March 12, 2018

The Honorable William Huizenga
Chairman
Subcommittee on Capital Markets,
Securities and Investments
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Carolyn Maloney
Ranking Member
Subcommittee on Capital Markets,
Securities and Investments
2129 Rayburn House Office Building
Washington, DC 20515

Re: Written Testimony before the Subcommittee on Capital Markets, Securities and Investments

Dear Hon. William Huizenga and Hon. Carolyn Maloney,

Liquid M Capital would like to submit the attached as written testimony before the Subcommittee on Capital Markets, Securities and Investments of the House Financial Services Committee for the Committee's March 14 hearing entitled "Examining the Cryptocurrencies and ICO Markets." Liquid M is very familiar with the regulatory challenges faced by FinTech firms that are issuing and trading digital assets and using blockchain technology. We would like to thank the Committee for their efforts in addressing these regulatory challenges and for the opportunity to submit this written testimony.

Please do not hesitate to call me at 646-595-1737 or our counsel, Richard B. Levin of Polsinelli PC at 202-772-8474 if you have any questions regarding the petition or any other matter.

Very truly yours,

Vincent R. Molinari
Chief Executive Officer
Liquid M Capital, Inc.

STATEMENT OF VINCENT MOLINARI

Chairman Huizenga, Ranking Member Maloney, and the distinguished members of the Committee, thank you for the opportunity to submit testimony for the record. I offer my testimony as a representative of Liquid M Capital, Inc. ("Liquid M"), a financial technology ("FinTech") company and broker-dealer registered with the U.S. Securities Exchange Commission ("SEC") and the Financial Industry Regulatory Authority ("FINRA"). Liquid M is the operator of an alternative trading system ("ATS") for the secondary trading of digital assets that are securities.[1] Given our experience in the industry, we commend the Chair and the Ranking Member for holding this hearing on this important issue and the role of Congress in helping to ensure that FinTech and the growing field of digital assets are properly regulated. As stated recently by Chairman Giancarlo of the U.S. Commodity Futures Trading Commission ("CFTC"), "[w]e are entering a new digital era in world financial markets."[2]

We believe it is critical for regulators to foster the value of innovation in FinTech without stifling it through unclear regulations. Chairman Clayton of the SEC and Chairman Giancarlo of the CFTC both noted in recent testimony before the Senate Banking Committee the great potential that distributed leger technology has to revolutionize the financial services industry.[3] We echo these sentiments and support the critical role of regulators in ensuring that this revolutionary technology is able to develop in a sustainable manner that benefits both industry participants and protects consumers.

For the purposes of this testimony, we will limit our comments to the securities laws of the United States because it is the area in which we have the most experience. The SEC has been very active over the past year, making its position on the regulation of digital assets increasingly clear through informal means, including enforcement actions and policy statements.[4] We agree with the SEC in their belief that most, if not all, digital assets that have been issued to the public through initial coin offerings ("ICOs") and other means qualify as securities, and therefore must only be offered pursuant to a registration with the SEC or an exemption from registration. While we believe the existing laws can be

[1] The terminology used by the FinTech industry and regulators to refer to these types of assets has varied between agencies, including property with the IRS, cryptocurrency with the CFTC, and digital assets with the SEC. For the purposes of this testimony, we will refer to such assets as digital assets.

[2] Written Testimony of Chairman J. Christopher Giancarlo before the Senate Banking Committee, Washington, D.C. (February 6, 2018) *available at:* http://www.cftc.gov/PressRoom/PressReleases/opagiancarlo37 ("Giancarlo Testimony").

[3] *See* Written Testimony of Chairman Jay Clayton before the Senate Banking Committee, Washington, D.C. (February 6, 2018), *available at:* https://www.banking.senate.gov/public/_cache/files/a5e72ac6-4f8a-473f-9c9c-e2894573d57d/BF62433A09A9B95A269A29E1FF13D2BA.clayton-testimony-2-6-18.pdf ("Clayton Testimony"); Giancarlo Testimony.

[4] *See* Munchee Inc., Securities Act Release No. 10445 (Dec. 11, 2017) *available at:* https://www.sec.gov/litigation/admin/2017/33-10445.pdf; *SEC v. REcoin Group Foundation, LLC, DRC World Inc. a/k/a Diamond Reserve Club, and Maksim Zaslavskiy,* 17 Civ. [ ] (Sept. 29, 2017) (Complaint); Public Statement, SEC Chairman Jay Clayton Statement on Cryptocurrencies and Initial CoinOfferings, SEC (Dec. 11, 2017), *available at:* https://www.sec.gov/news/public-statement/statementclayton-2017-12-11.

applied to the regulation of blockchain technology and digital assets, we believe there is a need to modernize the laws to keep pace with these new technologies and to not stifle innovation.

A. The SEC has taken important first steps in regulating digital assets.

Our commitment to the regulation of these new technologies as securities is evidenced by the petition for rulemaking by the SEC we filed on March 13, 2017, asking the SEC to publish a concept release and proposed rules for public comment on changes to existing rules to better address the regulation of digital assets.[5] As we noted in the petition, we support the SEC's efforts to perform its core duties: (i) to protect investors; (ii) to maintain fair, orderly, and efficient markets; and (iii) to facilitate capital formation.[6] The SEC has taken significant steps over the past year to provide guidance to the industry regarding the regulation of digital assets, through enforcement actions, investigative reports, investor alerts, testimony, and public speeches. Such actions, have played an important role in shaping innovation and indicating to the industry that the sale and dissemination of digital assets cannot occur without regulation.[7] Though valuable first steps, we believe the size and continuing expansion of this industry demands more tailored and comprehensive regulation.

B. The financial services industry needs clearer rulemaking regarding the regulation of digital assets.

We believe the existing rules that apply to the sales of securities and the exemptions from registration with the SEC, such as Rule 506 of Regulation D, and Regulation A, though helpful, do not fully meet the needs of companies seeking to issue digital assets. While the securities laws have served our capital markets well since their adoption on the 1930s, Congress and the SEC have recognized that at times those laws require amendments to address technological innovations.[8]

SEC enforcement actions have provided some guidance regarding when digital assets are securities, but have not fully addressed the needs of the financial services industry. Liquid M believes the publication of a concept release regarding the regulation digital assets is a meaningful first step in providing guidance to the industry. However, such guidance will only prove beneficial if it is followed by

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[5] *See* Petition for Rulemaking (Mar. 13, 2017), *available at:* https://www.sec.gov/rules/petitions/2017/petn4-710.pdf. At the time this petition was published, Liquid M operated as Ouisa Capital, LLC.

[6] Michael S. Piwowar, Acting Chairman, SEC, Remarks at the "SEC Speaks" Conference 2017: Remembering the Forgotten Investor (Feb. 24, 2017), *available at:* https://www.sec.gov/news/speech/piwowar-remembering theforgotten-investor.html.

[7] *See* supra note 4; *see also* Clayton Testimony; Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO (July 25, 2017) (the "DAO Report"), *available at:* https://www.sec.Qov/litiQationlinvestregort/34-81207.pdf; Dave Michaels and Paul Vigna, SEC Chief Fires Warning Shot Against Coin Offerings, Wall Street Journal. Nov. 9, 2017, *available at:* https://www.wsi.comlarticles/sec-chief-fires-warning-shot-against-coinofferings1510247148?mq=prod/accounts-wsi.

[8] Congress has historically taken opportunities to update federal securities laws, including the Securities Act Amendments of 1975, the National Securities Markets Improvement Act of 1996, and the Jumpstart Our Business Startup Act of 2012.

the SEC adopting a new rule on the regulation of digital assets – Regulation DA.[9] We believe that FinTech and the regulation of digital assets present the SEC with an opportunity to satisfy its statutory duties by engaging in a constructive dialogue with the industry on how to regulate digital assets.

The current guidance on the regulation of digital assets as securities requires a facts and circumstances based analysis by qualified counsel to determine if an asset is a security and if a firm's activities require registration as a broker-dealer, an exchange, or an ATS. Such analysis is often cost prohibitive to the early stage companies that drive much of the innovation in FinTech. Further, issuers are restricted by the current regulatory framework for securities offerings, which include artificially low caps on the funds that may be raised or the number of holders of record. We believe the existing securities laws need to be amended to promote capital formation, and the SEC needs to amend existing rules or adopt new rules specifically tailored to digital assets. Should the Committee desire a more thorough evaluation of current regulations and how they may be modified to better regulate the issuance of digital assets, we are happy to provide it.

C. Issuers of digital assets prior to guidance to the DAO Report should be provided an opportunity to remediate their potentially illegal offerings.

Though the lack of regulatory clarity creates difficulties for companies seeking to raise capital in the future, billions of dollars have been raised through ICOs over the past year that were more than likely sold in a manner that was not compliant with federal securities laws. We do not believe the majority these issuances were deliberately not compliant, but were rather the result of a lack of regulatory clarity. As the SEC's position on ICOs has become clear, FinTech firms have learned that digital assets generally must registered with the SEC or sold pursuant to an exemption from registration. However, this position was not clear to the industry prior to the publication of the DAO Report. Recognizing this issue, LiquidM submitted a petition for rulemaking to the SEC on January 23, 2018, asking the agency to offer issuers of digital assets that were sold in possible violation of the securities laws the opportunity to remediate their offerings.[10]

We encourage the SEC to provide an opportunity for issuers of digital assets through ICOs that took place prior to the publication of the DAO Report the opportunity to remediate their potentially illegal offerings. While we believe there are still uncertainties regarding the regulation of digital assets and blockchain, the regulatory climate has become increasingly clear in recent months following the publication of the DAO Report and various recent enforcement actions by the SEC against ICO issuers.[11]

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[9] We believe that the current regulatory challenges surrounding digital assets are analogous to challenges presented by the promulgation of electronic communications networks ("ECNs") in the mid-1990s that prompted the SEC to publish a concept release on how to regulate ECNs and other ATSs. The concept release afforded the industry an opportunity to engage in a productive discussion with the SEC staff on how to regulate ECNs and other ATSs, and eventually resulted in the adoption of Regulation ATS in 1998, which established how ECNs, ATSs, and exchanges would be regulated going forward and provided meaningful guidance to innovative firms that were launching ATSs.

[10] *See* Petition for Rulemaking (Jan. 23, 2018), *available at:* https://www.sec.gov/rules/petitions/2018/petn4-719.pdf.

[11] *See* supra note 4.

We propose that the SEC offer issuers of digital assets that may have violated the securities laws the opportunity to remediate their offerings by retroactively engaging in the appropriate filings under Rule 506 of Regulation D, Regulation A, or Regulation CF. This type of retroactive registration should be accompanied by a right of rescission to all purchasers of the digital assets or the chance to receive a new form security that was offered in compliance with the securities laws. This SEC provide issuers with a 180 day window to remediate their initial offerings by engaging in either an appropriate registration or exemption under the federal securities laws. We believe that by affording FinTech firms the opportunity to remedy their conduct, the SEC will be able to advance its interests in regulating securities while fostering innovation and regulatory compliance, meeting the agency's regulatory mandates.

D. The innovative nature of the technology demands an innovative approach to regulation.

We believe that the innovative nature of this industry demands an innovative approach to regulation. Though there has been guidance from the SEC regarding the treatment of digital assets as securities, we believe that there is likely a middle ground between the view that all tokens are securities and that all tokens are not securities. Though we agree that a majority of the tokens issued to date through ICOs have many of the attributes of securities and should be regulated as such, a rapidly expanding number of platforms in the FinTech space are being created that operate using a native digital asset, functioning as a currency, for the exchange of value on their platform. We believe regulations either need to be created or modified to better suit this type of business model, as registering digital assets as securities is impracticable for these companies.

We have identified three examples of offering structures that we believe would be compliant with securities law. It is important to note that in all cases, the digital asset must include a digital currency that has attributes like Bitcoin, including being distributed in exchange for work and not issued through some type of presale or crowd sale. First, we believe that a company could issue an equity security that would pay a dividend in a digital currency. Second, we believe that a company could issue a bond that would be sold as a security and then repaid in digital currency. Finally, we believe a company could issue a profit participation interest that would be paid in digital currency. To be compliant with federal integration doctrine, we believe that each example must be include the option for the purchaser to be paid in the digital currency, fiat currency, or a combination of the two. Innovative offering structures like these will help the issuances of digital assets to fit within securities laws, while also meeting the needs of the novel, innovative technology that is being developed in this space.

E. Conclusion

Innovation drives the American economy, and distributed leger technology is at the heart of innovation in the financial services industry. While the SEC has taken important steps to provide guidance to FinTech firms on the regulation of digital assets, and our capital markets are the most dynamic in the world, there is a need for a more thorough update to the regulatory framework. Congress has amended the federal securities laws in the past to keep up with market changes, and we believe that the current developments with digital assets necessitate a similar amendment. It is critical

regulators take thoughtful steps to better regulate digital assets in order to promote innovation and to ensure the protection of the public. If Liquid M or we can be of any further assistance to you in this matter, please do not hesitate to contact me.