

Via Hand Delivery

May 8, 2008

The Honorable Jay Clayton
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Dear Mr. Chairman:

I am writing to express our appreciation and support for your ongoing efforts to ensure that cryptocurrencies and initial coin offerings (ICO's) are subject to, when appropriate, robust oversight and enforcement available under our federal securities laws.

The Council of Institutional Investors (CII), is a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management exceeding \$3.5 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than \$25 trillion in assets under management.¹

One Lesson from the Financial Crisis

One lesson from the 2008 financial crisis is that overreliance on the “self-correcting nature of the markets” can have devastating effects on investors, workers, retirees, and the American and global economy.² More specifically, it is well accepted that the unregulated market for over-the-counter (OTC) derivatives contributed significantly to the crisis.³

¹ For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at <http://www.cii.org>.

² See Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report xviii (2011), http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf; see also The Investors’ Working Group, U.S. Financial Regulatory Reform, The Investors’ Perspective 8 (July 2009) (“[v]igorous governmental oversight was abandoned as regulators placed their faith in the ability of markets to self-police and self-correct”), https://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf.

³ See Financial Crisis Inquiry Commission at xxiv (“[w]e conclude over-the-counter derivatives contributed significantly to this crisis”); see also Investors Working Group at 11 (“[a]lthough OTC derivatives have been justified as vehicles for managing risk, they have also spread and multiplied risk throughout the economy in the current crisis, causing great financial harm”).

Beginning in 2009, CII became an active proponent of efforts by policy makers to establish a more robust federal regulatory regime for the OTC derivatives markets.⁴ For example, in a November 2009 letter to Committee on Banking, Housing, and Urban Affairs Chairman Christopher J. Dodd, we explained:

Unregulated trading in OTC derivatives contracts, especially credit default swaps, was at the heart of the global financial crisis. The global OTC derivatives market is enormous, yet virtually exempt from all regulation under the Commodity Futures Modernization Act of 2000. Prices are hidden, speculation is rampant and leverage is high. Although derivative contracts can help manage risk, left unchecked, they can also multiply and spread risk throughout the financial system, increasing the possibility of enormous damage. *The Council supports your efforts in the discussion draft to bring meaningful regulation and transparency to this highly influential market.*⁵

Our views in support of meaningful oversight of the OTC derivatives market were derived from by the findings and recommendations of the Investors' Working Group (IWG), an Independent Taskforce Co-chaired by former Securities and Exchange Commission (SEC or Commission) chairs William H. Donaldson and Arthur Levitt, Jr. and sponsored by CFA Institute Centre for Financial Markets Integrity and CII. In its seminal report on the 2008 financial crisis the IWG concluded:

The nation's regulatory umbrella should be comprehensive. Specifically, it should be broadened to cover important financial products, players and gatekeepers that lack meaningful oversight. Critical gaps that urgently need attention include OTC derivatives"⁶

As a result, we generally supported Title VII of the Dodd-Frank Wall Street Reform and Consumer Protect Act.⁷ Title VII established a comprehensive framework for the oversight of OTC derivatives.⁸

We understand that the SEC currently has eight (of 29) remaining outstanding proposed rules to implement provisions of Title VII.⁹ We encourage the SEC to complete those long-overdue and needed rules.

⁴ See, e.g., Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Christopher J. Dodd, Senate Committee on Banking, Housing, and Urban Affairs 3 (Nov. 18, 2009) (emphasis added & on file with CII).

⁵ *Id.*

⁶ Investors' Working Group at 10.

⁷ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, §§ 701-774 (July 21, 2010), <https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf>.

⁸ Press Release, Council of Institutional Investors, CII Welcomes Senate Passage of Financial Reform (July 15, 2010) ("These improvements will increase the transparency, lower the costs and reduce the risks of these complex but essential financial instruments that were at the heart of the financial crisis.") (on file with CII).

⁹ U.S. Securities and Exchange Commission, Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act (last visited May 2, 2018), <https://www.sec.gov/spotlight/dodd-frank.shtml#>.

Cryptocurrencies and Initial Coin Offerings

Our views on OTC derivatives inform our current views on cryptocurrencies and ICO's. We note that the size of the cryptocurrencies and ICO market has grown exponentially in recent months.

Earlier this month, it was reported that the second largest cryptocurrency by market capitalization, Ethereum, "has a roughly \$65 billion market cap."¹⁰ In addition, it has been estimated that almost \$4 billion was raised through ICO's in 2017.¹¹ Moreover, it has been reported that from "a smattering of exchanges back in 2014, the number of crypto exchanges has mushroomed to 191 and counting"¹²

We remain cautiously optimistic that some cryptocurrencies and ICO's might flourish and facilitate capital formation that benefits all long-term investors and the economy generally. However, we strongly believe that the potential long-term success of cryptocurrencies and ICO's is dependent on those products, and those who participate in the markets for those products, operating within the purview of the federal securities laws.

We understand that the primary entry into the SEC's jurisdiction is the offer and sale of securities, as set forth in the Securities Act of 1933.¹³ Moreover, the determination of whether a cryptocurrency or an ICO is security is a facts-and-circumstances analysis.¹⁴

In the near term, we believe that when the result of the analysis might be in question, the SEC should err on the side of investors and other market participants by interpreting the definitions broadly to conclude that the products are securities.¹⁵ In the longer term, we believe the SEC should consider whether additional guidance or rulemaking might provide a clearer, more uniform, and a more forward looking approach for applying the federal securities laws to these products.¹⁶

¹⁰ Kate Rooney, "Ethereum Falls on Report that the Second-Biggest Cryptocurrency Is Under Regulatory Scrutiny," CNBC, May 1, 2018, at 2, <https://www.cnbc.com/2018/05/01/ethereum-falls-on-report-second-biggest-cryptocurrency-is-under-regulatory-scrutiny.html>.

¹¹ Chairman Clayton, Chairman's Testimony on Virtual Currencies: The Roles of the SEC and the CFTC, Before the Committee on Banking, Housing, and Urban Affairs, United States Senate 4 (Feb. 6, 2018), <https://www.sec.gov/news/testimony/testimony-virtual-currencies-oversight-role-us-securities-and-exchange-commission>.

¹² Rakesh Sharma, "How SEC Regs Will Change Cryptocurrency Markets," Investopedia, Apr. 13, 2018, at 2, <https://www.investopedia.com/news/how-sec-regs-will-change-cryptocurrency-markets/>.

¹³ 15 U.S.C. § 77b (1933), available at <https://www.law.cornell.edu/uscode/text/15/77b>.

¹⁴ See, e.g., Lucas Mearian, "SEC Decision on Ethereum Cryptocurrency Could Affect Others Funded by ICOs," Computerworld, May 8, 2018, at 3-5 (analyzing whether Ether is a security under the federal securities laws), <https://www.computerworld.com/article/3269875/blockchain/sec-decision-on-ethereum-cryptocurrency-could-affect-others-funded-by-icos.html>.

¹⁵ Dave Michaels, "World's Second Most Valuable Cryptocurrency Under Regulatory Scrutiny," Wall St. J., May 2, 2018, at 4 (reporting that Gary Gensler, former chairman of the Commodity Futures Trading Commission said in a recent speech that Ethereum's Ether and Ripples XRP could be classified as securities), <https://www.wsj.com/articles/worlds-second-most-valuable-cryptocurrency-under-regulatory-scrutiny-1525167000>.

¹⁶ See, e.g., Asato Avan-Nomayo, "SEC Commissioner Says Crypto Fraud Protection Is Priority Number One," Bitcoinist, May 2, 2018, at 2 (quoting Commissioner Robert Jackson: "Down the road we will be thinking about

We note that our view is generally consistent with the view of many cryptocurrency and ICO industry experts.¹⁷ For example, the director of the Digital Currency Initiative at the Massachusetts Institute of Technology recently indicated that he believes many emerging cryptocurrencies are actually securities and failing to classify them as such can stifle innovation by deterring honest players because rampant scammers undermine market integrity.¹⁸

Other critical benefits of classifying cryptocurrencies and ICO's as securities include the ability to provide investors with (1) the procedural protections and information they need to make informed judgments about what they are investing in and the relevant risks involved; and (2) a wide array of remedies to address fraudulent or abusive activity, including criminal and civil actions brought by the Department of Justice and the SEC, as well as private rights of action.

For those cryptocurrencies or ICO's that are not classified as securities, we agree with you that the risks to all investors become higher and more numerous – “including risks caused by or related to poor, incorrect or non-existent disclosure, volatility, manipulation, fraud and theft.”¹⁹ More broadly, we agree with the recent comments by SEC Commissioner Robert Jackson that the cryptocurrency market is “full of troubling developments.”²⁰ Those troubling developments include a research study that reportedly identified 81% of ICO's as scams.²¹ And last week's prediction by Warren Buffett that cryptocurrencies “will come to a bad ending.”²²

Since last summer, the Commission has brought at least 10 enforcement actions pertaining to ICOs. We noted with interest that, in one of those cases, the SEC charged the issuers with defrauding investors by falsely claiming that their companies were backed by real estate assets and diamonds.²³ In another case filed just last month, the SEC charged ICO issuers who misled investors into believing they had a cutting-edge technology product while also fabricating their relationships with credit card companies and banks.²⁴ We applaud the SEC actions and encourage the Commission to continue to police the markets vigorously and recommend enforcement actions against those who conduct ICOs or engage in other actions relating to cryptocurrencies in violation of the federal securities laws.

ways to make those investments work consistent[ly] with those securities laws”), <http://bitcoinist.com/sec-protecting-investorscrypto-fraud/>.

¹⁷ See, e.g., Leigh Cuen, “Fear and HODLing at MIT; Blockchain Experts Weigh Impact of SEC Action,” Coindesk, Apr. 24, 2018, at 1, <https://www.coindesk.com/fear-hodling-mit-blockchain-experts-weigh-impact-sec-crackdown/>.

¹⁸ *Id.* (“insufficient regulation can actually stifle innovation by deterring honest players because rampant scammers undermine market integrity”).

¹⁹ Chairman Clayton at 1.

²⁰ Asato Avan-Nomayo at 3 (quoting a CNBC interview with Commissioner Jackson on April 30).

²¹ Catalin Cimpanu, “81% of Recent ICO's Were Scams, Research Finds,” Bleepingcomputer, Mar. 29, 2018, at 2, <https://www.bleepingcomputer.com/news/cryptocurrency/81-percent-of-recent-icos-were-scams-research-finds/>; Ethereum Scam Database (last visited May 2, 2018) (indicating that there have been more than 3,500 scams involving cryptocurrencies), <https://etherscamdb.info/scams>.

²² Jen Wiczner, “The 13 Best Warren Buffett Quotes from the Berkshire Hathaway Meeting,” Fortune, May 7, 2018, at 3, <http://fortune.com/2018/05/07/warren-buffett-berkshire-hathaway-meeting-quotes/>.

²³ Press Release, Securities and Exchange Commission, SEC Exposes Two Initial Coin Offerings Purportedly Backed by Real Estate and Diamonds (Sept. 29, 2017), <https://www.sec.gov/news/press-release/2017-185-0>.

²⁴ Press Release, Securities and Exchange Commission, SEC Charges Additional Defendant in Fraudulent ICO scheme (Apr. 20, 2018), <https://www.sec.gov/news/press-release/2018-70>.

Thank you for your continuing commitment to the needs of all investors in this challenging and evolving area. If we can be of any assistance to you on this or any other issue, please do not hesitate to contact me at 202.822.0800 or jeff@cii.org.

Sincerely,

A handwritten signature in cursive script that reads "Jeff Mahoney".

Jeffrey P. Mahoney
General Counsel

cc: The Honorable Robert L. Jackson Jr.
The Honorable Hester M. Peirce
The Honorable Michael S. Piwowar
The Honorable Kara M. Stein