White Paper

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Highlights

- Overview of SEC guidance on digital assets
- How the SEC's "framework" evolved from prior guidance
- Analysis of TurnKey Jet no-action letter

Inside

Navigating the SEC's digital asset "framework"

Executive summary

The SEC's Strategic Hub for Innovation and Financial Technology (FinHub), a repository of information on emerging financial technologies like blockchain, recently issued guidance in the form of a "framework" for determining when a digital asset is an investment contract and, thus, subject to SEC registration requirements. The SEC's Division of Corporation Finance also simultaneously issued the agency's first crypto no-action letter, recommending against Commission enforcement if a business jet carrier operated a tokenized jet card program.

Introduction

The issuance by the SEC of the "Framework for 'Investment Contract' Analysis of Digital Assets" represents its most detailed effort so far to explain how SEC staff considers whether a token may be a security subject to registration with the Commission. The "framework," however, did not materialize from thin air but rather is the product of nearly six years of SEC experience with digital assets, mostly in an enforcement context. The report of investigation on The DAO and a series of staff guidance documents also informed the SEC's "framework."

Moreover, when William Hinman, Director of the SEC's Division of Corporation Finance, gave a speech in June 2018 stating what he believed to be the critical factors in determining whether a token is a security, comments that almost sounded like staff guidance, much of what he said was overlooked by some media outlets in favor of his comments in the same speech on the status of Bitcoin and Ether (he suggested both virtual currencies, in their current, decentralized forms, would likely not be securities). In addition to spending the bulk of that speech discussing what does or does not make a token a security, Hinman also urged firms to talk to SEC staff before offering tokens.

Almost one year later, TurnKey Jet, Inc., persuaded SEC staff that its tokenized jet card program would not run afoul of federal securities laws. The Division of Corporation Finance, in what could be viewed as an application of the newly issued "framework," agreed with TurnKey Jet and concluded that, based on the company's representations, SEC staff would not recommend enforcement action if TurnKey Jet proceeded with its tokenized jet card program without registering the tokens with the Commission.

To date, the SEC has not proposed or adopted regulations on digital assets via notice-and-comment rulemaking, although many existing SEC regulations may be relevant to digital assets. Chairman Jay Clayton also has reiterated

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that agency guidance is not legally binding. Moreover, the framework takes a sliding scale approach to a narrow issue (investment contracts) with wide implications, but the framework may not provide the more comprehensive guidance on digital assets many have anticipated. For its part, Congress has only recently begun to propose legislation on a range of blockchain topics, including the re-introduction of the Token Taxonomy Act of 2019 (H.R. 2144), which was first introduced in the 115th Congress and would, among other things, amend Securities Act Section 2(a)(1) and Exchange Act Section 3(a)(10) to exclude "digital token" from the definition of "security."

The DAO report largely reiterated and applied the Supreme Court's familiar Howey *test for when something is an investment contract and, thus, a security that must either be registered with the Commission or subject to an exemption from registration.*

This paper begins by tracing the origins of the "framework" by showing how it evolved from the SEC's enforcement actions in the digital asset space and from the agency's guidance developed after the Commission issued The DAO report, which remains the seminal SEC document on digital assets. Later sections of the paper compare Director Hinman's speech to the framework, and the framework to the TurnKey Jet no-action letter.

Scope of SEC guidance on digital assets

Although the SEC has been involved in enforcement actions in the digital asset space since at least 2013 (*See, e.g.*, *SEC v. Shavers*, (E.D. Tex. 2013) (Bitcoin investment scheme was an "investment contract" and, thus, allowed the court to exercise subject matter jurisdiction)), it was not until June 2017 that the Commission issued what might be considered its first guidance on digital assets in the form of a report of investigation of The DAO. The DAO report largely reiterated and applied the Supreme Court's familiar *Howey* test for when something is an investment contract and, thus, a security that must either be registered with the Commission or subject to an exemption from registration.

The DAO was, in theory, a decentralized autonomous organization that was to function as a platform where its members could promote certain projects. According to the SEC, however, The DAO fell squarely within *Howey* because: (1) it involved an investment of money; (2) it was a common enterprise; (3) its members had a reasonable expectation of profits; and (4) those profits were to be generated by the entrepreneurial and managerial skills of The DAO's co-founders and a group of "curators" who controlled which projects were to be pursued.

The DAO report also left some important questions unanswered. For example, the DAO report did not address whether The DAO was an investment company because The DAO's projects never were funded. As a result, The DAO report simply referred persons operating in the digital asset space to the Investment Company Act. Likewise, The DAO report left open the question of whether The DAO was an investment adviser as defined by the Investment Advisers Act because projects were not funded.

Following release of The DAO report, the SEC's Division of Investment Management twice issued guidance on digital assets. A staff letter issued in January 2018, addressed a variety of issues facing mutual funds and exchange-traded funds regarding virtual currencies, including questions regarding valuation, liquidity, custody, arbitrage, and manipulation. A second letter issued in March 2019 asked for public comment on a number of issues regarding digital assets, including whether investment advisers consider digital assets when determining if they meet assets-under-management thresholds for purposes of registration with the Commission.

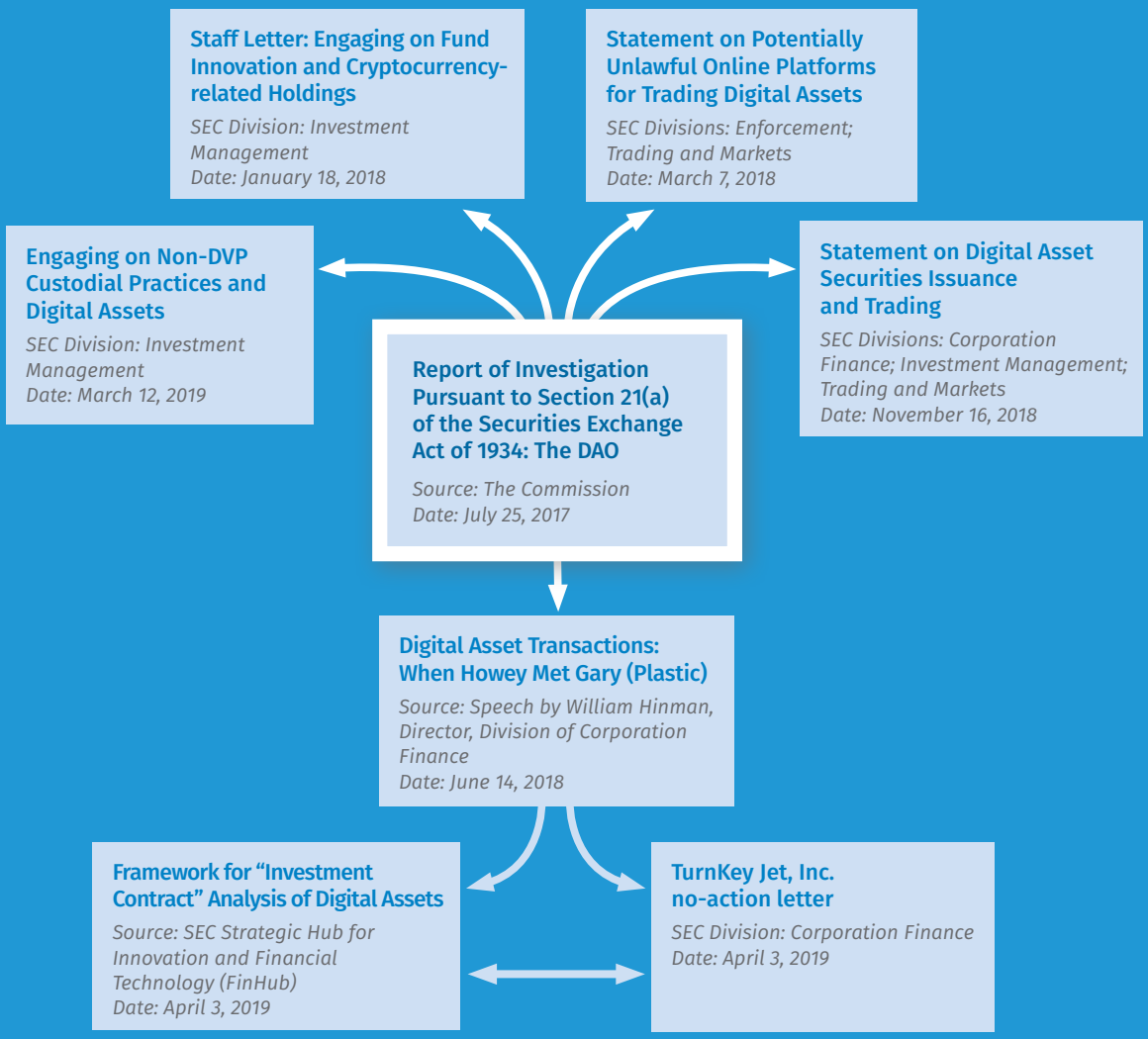
The SEC's other divisions also have teamed up to issue guidance regarding digital assets. In March 2018, the Enforcement and Trading and Markets Divisions issued brief guidance on the use of online platforms to trade digital assets. The guidance focused on the basics of determining if a platform is an "exchange" that must register with the Commission or satisfy an exemption from registration, such as for alternative trading systems.

The guidance also noted such platforms may be required to become registered broker-dealers and become members of a self-regulatory organization in addition to adopting rules to prevent fraud.

A November 2018 guidance document issued jointly by the Divisions of Corporation Finance, Investment Management, and Trading and Markets reiterated the SEC's prior guidance on digital assets with respect to whether a person or firm must register with the Commission in some capacity. The guidance also introduced a new possibility that had been implied by several of the SEC's enforcement actions regarding initial coin offerings. For example, AirFox and Paragon Coin allegedly failed to register tokens as securities and, after engaging in remedial actions and cooperating with the SEC, both firms avoided the imposition of greater penalties in exchange for adhering to a set of detailed undertakings that would result in registration of their tokens under the Exchange Act. According to the SEC's November guidance, both matters suggests that a pathway to compliance exists where firms have offered tokens in violation of the registration requirement under federal securities laws.

The SEC's guidance issued to date on digital assets is depicted in the interactive graphic below. The remainder of this paper will concentrate on the SEC's recently issued "framework" and on the application of that framework to the TurnKey Jet no-action letter.

SEC Guidance on Digital Assets and ICOs



The evolution of a digital asset framework

Prior to the SEC's publication of the framework, most of the agency's "guidance" on digital assets had to be gleaned from numerous enforcement actions and, to the extent the topic was covered, from The DAO report. After The DAO report, the SEC's several divisions began to issue multiple documents that sometimes contained information approaching the level of guidance, or which at least suggested where relevant guidance might be found among existing SEC materials. Within this milieu, two events stand out: Director Hinman's June 2018 speech on digital assets and the issuance by the SEC of the framework.

Moreover, Hinman said, using a label, such as "utility token," would not avoid application of the securities laws.

The Hinman speech. Director Hinman began his June 2018 speech with a brief recitation of *Howey* (*SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946)), and then proceeded to explain how the marketing of digital assets, in some instances, is no different from how the orange groves in *Howey* were marketed. Specifically, Hinman noted that promoters of digital assets, such as coins or tokens, often combine twin marketing claims: (1) the coins or tokens are inherently useful in some way; and (2) the coins or tokens can grow in value.

This scenario led Director Hinman to conclude that, absent other facts, coin or token offerings are akin to investment contracts and, thus, subject to federal securities laws. Said Hinman:

> In the ICOs I have seen, overwhelmingly, promoters tout their ability to create an innovative application of blockchain technology. Like in *Howey*, the investors are passive. Marketing efforts are rarely narrowly targeted to token users. And typically at the outset, the business model and very viability of the application is still uncertain. The purchaser usually has no choice but to rely on the efforts of the promoter to build the network and make the enterprise a success. At that stage, the purchase of a token looks a lot like a bet on the success of the enterprise and not the purchase of something used to exchange for goods or services on the network.

Director Hinman went on to note that the labels attached by promoters to coins or tokens are largely irrelevant because, under *Howey*, one looks to the economic substance of the arrangement and not its form. With respect to why promoters use "coin" or "token" to market such offerings, Hinman suggested a few explanations: (1) a false sense that one can label an offering in a manner that avoids federal securities laws; (2) to achieve marketing "sizzle;" and (3) to highlight the perceived efficiencies of the blockchain.

Moreover, Director Hinman said, using a label, such as "utility token," would not avoid application of the securities laws. Nearly six months before Director Hinman delivered his speech, the SEC had settled an enforcement matter against Munchee, Inc. (the company neither admitted nor denied the SEC's findings) in which Munchee promoted a restaurant review app that included a MUN token that promoters said had the potential to appreciate in value and could be traded on secondary markets. Paragraph 35 of the Munchee order stated:

> Even if MUN tokens had a practical use at the time of the offering, it would not preclude the token from being a security. Determining whether a transaction involves a security does not turn on labelling – such as characterizing an ICO as involving a "utility token" – but instead requires an assessment of "the economic realities underlying a transaction." (citing, among other things, *Howey* progeny *United Housing Found., Inc. v. Forman*, 421 U.S. 837 (1975)).

Hinman closed his speech with an invitation for token issuers to meet with SEC staff regarding compliance with federal securities laws. The relevant passage also contained a footnote in which Hinman discussed whether, in the context of tokens, something that is a security can morph into something that is not a security. The obvious reference is the Simple Agreement for Future Tokens (SAFT), an arrangement that contemplates an investment contract to be followed by functional, non-securities tokens (Hinman explicitly said he was not commenting on the "legality or appropriateness" of the SAFT). Hinman then stated: "From the discussion in this speech, however, it is clear I believe a token once offered in a security offering can, depending on the circumstances, later be offered in a non-securities transaction. I expect that some, perhaps many, may not."

The FinHub framework might be viewed as an expansion and further clarification of Hinman's June 2018 remarks. The concept of "morphing" may or may not be what is most important because what one gleans from the Hinman speech, and which is more explicitly stated in both the framework and the TurnKey Jet no-action letter, is that to avoid application of federal securities laws, a token must have immediate utility on a fully functional network and the token must not be traded on secondary markets. In other words, the token is structured in a manner that avoids the problems that would otherwise bring it within *Howey*'s ambit.

The framework. According to Director Hinman, speaking at the 39th Annual Ray Garrett Jr. Corporate & Securities Law Institute in Chicago, the framework brings an agency focus to digital assets that was less well developed before Clayton's chairmanship. For one, he said the SEC now can coordinate across the agency via FinHub regarding digital assets. He also said the framework is how SEC staff thinks about digital assets, although no one factor set forth in the framework is determinative of whether a digital assets is an investment contract.

The framework is narrowly focused on application of the *Howey* standard to digital assets. As a result, the framework follows the several prongs of the *Howey* standard: (1) investment of money; (2) in a common enterprise; (3) with a reasonable expectation of profits to be derived from the efforts of others. Moreover, the framework's explanation of *Howey* in the digital asset space generally takes a sliding scale, principles-based approach that may allow for highly fact-specific determinations. Put another way, the framework often provides that a small number of factors are critical and that other factors, which may be more or less present, can influence the resulting determination of whether a token is an investment contract and, thus, a security. The framework also states via footnote that it is grounded in SEC staff "experiences," is non-exhaustive, and may "evolve" over time in response to the evolution of digital asset markets.

The framework is narrowly focused on application of the Howey standard to digital assets.

The framework spends very little time discussing the first two prongs of *Howey*. With respect to an "investment of money," the framework observes that this requirement is generally met simply by exchanging a digital asset for fiat currency, other digital assets, or some other type of consideration. A footnote to this part of the discussion cites the SEC's Tomahawk enforcement action (air drops) for the principle that a bounty program or "air drop" would satisfy *Howey* because tokens exchanged for services in aid of the issuer's interests, including developing a trading market, constituted a sale or distribution of securities.

With respect to the "common enterprise" prong, the framework states that the SEC generally has found that the offering of digital assets meets this requirement. A footnote to the discussion reiterates that the SEC does not necessarily treat the "common enterprise" prong as a separate requirement and that the Commission, unlike many federal courts, does not strictly apply the concepts of vertical and

horizontal commonality. Rather, the SEC would find this prong satisfied where digital assets buyers' fortunes are linked to each other or to the promoter.

The bulk of the framework's *Howey* discussion focuses on the third prong, which can be further broken into two separate components: (1) reliance on the efforts of others; and (2) a reasonable expectation of profits. The remainder of this section describes what the framework would require for these requirements to be met while also attempting to show how the factors cited by the framework appear to have evolved from Director Hinman's June 2018 speech.

> *Note on terminology and sources:* The discussion below incorporates some of the terminology used by the framework. The framework often refers to third parties (e.g., promoters) by the abbreviation "AP" for "active participant." Moreover, the framework uses a broad meaning of "network" to include "the various elements that comprise a digital asset's network, enterprise, platform, or application." Text cited in charts has been taken verbatim from the cited source documents.

—*The role of third parties.* An important part of the *Howey* analysis is the extent to which prospective investors depend on the entrepreneurial and managerial efforts of others. The framework addresses this aspect of *Howey* by suggesting eight factors (in some instances with sub-factors) that can be applied in a flexible manner to determine if this component of *Howey* has been met.

First, the framework highlights two factors that would be considered essential to an evaluation of the efforts of others: (1) whether digital asset buyers "reasonably expect to rely" on the efforts of a third-party AP; and (2) whether the efforts of others are "undeniably significant" such that they affect the success or failure of the venture (as compared to "ministerial" efforts).

Next, with respect to a network that is not fully functional at the time of an offer or sale, the framework observes that there may be a reasonable expectation that an AP will continue to develop the network and that this expectation would be especially strong if the AP "promises further developmental efforts." This fully functional network factor was one of several factors that appears to have played a significant role in the SEC's CorpFin staff deciding to grant no-action relief to TurnKey Jet, whose network would be complete when tokens are issued (discussed in more detail below).

Similarly, the framework said that an AP's ongoing managerial involvement gives rise to several factors to be evaluated. Factors include: (1) whether, and how, to pay service providers; (2) deciding if, and where, a digital asset may be traded on a secondary market; (3) making decisions about who gets additional digital assets and the terms of such grants; (4) deciding how to "deploy" any funds raised; (5) taking a "leading role" in transaction validation or network security; and (6) making additional managerial decisions that can affect the network's success or failure, or which may impact the value of the digital asset.

Lastly, the framework contemplates that an AP would promote its own interests in a network or digital asset. These efforts may entail: (1) taking a stake in the digital asset; (2) using the digital asset as a mode of compensating managers or linking an AP's compensation to the market price of the digital asset; (3) owning or controlling relevant intellectual property; (4) taking steps to monetize a digital asset (the framework notes that this would be a strong factor if the digital asset is not fully functional).

The Role of Third Parties

Hinman speech: does third party create expectation of return on investment?	Framework: reliance on the efforts of others
Is there a person or group that has sponsored or promoted the creation and sale of the digital asset, the efforts of whom play a significant role in the development and maintenance of the asset and its potential increase in value?	**Are those efforts "the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise," as opposed to efforts that are more ministerial in nature?** An AP is responsible for the development, improvement (or enhancement), operation, or promotion of the network, particularly if purchasers of the digital asset expect an AP to be performing or overseeing tasks that are necessary for the network or digital asset to achieve or retain its intended purpose or functionality. There are essential tasks or responsibilities performed and expected to be performed by an AP, rather than an unaffiliated, dispersed community of network users (commonly known as a "decentralized" network).
Has this person or group retained a stake or other interest in the digital asset such that it would be motivated to expend efforts to cause an increase in value in the digital asset? Would purchasers reasonably believe such efforts will be undertaken and may result in a return on their investment in the digital asset?	An AP creates or supports a market for, or the price of, the digital asset. This can include, for example, an AP that: (1) controls the creation and issuance of the digital asset; or (2) takes other actions to support a market price of the digital asset, such as by limiting supply or ensuring scarcity, through, for example, buybacks, "burning," or other activities. An AP has a lead or central role in the direction of the ongoing development of the network or the digital asset. In particular, an AP plays a lead or central role in deciding governance issues, code updates, or how third parties participate in the validation of transactions that occur with respect to the digital asset. An AP has a continuing managerial role in making decisions about or exercising judgment concerning the network or the characteristics or rights the digital asset represents. Purchasers would reasonably expect the AP to undertake efforts to promote its own interests and enhance the value of the network or digital asset.
Has the promoter raised an amount of funds in excess of what may be needed to establish a functional network, and, if so, has it indicated how those funds may be used to support the value of the tokens or to increase the value of the enterprise? Does the promoter continue to expend funds from proceeds or operations to enhance the functionality and/or value of the system within which the tokens operate?	
Are purchasers "investing," that is seeking a return? In that regard, is the instrument marketed and sold to the general public instead of to potential users of the network for a price that reasonably correlates with the market value of the good or service in the network?	
Does application of the Securities Act protections make sense? Is there a person or entity others are relying on that plays a key role in the profit-making of the enterprise such that disclosure of their activities and plans would be important to investors? Do informational asymmetries exist between the promoters and potential purchasers/investors in the digital asset?	**Does the purchaser reasonably expect to rely on the efforts of an AP?**
Do persons or entities other than the promoter exercise governance rights or meaningful influence?	

Source: William Hinman, Digital Asset Transactions: When Howey Met Gary (Plastic) (June 14, 2018); SEC's Strategic Hub for Innovation and Financial Technology, Framework for "Investment Contract" Analysis of Digital Assets (April 3, 2019). The factors cited in both documents overlap and, thus, the matching of factors in the above table is intended for demonstration purposes only. Framework items in bold were given special emphasis by the framework.

With respect to one of the factors cited by Director Hinman ("Does application of the Securities Act protections make sense?"), reference is typically made to the Supreme Court's opinion in *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953). It was in this opinion that the court developed the generalized rubric for determining when to apply the disclosure regime contemplated by the federal securities laws. As a result, federal securities laws generally apply when investors cannot fend for themselves. This rubric results in a two-speed regulatory framework in which investors in private offerings may not require more fulsome disclosure because they have the resources to independently evaluate securities offerings. By contrast, disclosure is perhaps the only mode that other investors lacking such resources have for learning about securities offerings.

Director Hinman suggested in his June 2018 speech that, in the context of virtual currencies like Bitcoin, bringing to bear the full range of securities regulations may not be necessary, especially when a virtual currency or token is part of a highly decentralized network. Director Hinman explained further: "Over time, 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. And of course there will continue to be systems that rely on central actors whose efforts are a key to the success of the enterprise. In those cases, application of the securities laws protects the investors who purchase the tokens or coins."

—*Reasonable expectation of profits.* The framework begins its discussion of the "reasonable expectation of profits" requirement by reciting the most general conception of this requirement, which posits that capital appreciation is just one of several ways in which profits can occur. The framework also notes that growth in the value of a digital asset, or any other type of asset, that could be attributed "solely" to inflationary trends in the general economy typically would not be the kind of price appreciation needed to bring an asset within the *Howey* standard.

The framework then goes beyond the basic concept of price appreciation to cite 10 factors whose presence/absence could make a digital asset more/less likely to be an investment contract under *Howey*. Three of these factors merit further discussion. For one, if a digital asset confers on its holders the right to share in the venture's gains, appreciation may arise from at least two sources: (1) "the operation, promotion, improvement, or other positive developments in the network" (the framework notes that a secondary market for the digital asset would be an especially strong factor); and (2) a grant to holders of the right to receive dividends or other distributions.

The framework also asks whether a digital asset is marketed to the general public or to potential users of a network. Here, the framework explains that purchases of a digital asset that are disproportionately large or small as compared to a network user's expected needs could indicate an investment objective.

Lastly, the framework provides a list of 10 marketing methods to consider in determining if an investment contract exists:

- The expertise of an AP or its ability to build or grow the value of the network or digital asset.
- The digital asset is marketed in terms that indicate it is an investment or that the solicited holders are investors.
- The intended use of the proceeds from the sale of the digital asset is to develop the network or digital asset.
- The future (and not present) functionality of the network or digital asset, and the prospect that an AP will deliver that functionality.
- The promise (implied or explicit) to build a business or operation as opposed to delivering currently available goods or services for use on an existing network.
- The ready transferability of the digital asset is a key selling feature.
- The potential profitability of the operations of the network, or the potential appreciation in the value of the digital asset, is emphasized in marketing or other promotional materials.
- The availability of a market for the trading of the digital asset, particularly where the AP implicitly or explicitly promises to create or otherwise support a trading market for the digital asset.

The following chart, to the extent possible, traces the lineage of the framework's 10 factors. In some cases, the overlap between Director Hinman's speech and the framework is so extensive, no attempt has been made to match all related items, but readers should nevertheless consult both the speech and the framework.

Analyzing Profit Expectations

Hinman speech: does third party create expectation of return on investment?	Framework: reasonable expectation of profits
Has this person or group retained a stake or other interest in the digital asset such that it would be motivated to expend efforts to cause an increase in value in the digital asset? Would purchasers reasonably believe such efforts will be undertaken and may result in a return on their investment in the digital asset?	Purchasers reasonably would expect that an AP's efforts will result in capital appreciation of the digital asset and therefore be able to earn a return on their purchase. The AP is able to benefit from its efforts as a result of holding the same class of digital assets as those being distributed to the public.
Are purchasers "investing," that is seeking a return? In that regard, is the instrument marketed and sold to the general public instead of to potential users of the network for a price that reasonably correlates with the market value of the good or service in the network?	The digital asset is offered broadly to potential purchasers as compared to being targeted to expected users of the goods or services or those who have a need for the functionality of the network.
Has the promoter raised an amount of funds in excess of what may be needed to establish a functional network, and, if so, has it indicated how those funds may be used to support the value of the tokens or to increase the value of the enterprise? Does the promoter continue to expend funds from proceeds or operations to enhance the functionality and/or value of the system within which the tokens operate?	The AP has raised an amount of funds in excess of what may be needed to establish a functional network or digital asset. The AP continues to expend funds from proceeds or operations to enhance the functionality or value of the network or digital asset.
Hinman speech: Contractual/Technical Issues	**Framework: reasonable expectation of profits**
Are independent actors setting the price or is the promoter supporting the secondary market for the asset or otherwise influencing trading?	The digital asset is transferable or traded on or through a secondary market or platform, or is expected to be in the future.
Is it clear that the primary motivation for purchasing the digital asset is for personal use or consumption, as compared to investment? Have purchasers made representations as to their consumptive, as opposed to their investment, intent? Are the tokens available in increments that correlate with a consumptive versus investment intent?	There is little apparent correlation between the purchase/offering price of the digital asset and the market price of the particular goods or services that can be acquired in exchange for the digital asset.
Are the tokens distributed in ways to meet users' needs? For example, can the tokens be held or transferred only in amounts that correspond to a purchaser's expected use? Are there built-in incentives that compel using the tokens promptly on the network, such as having the tokens degrade in value over time, or can the tokens be held for extended periods for investment?	There is little apparent correlation between quantities the digital asset typically trades in (or the amounts that purchasers typically purchase) and the amount of the underlying goods or services a typical consumer would purchase for use or consumption.
	Framework: additional factors
	The digital asset gives the holder rights to share in the enterprise's income or profits or to realize gain from capital appreciation of the digital asset.
	The digital asset is marketed, directly or indirectly, using any of the following [methods].

Source: William Hinman, Digital Asset Transactions: When Howey Met Gary (Plastic) (June 14, 2018); SEC's Strategic Hub for Innovation and Financial Technology, Framework for "Investment Contract" Analysis of Digital Assets (April 3, 2019). The factors cited in both documents overlap and, thus, the matching of factors in the above table is intended for demonstration purposes only.

—*Reevaluation of third parties and profit expectations.* The framework also contemplates the reevaluation of digital assets previously sold as securities as the digital asset, its network, and the market evolve over time. This aspect of the framework can be traced back to hints provided in Director Hinman's June 2018 speech in which he suggested the possibility that a token offered as a security may, in the future, be offered via a non-securities transaction.

The framework's discussion of reevaluation focuses on the "efforts of others" and "reasonable expectations of profits" components of *Howey*. According to the framework, each of these components would be reevaluated under both the longer lists of factors applied to them (discussed above) and under several additional factors.

With respect to the "efforts of others" component of Howey, the framework suggests three additional factors to consider: (1) whether or not the efforts of an AP, including any successor AP, continue to be important to the value of an investment in the digital asset, (2) whether the network on which the digital asset is to function operates in such a manner that purchasers would no longer reasonably expect an AP to carry out essential managerial or entrepreneurial efforts, and (3) whether the efforts of an AP are no longer affecting the enterprise's success. The framework also suggests six additional factors that may be relevant to a reevaluation of the "reasonable expectations of profits" component in Howey:

- Purchasers of the digital asset no longer reasonably expect that continued development efforts of an AP will be a key factor for determining the value of the digital asset.
- The value of the digital asset has shown a direct and stable correlation to the value of the good or service for which it may be exchanged or redeemed.
- The trading volume for the digital asset corresponds to the level of demand for the good or service for which it may be exchanged or redeemed.
- Whether holders are then able to use the digital asset for its intended functionality, such as to acquire goods and services on or through the network or platform.
- Whether any economic benefit that may be derived from appreciation in the value of the digital asset is incidental to obtaining the right to use it for its intended functionality.
- No AP has access to material, non-public information or could otherwise be deemed to hold material inside information about the digital asset.

—*Additional considerations.* The framework develops a set of further considerations that token issuers may consult in determining if the specific token is a security. As with the factors identified by the framework as being important to the question of whether others' efforts will be relied upon and whether there is a reasonable expectation of profits, the various additional considerations generally match up with the additional considerations identified by Director Hinman in his June 2018 speech.

The one topic, however, that does not have an obvious tie to the Director Hinman speech is that of virtual currencies. But even here, one can find similarities between the Hinman speech and the framework. The framework states that a virtual currency would be used widely as a substitute for fiat currencies. The framework then explains that it should be possible to make payments with the virtual currency without converting it into another digital asset or real currency. Moreover, the framework describes a virtual currency as being a digital asset that "actually operates as a store of value" that can be accessed and used in the future. This latter point emphasizes one of the characteristics ascribed by the Internal Revenue Service to a virtual currency. According to IRS Notice 2014-21: "virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value."

With respect to virtual currencies, Director Hinman's speech emphasized the concept of decentralization, which refers to virtual currencies as being nearly autonomous in that there is no need for a core of persons to maintain the virtual currency and, thus no need to invoke federal securities laws (although other laws may apply to virtual currencies). Hinman posited that Bitcoin and Ether (at least in their current forms) would not be securities; Hinman did not mention Ripple, which is the subject of private law suits alleging that it is an unregistered security.

Additional Considerations for Tokens

Hinman speech: contractual/technical issues	Framework: other relevant considerations
Is token creation commensurate with meeting the needs of users or, rather, with feeding speculation?	The digital assets' creation and structure is designed and implemented to meet the needs of its users, rather than to feed speculation as to its value or development of its network.
Are independent actors setting the price or is the promoter supporting the secondary market for the asset or otherwise influencing trading?	Restrictions on the transferability of the digital asset are consistent with the asset's use and not facilitating a speculative market. If the AP facilitates the creation of a secondary market, transfers of the digital asset may only be made by and among users of the platform.
Is it clear that the primary motivation for purchasing the digital asset is for personal use or consumption, as compared to investment? Have purchasers made representations as to their consumptive, as opposed to their investment, intent? Are the tokens available in increments that correlate with a consumptive versus investment intent?	Prospects for appreciation in the value of the digital asset are limited. Any economic benefit that may be derived from appreciation in the value of the digital asset is incidental to obtaining the right to use it for its intended functionality. The digital asset is marketed in a manner that emphasizes the functionality of the digital asset, and not the potential for the increase in market value of the digital asset. Potential purchasers have the ability to use the network and use (or have used) the digital asset for its intended functionality.
Are the tokens distributed in ways to meet users' needs? For example, can the tokens be held or transferred only in amounts that correspond to a purchaser's expected use? Are there built-in incentives that compel using the tokens promptly on the network, such as having the tokens degrade in value over time, or can the tokens be held for extended periods for investment?	Holders of the digital asset are immediately able to use it for its intended functionality on the network, particularly where there are built-in incentives to encourage such use. With respect to a digital asset that represents rights to a good or service, it currently can be redeemed within a developed network or platform to acquire or otherwise use those goods or services.
Is the asset marketed and distributed to potential users or the general public?	
Are the assets dispersed across a diverse user base or concentrated in the hands of a few that can exert influence over the application?	
Is the application fully functioning or in early stages of development?	The distributed ledger network and digital asset are fully developed and operational.
	With respect to a digital asset referred to as a virtual currency, it can immediately be used to make payments in a wide variety of contexts, or acts as a substitute for real (or fiat) currency.

Source: William Hinman, Digital Asset Transactions: When Howey Met Gary (Plastic) (June 14, 2018); SEC's Strategic Hub for Innovation and Financial Technology, Framework for "Investment Contract" Analysis of Digital Assets (April 3, 2019). The factors cited in both documents overlap and, thus, the matching of factors in the above table is intended for demonstration purposes only.

Applying the framework: TurnKey Jet no-action letter

This section will highlight the similarities between the framework and the TurnKey Jet no-action letter issued the same day as the framework. Although the TurnKey Jet no-action letter could be viewed as an application of the framework, it is less clear that the no-action letter was timed to coincide with the release of the framework. Director Hinman recently told an audience attending the 39th Annual Ray Garrett Jr. Corporate & Securities Law Institute in Chicago that it was "coincidental" that the framework was issued along with the TurnKey Jet no-action letter. Hinman also told the Garrett Institute audience that the TurnKey Jet no-action letter was a comparatively simple matter. Specifically, Hinman emphasized that TurnKey Jet's token was structured to avoid secondary market trading, was not marketed as an investment, and sought to maintain a $1 to $1 ratio of consumer deposits to tokens issued to consumers.

Tokenized jet card business. According to TurnKey Jet, Inc., a Florida-based Delaware company, it plans to offer a tokenized business jet service to consumers, brokers, and carriers (brokers and carriers could not be consumers and only consumers can buy tokens). The company has two business jets (a video on its website says they are Beachcraft Hawker aircraft) and is trying to acquire a third jet. TurnKey Jet asserted that it has operated under Federal Aviation Administration (FAA) regulations since 2012 and has conducted more than 600 flights for over 140 customers. In addition to FAA and related Department of Transportation regulation, TurnKey Jet said it will abide by the USA Patriot Act and FinCEN's anti-money laundering regulations.

TurnKey Jet said it wants to tokenize access to its fleet for purposes of efficiency and transparency versus current credit card-driven solutions, but the program will otherwise mimic existing jet card programs within the charter industry. TurnKey Jet explained that it will function as program manager for a private, permissioned network in which users will gain access to its platform via an app and wallet. Consumer users will buy TurnKey Jet tokens for $1 each as long as the program exists and, typically, redeem tokens for air charters. The platform also will have a smart contract that embeds terms of service, including limits on the transfer of tokens and restricting transfer of tokens only to TurnKey Jet wallets (no external wallets allowed). Consumers could exchange circulating TurnKey Jet tokens only within the TurnKey Jet network. TurnKey Jet said there will be separate program membership and token sales agreements. These agreements plus the smart contracts will further provide that TurnKey Jet may use any escrowed funds only in payment for air charter services at redemption.

Perhaps one the more telling statements in TurnKey Jet's no-action request letter deals with platform development: "Construction of the TKJ Platform, Network, App and Token will be funded by TKJ Jet through its own capital resources. At no time will TKJ Jet utilize funds received for the purchase of Tokens to develop the TKJ Jet Platform, Network, App or Token, and each of these will be fully developed and operational at the time any Tokens are sold." Moreover, TurnKey Jet represented that it seeks to establish a 1:1 ratio of TurnKey Jet tokens to U.S. dollars and that this ratio should disincentivize consumers from seeking to acquire TurnKey Jet tokens from other TurnKey Jet token holders at a premium above that ratio.

***Howey* analysis.** TurnKey Jet's counsel, James P. Curry, opined that the company's proposed tokenized jet card would not fall within the ambit of federal securities laws. As a result, Turnkey Jet posited that its token would not be an "investment contract" under *Howey*, nor would it be a "note" or "evidence of indebtedness" under the *Reves* family resemblance test.

As is typical in analyzing digital assets under *Howey*, the first prongs regarding an investment of money and a common enterprise generate little analysis because they almost always exist. TurnKey Jet quickly conceded an investment of money. With respect to a common enterprise, TurnKey Jet answered that a common enterprise may exist regarding brokers and carriers that will interact with the token, but that consumers of the token would rely on TurnKey Jet only to deliver air charter services, not a return on capital.

With respect to the "expectation of profits to be derived solely from the efforts of [others]" requirement, TurnKey Jet stated that the token

will not provide consumers with a share of the company's income, nor will the company pay dividends or make other distributions. TurnKey Jet also said that its token will have contractual and smart contract limits to ensure that only consumers, brokers, and carriers can obtain tokens. Other requirements advise token holders that tokens are not an investment and consumers must aver that they do not have an investment purpose and that they will use tokens for their own use without a view to distribution of tokens. Consumers also must aver that there is no market for the tokens and that TurnKey Jet and others will not create a secondary market. Additionally, marketing materials emphasize the goal of the token program is to provide air charter services and that consumers will agree to transfer and redemption limits, while escrowed funds would be used to pay for air charter services when tokens are redeemed. Moreover, the tokens will have a "consumptive nature" because of the lack of a secondary market and the economic disincentive to trade tokens resulting from the 1:1 ratio of TurnKey Jet tokens to U.S. dollars.

The following chart traces the TurnKey Jet representations cited by the SEC's no-action letter response to the relevant language in the framework (comparisons also can be made to Director Hinman's June 2018 speech, although this section will focus on the framework). Overall, the representations cited by the SEC emphasize that the tokens will not be marketed in a manner the suggests an investment, the U.S. Dollar ratio employed would disincentivize speculation over the price of tokens, and the closed network will be fully functional at the time tokens are sold. The chart groups related framework factors, although these factors are divided into several groups in the framework, such as "reasonable expectation of profits," "efforts of others," and additional factors to be considered. In some instances, the framework uses nearly identical language in others, one can infer the representation made by TurnKey Jet from the inverse of the framework factor. Moreover, readers may wish to further consult the various framework factors applicable to the reevaluation of a determination about whether a token is an investment contract.

Comparison of Framework Factors and TurnKey Jet Representations

Framework factors	SEC no-action letter response
An AP is responsible for the development, improvement (or enhancement), operation, or promotion of the network, particularly if purchasers of the digital asset expect an AP to be performing or overseeing tasks that are necessary for the network or digital asset to achieve or retain its intended purpose or functionality. An AP has a lead or central role in the direction of the ongoing development of the network or the digital asset. The AP has raised an amount of funds in excess of what may be needed to establish a functional network or digital asset. The distributed ledger network and digital asset are fully developed and operational.	TKJ will not use any funds from Token sales to develop the TKJ Platform, Network, or App, and each of these will be fully developed and operational at the time any Tokens are sold.
Holders of the digital asset are immediately able to use it for its intended functionality on the network, particularly where there are built-in incentives to encourage such use. With respect to a digital asset that represents rights to a good or service, it currently can be redeemed within a developed network or platform to acquire or otherwise use those goods or services. Potential purchasers have the ability to use the network and use (or have used) the digital asset for its intended functionality.	[T]he Tokens will be immediately usable for their intended functionality (purchasing air charter services) at the time they are sold.

Framework factors	SEC no-action letter response
Restrictions on the transferability of the digital asset are consistent with the asset's use and not facilitating a speculative market.	TKJ will restrict transfers of Tokens to TKJ Wallets only, and not to wallets external to the Platform.
The digital asset gives the holder rights to share in the enterprise's income or profits or to realize gain from capital appreciation of the digital asset. The digital asset is transferable or traded on or through a secondary market or platform, or is expected to be in the future. There is little apparent correlation between the purchase/offering price of the digital asset and the market price of the particular goods or services that can be acquired in exchange for the digital asset. There is little apparent correlation between quantities the digital asset typically trades in (or the amounts that purchasers typically purchase) and the amount of the underlying goods or services a typical consumer would purchase for use or consumption. The digital assets' creation and structure is designed and implemented to meet the needs of its users, rather than to feed speculation as to its value or development of its network. Prospects for appreciation in the value of the digital asset are limited.	TKJ will sell Tokens at a price of one USD per Token throughout the life of the Program, and each Token will represent a TKJ obligation to supply air charter services at a value of one USD per Token.
An AP creates or supports a market for, or the price of, the digital asset [discussing buybacks and "burning"].	If TKJ offers to repurchase Tokens, it will only do so at a discount to the face value of the Tokens (one USD per Token) that the holder seeks to resell to TKJ, unless a court within the United States orders TKJ to liquidate the Tokens.
The digital asset is offered broadly to potential purchasers as compared to being targeted to expected users of the goods or services or those who have a need for the functionality of the network. The digital asset is marketed, directly or indirectly, using any of the following [citing eight methods]. The digital asset is marketed in a manner that emphasizes the functionality of the digital asset, and not the potential for the increase in market value of the digital asset.	The Token is marketed in a manner that emphasizes the functionality of the Token, and not the potential for the increase in the market value of the Token.

Source: SEC's Strategic Hub for Innovation and Financial Technology, Framework for "Investment Contract" Analysis of Digital Assets (April 3, 2019). Response of the Division of Corporation Finance, TurnKey Jet, Inc., (April 3, 2019). The factors cited in both documents overlap and, thus, the matching of factors in the above table is intended for demonstration purposes only.

***Reves* family resemblance test.** TurnKey Jet's no-action request letter went one step further than many analyses of digital assets have gone (they often begin and end with *Howey*) and opined on whether the tokens were "notes" or "evidence of indebtedness" such they would be securities. The basis for this step is the Supreme Court's *Reves* opinion (*Reves v. Ernst & Young*, 494 U.S. 56 (1990)), which established the test for whether a "note" is a security. The SEC's guidance on digital assets has made only fleeting reference to *Reves* in a single footnote (No. 4) in The DAO report, where *Reves* was cited for the general proposition that Congress intended for the federal securities laws to cover investments regardless of their "form" or "name."

Under *Reves*, it is presumed that all notes are securities, but this presumption can be rebutted by showing that the instrument bears a family resemblance to other instruments that have been found not to be securities. The *Reves* court also provided a rubric for evaluating instruments for a family resemblance; thus, one would look to: (1) the buyer's and seller's motivations and the commercial or consumer purpose of the instrument; (2) the plan of distribution; (3) the reasonable expectations of the investing public; and (4) whether a regulatory scheme other than federal securities law would apply to the instrument.

TurnKey Jet devoted one paragraph of its no-action request letter to *Reves*. According to the company, the tokens to be issued under its jet card program have a "strong resemblance" to instruments historically excluded from "security" under *Reves*. TurnKey Jet explained that its tokens would be "an open-account debt incurred in the ordinary course of business," which the company said is among those instruments found not to be securities (the company cited opinions from the Fifth and Tenth Circuits). TurnKey Jet also bolstered its argument by noting that its tokens are to be held in escrow with equivalent $1 deposits at FDIC-insured banks and that the tokens would not be marketed as a profit-making investment.

Conclusion

The addition of the "framework" to the SEC's constellation of guidance on digital assets offers a more nuanced application of the quite broad concept of "investment contract" with respect to registration of digital assets. While the framework may not be the comprehensive guidance many in the blockchain space had anticipated, it does elucidate SEC staff thinking on when digital assets fall within the definition of "security." In this respect, the framework provides a flexible approach to a specific type of question that issuers of digital assets must seriously consider.

However, the framework's application to TurnKey Jet may leave some questions unanswered, especially in light of the sliding scale approach taken by the framework, which may lend itself to very fact-specific determinations. For example, the inherent challenges in applying the framework could materialize in cases with much closer facts than appears to have been the case with TurnKey Jet. Nevertheless, TurnKey Jet appears to have set the early benchmark for what digital asset firms must do in order to satisfy the SEC that federal securities laws should not apply to certain digital assets. It remains to be seen if other firms can achieve similar results.