POLICY CLARITY WOULD BE BETTER THAN SATIRE

With the creation of the HoweyCoins website, the SEC proved both that they have a sense of humor AND that they understand many of the issues surrounding crypto-asset issuance. Now comes the hard part, however, which will be to provide companies and/or distributed projects with clarity on how they can issue crypto-assets to the public. The SEC has provided a clear example of what NOT to do, so now it is time for them to clarify what issuers SHOULD do, when raising money via a coin offering. This is necessary to avoid disadvantaging US investors and entrepreneurs in the global marketplace for an important new technology.

Despite widespread skepticism over the value of crypto-assets, I believe that there is enormous potential. The main reason for my belief is crypto's polymorphic nature, where it can function as an investment, as a currency or store of value, as a commodity, or embody utility all at the same time. Two examples should underscore this point.

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First, consider our own proposed token: the RouteCoin. (whitepaper available for download on www.coinroutes.com). The Routecoin will function as both collateral to secure participation in the information sharing network and as a smart contract that will enforce penalties for participants caught violating network rules. It is the dual nature of the coin that will enable the self-policing functionality of the network, which would not have been possible without crypto-innovation. Self-policing, which aligns the incentives of all participants will be much more efficient and effective than establishing an expensive self regulatory body. The result will be a major step forward for traders in the crypto universe as they will become far more effective at liquidity discovery in a distributed environment.

Second, crypto assets enable transparent compensation for open source collaboration. Consider how much social good has been created by the open source movement already. It has created operating systems, databases, compilers, web servers and a lot of other important software. This has occurred despite no dependable method for compensating the people who contribute their hard work and intellectual capital to such efforts. The ability of distributed networks of individuals to create crypto-assets, however, provides a means for compensating open source efforts directly, in a democratic and distributed manner. This could herald a massive increase in productivity, but not if such networks are denied access to investor capital.

So, with that as a background, let's get back to the SEC and what they need to do. For context, it is worth looking at their core mission. From SEC.gov, the Securities and Exchange Commission (SEC) has a three-part mission:

Protect investors

Maintain fair, orderly, and efficient markets

Facilitate capital formation

To accomplish that mission, however, the SEC can't simply be a barrier to capital formation or completely block investors from investing in new technologies.

“Protecting” investors shouldn’t mean putting them in a plastic bubble, but rather to make sure that they have sufficient information to make decisions and that providers of that information tell the truth. To their credit, the SEC has (so far) resisted the temptation to shut down the market, and have focused on investor education and prosecuting fraud. Both of those are vital areas of focus, but the core problem is that current rules are outdated & many are irrelevant, inapplicable, or both with regard to crypto-assets. This explains why there is such concern with coins being labelled as “securities.” If the existing rules were easy for legitimate issuers or trading firms to comply with, did not discourage real liquidity, and provided investors with better information and protection, no one would object. The fact that current rules could potentially disrupt the crypto markets, if applied to all assets, while providing little real protection, is the issue.

To be blunt, very few people dispute the notion that coins “listed” on crypto “exchanges” are being bought and sold as investments, nor do people argue with the fact that many companies are raising capital via ICOs. It ***is*** true, however, that crypto assets are polymorphic, which provides an excuse for issuers to use the designation of being a “utility token” to avoid the myriad of securities rules, many of which would be counterproductive. (or, much worse for the U.S., companies are raising money overseas with ICOs and ignoring the U.S. market altogether)

So, getting back to the SEC core mission, the only real path forward is for them to create a new set of rules for crypto with a focus on capital raising and investor protection. To underscore this point, it is vital to avoid shoehorning crypto assets into rules that makes capital raising impossible, such as always requiring corporate financial history disclosures. For example, Reg A+ requires 2 years of corporate financials, but, 1) financial operating data is irrelevant to crypto projects whose value is based on future utility & 2) many projects have no operating history whatsoever… In many cases, such assets aren’t even related to a single corporate entity, and even when they are, the assets are not directly related to previous efforts of that entity. Future crypto-asset rules should focus on disclosures relevant to crypto projects, such as the specific rights of token holders, precision with regard to current & token supply, network governance, use of proceeds, and disclosures of all conflicts of interest. Conflict of interests are particularly important since many offerings are promoted by "advisers" who have been granted tokens for their efforts. While not wrong per se, such arrangements directly reflect upon the credibility of the promotion, and investors who are being persuaded to invest based on those endorsements have a right to know.

I have described the issues with fair and orderly markets and investor protection at length in previous posts, but one point bears emphasis: The SEC should NOT let the PERFECT be the enemy of the GOOD. Simply stated, the current state of completely unregulated trading markets is far worse than a limited form of regulation, while suffocating the market completely by applying equity rules would actually be the worst outcome. As a result, I have previously suggested that the SEC should issue "no action" relief for registered broker dealers and alternative trading systems to be able to trade crypto-assets on behalf of their clients. Such an action, while not forcing their trading to follow the detailed rules of other asset classes, would put principles such as fair access and best execution into play. At the same time, the SEC could work with the CFTC to harmonize and simplify the applicable rules for crypto assets. Such an effort could be accelerated by the delegation of oversight to an industry SRO, provided that such an organization adopts key principles of transparency, fair access, best execution and disclosures of conflicts of interest.

When considering this approach, one must be aware that much of the history of investor protection regulation (securities and otherwise) has been written via a patchwork of enforcement actions and court decisions. Consider how much airtime has been devoted to the "Howey" case, which related to 75+ year old laws enforced on a real estate investment scheme. Would ANYBODY suggest that regulation of polymorphic crypto investments be based on such a precedent if they had a choice??? Of course not! Crypto-Assets can function as investment products, commodities, currencies or derivative products at the same time, which is a fact that confounds current regulations.

At CoinRoutes, we are part of a growing cohort of companies providing services that will improve the quality of the crypto trading market. In our case, we have developed unique consolidated views of market data, useful composite benchmarks to measure trading and value positions, and, of course smart order routing and algorithmic execution. We have, however, experienced some resistance to our product suite from some of the established players, whose ability to extract high margins are potentially threatened by innovation. While we believe market forces will be sufficient to dislodge this resistance, it is worth noting that the history of financial markets has many examples where thoughtful regulation has encouraged innovation. For example, the Nasdaq settlement of the mid 1990s, followed by Reg ATS, the order handling rules and eventually Reg NMS facilitated the growth of electronic trading, the reduction of trading costs over 90% and an explosion of trading volumes. It wasn't the rules themselves that did this, but rather industry innovations including new venues, connectivity, routers, algorithms, and the supporting data products. It is about time for U.S. regulators to encourage such players in the crypto markets while continuing to act with restraint.