to untangle over time.

[10] DRC Report, https://thedrcenter.org/wp-content/uploads/2025/04/DRC-Flourishing-v2.pdf.

By contrast, the CLARITY Act offers a bright line control-based maturity test while also empowering the SEC to establish other paths to network maturity. It permits digital assets to evolve out of securities treatment once risks to investors have been meaningfully reduced through network maturity.[11] This approach ties legal status to quantifiable metrics that measure the relative retained control by the issuer and insiders, rather than formalistic distinctions. It reflects the economic realities of digital asset markets and provides regulators, courts, and developers with clear guidance. The CLARITY Act also ensures that projects can graduate from securities oversight without compromising investor protection along the way.

We encourage the Committee to adopt the CLARITY Act framework, or build upon it, rather than enshrine a concept that risks propagating more regulatory uncertainty.

b. Should legislation rely on existing concepts, such as from SEC v. W.J. Howey Co. (Howey), when defining which digital assets are securities?

Yes, it should rely on these concepts, but with some adjustment. There is no compelling reason to deviate from the long-established framework articulated in SEC v. W.J. Howey Co., 328 U.S. 293 (1946). The Howey test continues to serve as a functional and flexible standard for identifying "investment contracts" under federal securities law and is well-suited to assessing digital asset offerings when properly applied.

However, the digital asset context requires a more precise and modernized application of Howey, along with legislative or regulatory guidance that ensures clarity for builders while maintaining investor protection. But rather than discard Howey, we encourage the Committee to focus on two targeted improvements that have been broadly discussed since at least 2018, and are both mentioned throughout the White House Report:[12]

1. A clear acknowledgment that the securities analysis of a digital asset must be separated from the analysis of the investment contract in which it may have been initially offered; and
2. A safe harbor framework for responsible public distributions of digital assets.

Distinguishing the scheme from the asset is critical. Howey is a transaction-focused test. It assesses whether a scheme constitutes an "investment contract," not whether the thing sold (e.g., an orange grove or a token) is itself a security. The Committee should make explicit that the status of a digital asset evolves based on its functional characteristics and control structures. This is reflected in the CLARITY Act, which distinguishes between the initial

[11] CLARITY Act § 202.
[12] White House Report, at 48-54.

fundraising transaction and the characteristics of the asset as it circulates over time, particularly in cases where control has been meaningfully decentralized.

The second point, the safe harbor, has been a focus of policy dialogue at the SEC for years, most notably through initiatives such as Commissioner Hester Peirce's "Token Safe Harbor Proposal."[13] The goal is to provide a time-limited exemption for token distribution in ways that preserve investor protection while enabling the development of open, permissionless infrastructure. The CLARITY Act takes a similar approach. Section 202 of the CLARITY Act provides certain exemptions for primary transactions in digital commodities, while the reporting requirements are altered once decentralization and functional maturity are achieved. Together, these provisions support innovation by recognizing the unique market dynamics of blockchain networks (including the need for "network effects" and the ability to distribute digital commodities to users) while maintaining investor protection and regulatory accountability.

Combined with clear guidance around permissible forms of crowd-based fundraising (with appropriate disclosure and anti-fraud protections), these refinements would modernize Howey's application without discarding its core principles. They would also address concerns around regulatory uncertainty, overreach, and the chilling effect on U.S.-based innovation — all without compromising the SEC's tripartite mission.

c. Should legislation mandate, as under proposed discussion draft Section 105, that the SEC undertake a rulemaking to clarify the definition of "investment contract" as articulated in Howey? If so, how?

We caution against a statutory mandate requiring the SEC to undertake rulemaking to redefine or "clarify" the meaning of "investment contract" under Section 105 of the Discussion Draft. Such a mandate risks undermining the functional flexibility that has made Howey a durable and context-sensitive standard for nearly 80 years.

Section 105(a) of the Discussion Draft would require the SEC to initiate a rulemaking to further define and clarify the investment contract test. This may seem like a path toward clarity, but it risks enshrining an untested framework that may inappropriately narrow the scope of Howey.

The strength of the Howey test lies in its facts-and-circumstances approach, allowing courts and regulators to analyze economic realities over formal labels or structures. Codifying a revised definition, whether through legislation

[13] Hester M. Peirce, Running on Empty: A Proposal to Fill the Gap Between Regulation and Decentralization, Appendix, U.S. Securities and Exchange Commission (Feb. 6, 2020) https://www.sec.gov/newsroom/speeches-statements/peirce-remarks-blockress-2020-02-06, and Hester M. Peirce, Token Safe Harbor Proposal 2.0, U.S. Securities and Exchange Commission (Apr. 13, 2021), https://www.sec.gov/news/public-statement/peirce-token-safe-harbor-2.0.

or mandated SEC rulemaking, could narrow the scope of investor protection, embolden regulatory arbitrage, and reduce the test's adaptability in rapidly evolving markets.

The better approach is not to redefine the investment contract, but to ensure that the application of Howey reflects economic realities. This includes recognizing that tokens can evolve over time and that securities status should not attach permanently to a digital asset once the original investment contract conditions have passed and decentralization has been achieved. Specifically, the appropriate legislative focus should:

- Acknowledge that Howey applies to the scheme or transaction, not necessarily the underlying asset itself;
- Provide safe harbor pathways, like those proposed in Commissioner Peirce's Token Safe Harbor and codified more robustly in the CLARITY Act, to support network development while preserving investor protection; and
- Define conditions under which certain issuer and insider digital commodity transactions can transition from SEC purview to CFTC purview, based on the concept of "mature blockchain systems," as defined in Section 205 of the CLARITY Act.

We encourage the Committee to preserve the Howey test's functional framework, while improving its application through control-based thresholds, disclosure requirements, and transitional safe harbors grounded in economic substance.

d. Should Congress revisit other terms within the existing definition of security, such as note, to accommodate digital assets and to prevent a later SEC from inappropriately construing these terms?

Yes, Congress should consider modest clarifications where necessary to prevent misapplication in the digital asset context, particularly in light of judicial tests that introduce uncertainty when applied to novel instruments. However, any revisions must be aimed at offering principled clarity, rather than creating blanket exemptions.

For example, whether a "note" constitutes a security is assessed under the Reves v. Ernst & Young, 494 U.S. 56 (1990) "family resemblance" test. This four-factor framework considers the motivations of the buyer and seller, the plan of distribution, the reasonable expectations of the investing public, and whether other regulatory regimes adequately reduce the risk of the instrument. The test is inherently contextual and subject to interpretation, particularly when applied to digital assets that blur traditional classifications.

Rather than rewriting foundational terms like "note," we recommend that the Committee focus on articulating the outer limits of the SEC's jurisdiction, especially in cases where a blockchain network is not controlled by an individual or group. The CLARITY Act exemplifies this approach: its definition of a "digital commodity," for instance, is designed to establish the outer limits of securities jurisdiction without opening the door to unchecked regulatory arbitrage.

These provisions do not attempt to redefine "note" or "investment contract" outright. Rather, they establish a functional perimeter that guides when a digital asset has transitioned out of securities treatment, thereby limiting overbroad or unintended application of existing statutory terms without undermining their foundational utility.

Instead of creating new statutory categories or rewriting foundational legal terms, the Committee should focus on delineating when a digital asset is no longer subject to securities regulation based on characteristics of control, like those outlined in the CLARITY Act. Doing so can reduce regulatory uncertainty while maintaining fidelity to longstanding principles of U.S. financial regulation.

e. Should legislation provide for a specific token taxonomy based on the underlying characteristics of an asset? If so, what approach? How could such a taxonomy remain merit and technology neutral?

Yes. A token taxonomy that draws distinctions based on underlying characteristics, rather than subjective intentions or surface-level form, can provide much-needed clarity to developers, users, and regulators. However, such a taxonomy must be functional, technology-neutral, and grounded in principles that reflect economic realities rather than attempting to legislate specific design architectures.

We believe the CLARITY Act offers the right starting point. Rather than attempting to invent new categories from whole cloth, it applies existing legal concepts in a refined way to carve out tokens that are no longer investment contracts. Its definition of digital commodity[14] and certification process for mature blockchain systems[15] is built to ensure that:

- Value accrual alone does not render an asset a security;
- Decentralization, lack of issuer control, and functional utility are relevant limiting factors; and
- Exclusion from securities classification cannot be circumvented through form-over-substance structuring.

[14] CLARITY Act § 103.
[15] CLARITY Act § 205.

Such an approach supports innovation while preventing regulatory arbitrage. It also avoids merit-based judgments about whether a token is "good" or "bad," instead focusing on objective features like control of code and degree of issuer involvement. That neutrality is critical, particularly given the sector's rapidly evolving technical landscape. For any taxonomy to succeed, it must do the following:

- Maintain existing consumer protections by layering on appropriate oversight for relevant tokens;
- Avoid categorical exclusions that turn token design choices into compliance loopholes; and
- Provide clear pathways for digital assets to evolve out of securities treatment as network maturity increases and reliance on promoters decreases.

The CLARITY Act shows that this balance is possible. A taxonomy built on its foundation could serve as the legislative anchor for a future-proof, innovation-aligned framework.

f. Should legislation clarify the status of certain technology functions that are inherent to the operation of a distributed ledger network? This could include technology functions such as running consensus algorithms, executing smart contracts, or engaging in activities like staking and mining.

Yes. Legislative clarity around foundational blockchain functions, such as mining, staking, consensus participation, and smart contract execution, is essential to foster innovation and reduce regulatory ambiguity. These activities are foundational to decentralized, public infrastructure, and they promote transparency and system resilience. They should not, by themselves, trigger regulatory obligations under U.S. securities or commodities laws, especially when performed by users rather than coordinated intermediaries.

The principle is straightforward: operating a protocol is not the same as offering a financial product. This distinction is reflected in longstanding internet policy, which separates neutral infrastructure (e.g., internet protocols) from the applications and platforms that operate on top of them.[16] Blockchain networks warrant the same treatment. Validators and node operators should not be regulated as financial intermediaries simply because the networks they support host financial applications.

Entities that merely participate in network security or computation, such as validators or node operators, should not be treated as financial intermediaries simply because the protocols they support host financial applications.

[16] SEC Division of Corporation Finance, Staff Statement on Meme Coins (Feb. 27, 2025), https://www.sec.gov/newsroom/speeches-statements/staff-statement-meme-coins.

This approach aligns with recent policy recommendations from the President's Working Group, which has emphasized that certain regulatory oversight should be based on whether an entity exercises control over user funds.[17]

The CLARITY Act provides some good foundations for distinguishing non-custodial technical participants from regulated intermediaries, like those set out below:

- Section 309 provides an exclusion for decentralized finance, and states that entities shall not be treated as a regulated entity solely due to its publication or maintenance of software that enables protocol-based transactions, provided that the operator does not exercise unilateral control or custody over user assets;
- Section 409 applies a similar standard, ensuring that technical contributors are not subject to regulatory burdens unless they functionally resemble intermediaries with discretion over funds; and
- The CLARITY Act also defines a "decentralized finance messaging system" as a software application that provides a user with the ability to create or submit an instruction, communication, or message to a decentralized finance trading protocol for the purpose of executing a transaction by the user.

We believe that legislation should build on those points to align with the positions on this topic set out by the DeFi Education Fund, and we specifically agree with the following positions from their RFI response, which stipulate that market structure legislation requires:[18]

- "A fundamental distinction between, on the one hand, software developers, the permissionless software they create or the technical activities in which they or others are involved, and, on the other hand, centralized intermediaries;
- "Clear definitions for centralized intermediaries who are required to register rather than deferring such definitions to agencies;
- "Definitive criteria to evaluate the absence of unilateral and independent control over decentralized systems and user assets, rather than delegating that critical task to agencies; and
- "Blockchain technology itself should be treated as neutral infrastructure, akin to the internet, rather than as entities subject to ill-suited registration or compliance obligations."[19]

These provisions together establish a control-based threshold for determining when technical actors cross the line into regulated activity. If a validator, miner, or developer does not have the abilities of a traditional financial

[17] White House Report at 6, 57 and 58, among others.
[18] DeFi Education Fund RFI Response, https://www.defieducationfund.org/_files/ugd/84ba66_fe9e31549b3443d09840438f38421a16.pdf.
[19] DeFi Education Fund RFI Response, at 3.

institution (to unilaterally alter, halt, or misappropriate value), they should not be regulated as a traditional financial institution.

We encourage the Committee to codify a non-exhaustive list of exempt technical functions to provide helpful guidance while maintaining flexibility as technology evolves. Most importantly, it ensures that regulation targets intermediated risk rather than neutral participation, and that the regulatory perimeter reflects control, custody, and discretion, not just activity.

g. Should existing tokens be grandfathered into a new token classification framework created by Congress? If so, how?

A thoughtful transition regime is essential, but blanket grandfathering without condition is not the answer. We support transition relief that is time-bound and conditioned on compliance milestones, but caution against any regime that grants blanket exemptions to projects with ongoing control dynamics.

The CLARITY Act provides a structured framework through Section 205, which establishes the statutory conditions that a blockchain system must meet to be certified as a mature blockchain system. Under this scheme, digital assets, including those issued prior to enactment, can be treated as digital commodities only if the system can be certified as no longer under the control of related persons.

This certification requirement provides both procedural fairness and regulatory rigor. It allows projects that have made good-faith efforts to decentralize to gain appropriate status under the new regime, while leaving room for agencies to challenge certifications that are inconsistent with economic reality.

Critically, this is not a "grandfathering" provision in the traditional sense. It does not immunize all pre-enactment activity or assets. Instead, it requires affirmative demonstration that the asset is no longer under common control by related persons; a core test that determines whether SEC jurisdiction should continue.

We recommend the Committee follow this model: transition relief should be available, but only where the conditions that give rise to investor protection concerns no longer exist. Tokens that remain subject to centralized control, discretionary tokenomics, or opaque governance should not be shielded from oversight merely because of when they were launched.

Question 4: Should legislation allow market participants the freedom to choose between being subject to SEC jurisdiction or CFTC jurisdiction? If so, how?

No. The Committee should not permit market participants to unilaterally elect whether their activities fall under SEC or CFTC oversight. Regulatory jurisdiction must be determined by the economic substance of the asset and the functional nature of the activity, not by the discretionary preference of the issuer or trading venue.

Allowing firms to choose their regulator would risk incentivizing jurisdictional arbitrage and eroding investor protections, especially in cases where the underlying asset or activity more appropriately falls under the remit of one agency. Oversight should be tailored to the asset's economic characteristics and associated risks, whether those are investment-like expectations of profit under the SEC's framework or commodity-based spot market trading under the CFTC's.

That said, market participants deserve a predictable framework through objective, observable indicators. The CLARITY Act establishes clear statutory definitions and safe harbors to determine when an asset transitions from a security to a commodity, based on objective indicators like decentralization, protocol control, and the presence of informational asymmetries.

The Committee should ensure that regulatory lines are drawn based on the risk profile of the asset and the level of control exercised by the issuer, rather than permitting self-selection of the preferred agency.

<u>Investor Protection</u>

Question 2:

a. **Are the factors in proposed Section 103 for determining whether an ancillary asset "is not under common control by related persons" appropriate? If not, how should they be modified?**

The factors in proposed Section 103 of the Senate discussion draft represent a constructive first step in delineating when an ancillary asset is no longer under "common control by related persons." However, as currently drafted, the test risks introducing ambiguity that could undermine the very purpose of this threshold, particularly given the wide variation in how digital networks structure governance, development, and technical control.

To strengthen this section, we recommend the Committee build upon the more robust control-based framework outlined in the CLARITY Act, which offers a clear test for assessing whether an asset has exited the issuer's

control and thus warrants an exclusion. The legislation should also draw from the CLARITY Act's Section 205, which authorizes the SEC to adopt rules establishing objective metrics for evaluating decentralization. These thresholds can help operationalize the concept of "no common control" and reduce reliance on subjective agency determinations.

Without tightening these factors, there is a risk that centralized projects may exploit gaps in the statutory language to claim decentralization prematurely. That would not only dilute the integrity of the exemption but also incentivize surface-level decentralization while core systems remain controlled.

* * *

We sincerely appreciate the opportunity to provide input on these critical issues and welcome engagement with the Committee moving forward.

Respectfully,

Decentralization Research Center