

*diffusetap*  
Virtual Event Series

SEC's Treatment of Crypto:  
**Pro or Con  
Innovation?**

*Guest Speaker:*



**Pat Daugherty**  
Partner  
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*Hosts:*



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## DiffuseTap: SEC's Treatment of Crypto: Pro or Con Innovation?

Last time on DiffuseTap, Pat Daugherty, Partner at Foley & Lardner, talked to us about the SEC's responsibilities and how they extend to crypto exchanges, problems with the SEC's approach to crypto regulation, and what the CFTC taking over crypto regulation could mean for the industry.

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### DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)... straight from your armchair like a boss.

### Meet the Speaker



Pat Daugherty created and leads the digital assets and Web3 practice of Foley & Lardner, which consults for major exchanges, custodians, merchant banks, institutional investors, crypto funds and proprietary trading firms. Pat is also an Adjunct Professor teaching Crypto Assets and Web3 in residence at Cornell Law School. Now in his fifth decade of corporate law practice, in his youth he served as counsel to former SEC commissioner Edward H. Fleischman at SEC headquarters, helping create Rule 144A and Regulation S. LinkedIn: [@patrick-daugherty](#)

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**KENNY ESTES:** We're here today to hear from Mr. Pat Daugherty. Pat, do you want to introduce yourself and your background?

**PAT DAUGHERTY:** Thanks for having me on this morning, Kenny. For 40 years, I was a traditional finance lawyer, planning and executing IPOs, takeovers, ETFs, interest rate swaps, and so on. In fact, I still do that. But five years ago, I went down the rabbit hole of crypto. And now, I am fortunate to represent and advise several of the larger exchanges, proprietary trading firms, core development teams, custodians, merchant banks, and other institutional players in this space.

I'm also on the board of directors of the [Global Digital Asset and Cryptocurrency Association](#). To those of you who haven't looked into it, I encourage you to look into the Global DCA because it's a great place to obtain timely, valuable information and to meet subject matter experts who can help you succeed. I'm also readying myself to teach at Cornell Law School while maintaining my law practice at Foley & Lardner. I'm moving to Ithaca, New York, in eight days, where I will teach Crypto Assets and Web3. In this next semester I will also teach sessions to law students at Northwestern, IIT-Kent and the University of Miami.

**AYLA KREMB:** Very exciting. All right, now we will toss you into the deep end. Many people talk about what the real responsibility of the SEC is. In your view, what is the SEC's mandate today as it relates to all things crypto?

**PAT:** I'm a lawyer. I will describe the SEC's role with reference to its legal duties. Congress has given the SEC a [triple mandate](#): investor protection; the maintenance of fair, orderly and efficient markets; and the facilitation of capital formation. Three goals, not one. In each case, though, it's limited to securities. Regarding investor protection, for example, there are investments other than securities. Some people invest in real estate. That's none of the SEC's business. They're not supposed to go there, and they don't.

But in securities, they do. The SEC has the power to regulate securities offerings. It does this through its [Division of Corporation Finance](#). It has the power to regulate securities brokers, dealers, and exchanges. It does that through its [Division of Trading and Markets](#). It has the power to regulate securities funds, such as mutual funds or exchange traded funds, private funds, and also securities advisors. It does this through its [Division of Investment Management](#). It also has the power to enforce the statutes, rules and regulations relating to all these activities. It does that through its [Division of Enforcement](#).

After the [Bernie Madoff](#) scandal, the SEC also grew a new division called the [Office of Compliance Inspections and Examinations](#). Basically, that division audits investment advisors and brokerage firms. It's a huge division. In addition, there is a [Division of Economic and Risk Analysis](#), which exists because the SEC is charged with regulating in a way that is thoughtful with regard to economic considerations and the economic effects of its actions.



The SEC's Enforcement Division has very broad powers in these areas, in terms of the sanctions it can mete out or the court can mete out upon the SEC's request, such as injunctions and disgorgement. In other words, give back all the money you raised – that's disgorgement. And civil money penalties.

In other words, okay, you coughed up \$10 million? How about another \$10 million, so you won't do it again? That's the purpose of a civil money penalty. And the SEC Division of Enforcement can go after the "direct violators" of these statutes as well as the "controlling persons" who direct the activity that the SEC is complaining about. I could go on and talk about how the SEC is organized. There are Commissioners and a Chairman, or Chair. There's a political process whereby they get appointed. There's an immense Staff, as I mentioned. It's mainly in Washington, but also around the country.

I'm speaking to you from Chicago, where we have the Chicago Regional Office. SEC lawyers in the regional offices used to just look at matters arising in their backyards. But with work from home now allowing them to be more mobile, we have SEC enforcement people filing cases all over the country. The Chicago Regional Office just failed one in Seattle last week. That's the [Dragonchain case](#). You might want to read about that one.

**KENNY:** Let's dig in on the crypto angle. It sounds like the SEC does a lot of things. Where is crypto regulation in all that? What's the lay of the land? Are cryptocurrencies securities? I've heard rumors about the SEC taking more control of it, and there seems to be a bunch of Washington acronyms fighting for control to regulate this space. Where is it, and where do you see it going?

**PAT:** That's the big question here. The statutes don't classify [crypto assets](#) one way or the other. They just define what it means to be a security. Pretty much everything is a commodity. There are a couple of exceptions not worth talking about, but basically everything is a commodity. However, many commodities are also securities. And if they are, the SEC has jurisdiction over them and can sue to enforce violations of its laws.

The problem is, the term "security" is not self-defining. We know that investment contracts are securities, but the statute doesn't tell us what an investment contract is, nor do the laws classify particular assets as securities or non-securities. You can't look in the law books and see that, for example, Bitcoin, Ether, Avax, and Solana are not securities. It's all a matter of interpretation. And in Washington, agencies tend to pursue their own interests. They do have interests of their own in addition to the public interest. They're supposed to serve the public, and I'm not saying they don't have that goal in mind, but the interest of an agency generally is maximized by maximizing its jurisdiction over the economy and businesses.

And now, especially under Chair Gensler, we've had a very aggressive [push by the SEC](#) to assert that pretty much everything in the crypto space is a security. He does not even acknowledge that Ether is not a security, although his predecessor did. This is a little-noticed point, which reveals how things have changed. Former SEC Chairman Jay Clayton acknowledged that [Ether is not a security](#). His successor in the new administration, Chair Gensler, has been asked pointedly (at least twice that I know of) whether Ether is a security, and he has refused to answer. The only thing he will admit publicly is that Bitcoin is not



a security – which everyone already knows. So, as far as his program for expanding his jurisdiction is concerned, everything else – every crypto asset other than Bitcoin – is subject to possible attack by the Gensler Commission.

That's why we are seeing this proliferation of SEC lawsuits. There is an SEC office called [FinHub](#), whose job is supposed to be to help clarify this area – but they don't. They really don't. There has been no useful guidance in this new administration. The last time we got anything useful out of the SEC by way of interpretation was the IMVU [no-action letter](#) at the end of the last administration.

The SEC has the duty to facilitate capital formation. Remember, it's one of its three statutory duties. But capital formation is unfortunately the redheaded stepchild of SEC duties. It gets no respect. It gets no love. The SEC could clarify what is, and is not, a security as it relates to crypto assets, but have refused to do so ever since the end of the last administration.

**AYLA:** We're going to pick up a question from Scotty in the chat, which is specifically around this point of lawsuits and regulations that are trying to work around these lawsuits, including Gensler's September regulation. Scotty says that right now, there are 50 crypto bills being lobbied in Congress. Which one of these do you think are actually getting proper traction, and which ones are probably going to be dead in the water?

**PAT:** There are three that I'm following closely, and so is the Global DCA, by the way. One of them is the Lummis-Gillibrand bill, which I think is in the lead position. I'm not a Washington insider, even though I worked at SEC headquarters in the past. I now work from Chicago and Cornell New York. I regard Lummis-Gillibrand as the favorite because it's the aircraft carrier legislation. It covers everything. A lot of time went into developing it. That's the [Responsible Financial Innovation Act](#).

There's also the [Digital Commodity Exchange Act](#), which was sponsored by Glenn Thompson, Ro Khanna from Silicon Valley, Tom Hammond from Minnesota, and others. And the third one is the [Digital Commodities Consumer Protection Act](#), sponsored by Debbie Stabenow from Michigan and John Boozman. The reason I like these three and favor them over the others is that they're all bipartisan. Bipartisan bills have a chance of being enacted. Strictly partisan bills probably don't.

The bipartisan bills are also more sensible than the others. And note this carefully: Every one of these bills assigns primary jurisdiction over crypto assets not to the SEC, but to the CFTC. That's interesting. Capitol Hill seems to think that the CFTC is where crypto regulation belongs. I don't think any of these bills will be adopted in this term, because the elections are coming up too soon. But I expect them all to be reintroduced next January, and I expect to see one or more get traction. There are other, smaller bills coming, too, including smaller bipartisan bills. I don't mean to overlook them here, I'm just focusing on 3 out of 50.



**KENNY:** Question from Robert. It's a knock-on from your comments here. You mentioned it sounds like Capitol Hill is leaning toward the CFTC having the pole position. Do you agree with that? And do you think that might be part of the reason the SEC is being less than clear because they know that they're not going to be the ones holding the bag at the end of the day?

**PAT:** I do agree with that assessment. I do not believe the SEC has the same record for assisting market development that the CFTC does. The SEC is something like six times the size of the CFTC. But the CFTC punches way above its weight class.

The bills do not assign the responsibility to the CFTC exclusively. And, in fact, there's a risk in a couple of the bills that the SEC will read the text and proclaim,, "Well, we haven't been left out of this process at all. It's for us at the SEC to determine what is a security. We hereby declare that every crypto asset other than Bitcoin and maybe Ether is a security." That could happen, especially with the third bill, the Digital Commodities Consumer Protection Act.

That's a risk, one that I hope will be addressed in hearings and mark-ups. They'll sort it out on Capitol Hill. And, to be clear, I acknowledge that there is a legitimate role for the SEC in crypto market regulation. It's just that I believe that the SEC's legitimate role is not nearly as expansive as the SEC would like it to be.

**AYLA:** One question from Tony. Can you talk a little bit about the role of FINRA?

**PAT:** FINRA is an SRO, a self-regulatory organization, that is regulated by the SEC. It's enormous. I think it's bigger than the SEC. FINRA is an organization that every brokerage firm is required to join. It has rules for its members and for the conduct of member business. FINRA's rules align with and are ancillary to and supplement the SEC's rules.

FINRA is supervised by the SEC, rather closely at that. The overlap of personnel migrating from one to the other is extraordinary. They're in lockstep in everything they do in the crypto markets in particular, in my view. The SEC also regulates other securities industry SROs. For example, each stock exchange is an SRO. The New York Stock Exchange is an SRO. So is Nasdaq.

The SROs have rules governing conduct and the SROs are required by law to enforce their rules, and they do. The SEC oversees SRO disciplinary proceedings. The PCAOB (the Public Company Accounting Oversight Board), which regulates the auditing profession, is also an SRO that the SEC oversees. One question is, when I say that FINRA is supervised by the SEC, does it do the bidding of the SEC?

My answer is that, often, FINRA is out there in the field, doing work that the SEC has not yet gotten around to doing itself, or has left to FINRA to perform. That's my view. In my experience, FINRA may do the bidding of the SEC, but they don't like to acknowledge it. They profess to be making their own judgments. But then when it's decision time they'll say, "Well, we have to talk to SEC Staff, and after that we will get back to you."



FINRA has an important role. It regulates securities broker-dealers, every one of which conducts a public business is required to submit to its discipline. FINRA started small, grew by merger, and became a giant. I haven't seen its recent headcount, but I believe it's bigger than the SEC.

**KENNY:** Gotcha. DD30 is going through the process with FINRA at the moment, and interestingly enough, our positioning is reliant upon having read the tea leaves correctly. That this is going to land at the CFTC, not the SEC. The SEC actually hasn't figured it out yet.

**PAT:** There is a comment in the chat from Alexi, who asks about possible outcomes of this sorting out of regulatory jurisdiction. The worst case is that the SEC takes over and everything is treated as a crypto asset. That's where the current chair seems to want it to go. It's the politically ambitious agenda of a politically ambitious chair. The only people who can stop that are Congress and the courts. I say that because the statutes encourage SEC-CFTC collaboration, but they do not require it. The administration also has a role to play, but it has been deferential to the agency chairs so far. That is the normal posture of the executive branch then in come independent agencies like the SEC.

Just a couple weeks ago, the CFTC commissioner Pham complained publicly about what the SEC is doing in its enforcement program. She called SEC v. Wahi "a striking example of 'regulation by enforcement'." But the SEC need not pay attention to CFTC Commissioner's only court orders and acts of Congress that can inhibit the SEC, absent executive influence.

**ALEXI SOLIT:** Yeah. What I'm trying to do is assess the probability of these scenarios. If the SEC takes over and tries to make most things a security, what does that mean and what will that do to the market? Then, there's also the CFTC. Do you have a view on what the practical outcome of that scenario could be? Do we go from 20,000 tokens to 2,000? Because for most companies, it's too costly to release a token.

**PAT:** I believe you are right. The more expensive it is to design and mint a token – because of ever-higher regulatory burden – the less proliferation you will see of crypto assets. There are vested interests such as trad-fi bankers who yearn for that result. If the SEC drives up the cost of producing tokens, there will be fewer tokens, and they won't get the same traction they otherwise would.

Someone asked, "What else is motivating the SEC? Is it only political ambition?" No, I don't think so. I believe there also is a sincere desire to protect investors. In 2017 and again in 2022, there has been a lot of damage, especially in the retail markets, to crypto token buyers who seem to have been misled. But understand this: regulation and enforcement do not need to come from the SEC. Fraud is illegal regardless of what has been sold. But it's only "securities" fraud that the SEC is empowered to police.

The SEC was never given the job of policing real estate fraud, for example. With exceptions not worth mentioning, the SEC is not allowed to police fraud in the futures markets. We have a CFTC, and the futures markets are its turf. So, too, with the commodities markets. There's fraud in the fine art market, and fraud in the fine wine market, but the SEC is not supposed to police that because art and wine aren't securities. An aggressive SEC Chair looking to expand its power might say that she's only protecting



investors when she attacks fraud in alternative asset classes such as these. The rebuttal to that claim is that ours is a government of limited powers. We cherish our economic freedoms. So, if it's not a security that we're talking about, then, with all due respect, it's none of your business, SEC.





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**Dennis Chookaszian**

Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

Sharing his decades-long expertise on corporate governance, Dennis talked about how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. [Read on](#)



**Susan Brazer**

CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan described the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. [Read on](#)



**Raj Mukherjee J.D.**

VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for [Coinbase](#) and [Binance](#) from scratch, and how investors can profit from crypto without getting caught in a taxation mess. [Read on](#)

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