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SUMMARY: This paper reviews historical financial crashes and crises, focusing on regulatory frameworks that failed to adequately address speculative excesses and systemic risks in emerging financial markets. It examines the challenges faced by current regulators, such as the SEC and CFTC, in applying old legal precedents like the Supreme Court case *Howey* to new digital asset markets like cryptocurrencies. The paper draws lessons from past crises, such as the 1929 stock market crash and the 2008 financial crisis, to highlight the dangers of financial deregulation and unchecked risk-taking. It also discusses the potential vulnerabilities of the current regulatory frameworks in managing the rapidly expanding derivatives sector and the risks posed by digital assets.

METHOD: The research reviews historical financial crashes and crises, analyzing the regulatory frameworks that failed to address speculative excesses and systemic risks. It examines the challenges faced by current regulators, such as the SEC and CFTC, in applying old legal precedents to new digital asset markets. The methodology includes a review of historical data and legal precedents, as well as an analysis of current regulatory frameworks.

KEY FINDINGS:

- The 1929 stock market crash and the 2008 financial crisis highlighted the dangers of financial deregulation and unchecked risk-taking.
- The derivatives market, particularly over-the-counter derivatives, played a significant role in both crises.
- The current regulatory frameworks struggle to adequately address the risks posed by digital assets and their derivatives markets.
- The application of old legal precedents like the *Howey* case poses challenges in regulating new digital asset markets.

IMPLICATION FOR TRADING: The research underscores the importance of robust and up-to-date regulatory frameworks in managing risks in financial markets. Practitioners should be aware of the potential vulnerabilities in current regulatory structures and the need for continuous adaptation to evolving market conditions. They should also consider the implications of regulatory decisions on market stability and investor protection.

FINANCIAL LAW AND REGULATIONS RESEARCH

Regulatory Challenges in Addressing Speculative Excesses and Systemic Risks in Emerging Financial Markets: Lessons from Past Crises and the Rise of Cryptocurrencies

By: Ingrid Yu

Introduction

This paper reviews historical financial crashes and crises through the lens of regulatory frameworks that either malfunctioned, failed to regulate adequately, or neglected to anticipate market risks. Then analyze the regulations challenges under the old Supreme Court case *Howey*, how the current two major digital asset regulators, SEC and CFTC, found the jurisdictions difficult to apply.

The 1929 stock market crash, which led to the Great Depression, was primarily driven by an over-speculative market that operated without meaningful government oversight.¹ Speculation in equities and financial products ran unchecked, inflating asset prices far beyond their intrinsic value and creating a fragile economic environment. In the absence of effective regulation, this speculative bubble eventually burst, with catastrophic consequences for the global economy.

Decades later, the 2008 financial crisis exposed the dangers of financial deregulation, particularly regarding the derivatives market. The credit crisis was partly attributed to the deregulation of over-the-counter derivatives through the Commodity Futures Modernization Act (CFMA) of 2000, which exempted products such as credit default swaps (CDS) from federal oversight.² Initially intended for professional investors, these highly speculative financial instruments allowed parties to bet on the creditworthiness of debt instruments without holding the underlying assets. As these products were aggressively marketed, driven by lucrative sales commissions, they increasingly attracted retail investors, pension funds, and institutions often unaware of their underlying risks. The absence of collateral requirements and regulatory safeguards transformed the derivatives market into a speculative time bomb. When defaults in the subprime mortgage market triggered a chain reaction, financial institutions faced massive liabilities they were ill-prepared to cover.

This crisis ultimately shattered the long-held belief that major financial institutions were “too big to fail.”³ Even financial giants such as American International Group (AIG) teetered on the edge

¹ Federal Reserve History, *Stock Market Crash of 1929*, (Nov 22, 2013), <https://www.federalreservehistory.org/essays/stock-market-crash-of-1929>.

² Lynn A. Stout, *Derivatives and the Legal Origin of the 2008 Credit Crisis*, Cornell L. Faculty Pubs., Paper No. 720, 1 (2011), <https://scholarship.law.cornell.edu/facpub/720>.

³ The Financial Crisis Inquiry Report, (Jan, 2011), <https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

of collapse.⁴ It exposed not only the fragility of the global financial markets but also the vulnerabilities within the economic regulatory system. The crisis revealed how a deregulated, over-leveraged financial environment, fueled by speculative derivatives and unchecked risk-taking, could overwhelm existing safeguards. The interconnectedness of institutions and markets meant that the failure of a few institutional players threatened to destabilize the entire system. The inadequacy of contemporary regulatory frameworks should also address evolving financial products and market behaviors and its adverse consequences.

More recently, the collapse of Silicon Valley Bank in 2023 served as a reminder of continuing vulnerabilities within the financial system, particularly in sectors where risk management has not kept pace with financial innovation.⁵ As we progress through the 21st century, another systemic risk looms in the form of cryptocurrency markets and their rapidly expanding derivatives sector. These markets have become fertile ground for speculative schemes targeting retail investors, institutional portfolios, and even retirement funds. Should these digital assets be formally integrated into the broader financial system? Should the digital assets be punished by CFTC and SEC with unclear laws? Or should they be exempted by a deregulated authority like CFMA without appropriate oversight? The questions on how digital assets and its expanding markets should be managed in legal framework remain unsolved. So far, only the jurisdictions like courts are interpreting the law with an old common law *Howey*⁶, or under the overly-broad contextual language in Federal laws. Nevertheless, the resulting speculative bubble could become dangerously large and difficult to contain. In such a scenario, regulators might once again find themselves forced to react to a crisis rather than prevent it, jeopardizing financial stability on a global scale.

This research will discuss the existing laws regarding digital asset control only in common law and federal level, the state “Blue Sky” laws will not be discussed.

Underregulated Derivative Market Contributed To Financial Systemic Crashes

⁴ *Id.*

⁵ Graham S. Steele, *Major Questions' Quiet Crisis*, 31 Geo. Mason L. Rev. 265 at 268 (2024).

⁶ *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946).

Derivatives are financial contracts whose value is derived from the performance of an underlying asset, index, interest rate, or event.⁷ These instruments can take many forms, including futures, options, swaps, and credit default swaps, and serve a dual role in financial markets.⁸

Derivatives serve two primary functions: hedging and speculation.⁹ On one hand, they play a vital role in risk management by enabling businesses, investors, and institutions to hedge against price fluctuations in commodities, currencies, interest rates, or securities. When used for hedging, derivatives help reduce risk by allowing parties to offset existing economic exposures.

¹⁰ For example, a construction company concerned about rising steel prices might purchase a call option on steel or enter into a futures contract to lock in a predetermined price, protecting itself from unexpected inflation. Hedging transactions often involve physical delivery, meaning the seller either holds the underlying commodity or agrees to deliver it upon the contract's maturity.¹¹

On the other hand, derivatives can also be used for speculative purposes, allowing traders to wager on future market movements without holding any underlying economic interest in the asset itself.¹² Unlike hedging, speculation through derivatives increases risk, as participants are not offsetting real economic exposures but rather transferring risks between one another.¹³ In speculative markets, these transactions become a zero-sum game, one party's gain is necessarily another's loss, contributing to heightened systemic risk.¹⁴ The emergence of derivative instruments such as interest rate swaps and credit default swaps (CDS) exemplified how speculation could be taken to excess, with parties betting on interest rate fluctuations and the creditworthiness of third parties, often without any direct stake in the underlying obligations.¹⁵

The "Rule Against Difference Contracts" comes from English common law in the 18th and 19th centuries, during the rapid growth of commodity and stock exchanges in London.¹⁶ It was essentially an anti-wagering rule applied by courts to speculative contracts on price differences

⁷ Lynn A. Stout, *Regulate OTC Derivatives by Deregulating Them*, UCLA Sch. of Law, 32 (2009).

⁸ Stout, *supra* note 2. at 6.

⁹ *Id.* at 1.

¹⁰ *Id.* at 7.

¹¹ *Id.* at 11.

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.* at 9.

¹⁵ *Id.* at 7.

¹⁶ *Id.* at 11-12.

where neither party intended actual delivery of the commodity or asset being traded.¹⁷ The Rule remained influential into the late 19th century as financial speculation increased, and it influenced U.S. courts as well, particularly during the 19th and early 20th centuries when futures and options markets were evolving in Chicago and New York.¹⁸

Under the “Rule Against Difference Contracts”, derivatives traded over-the-counter (OTC) in earlier times risked being classified as illegal wagers unless certain conditions were met.¹⁹ To have a court recognize the trade as a legitimate transaction rather than a wager, the parties (or the party seeking enforcement) typically needed to prove one of the following: (1) An intention to make or take actual delivery of the underlying commodity or asset upon the contract's maturity; or (2) A legally enforceable obligation to deliver or accept delivery of the underlying asset, regardless of whether delivery actually occurred.²⁰ Without satisfying either of these conditions, courts could deem the transaction a mere wager on price differences, rendering it unenforceable under anti-wagering laws.²¹

However, as financial markets grew and speculative practices became more widespread, this cautious common law framework began to break down. “The Rule Against Difference Contracts”, which only applied when a legal dispute was brought to court, failed to prevent speculative behavior that occurred in the absence of disputes or legal actions. This created a gap where risky financial practices, like margin trading, went largely unregulated. In the years leading up to the 1929 stock market crash, markets were flooded with speculative investments where investors, often with little real capital or economic interest in the underlying stocks, were essentially gambling on price movements.²² This unchecked speculation amplified market instability, leading to the devastating crash.

Congress recognized that restoring public trust in financial markets required regulating both the sale of new securities and the ongoing trading of those securities. In response, the Securities Act of 1933 and Securities Exchange Act of 1934 were introduced to address these risks, and restore

¹⁷ *Id.*

¹⁸ *Id.* at 12.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² Federal Reserve History, *supra* note 1.

financial stability.²³ The Securities Act of 1933 was the first federal securities law, designed to protect investors during the initial offering of securities by requiring companies to disclose important financial information and prohibiting fraud in the sale of new stocks and bonds.²⁴ However, the Securities Act 1933 only addressed the primary market, the moment when securities are first sold to investors. It did not regulate the secondary market, where those securities are later traded among investors on stock exchanges and over-the-counter markets. To fill this gap, Congress passed the Securities Exchange Act of 1934, which established a comprehensive framework to regulate the ongoing trading of securities, prevent market manipulation and insider trading, and require publicly traded companies to disclose financial information on a continuing basis.²⁵ Importantly, the 1934 Act also created the Securities and Exchange Commission (SEC) to enforce both the 1933 and 1934 Acts and oversee the operation of the nation's securities markets.²⁶

Despite these mid-20th-century reforms, the pattern reemerged decades later. According to the Bank for International Settlements, by the end of 1999, the total notional value of OTC derivatives, predominantly interest rate swaps and other financial instruments, stood at approximately \$88 trillion.²⁷ At the time, many of these derivatives operated in a regulatory gray area, as the Commodity Exchange Act (CEA), originally designed to oversee agricultural futures, had not been clearly extended to cover the rapidly expanding OTC derivatives market. This left a significant portion of the derivatives market effectively unregulated. The passage of the CFMA in 2000, explicitly exempted most OTC derivatives from the CEA's oversight, legitimizing an already growing market.²⁸ By 2008, the notional value of OTC derivatives had grown nearly eightfold to over \$670 trillion, amplifying the consequences of this deregulation during the global financial crisis.²⁹

Many scholars have certified that the 2008 subprime credit crisis was not primarily the result of inherent market fluctuations, but rather the consequence of dramatic legal changes. The CFMA's

²³ State of Wisconsin Department of Financial Institutions, *A Brief History of Securities Regulation*, <https://dfi.wi.gov/Pages/Securities/Filings/SecuritiesRegulationHistory> (Last visited Apr 20, 2025).

²⁴ Securities Act of 1933, 15 U.S.C. § 77 (2018).

²⁵ Securities Exchange Act of 1934, 15 U.S.C. §§ 78 (2018).

²⁶ U.S. Securities and Exchange Commission, *Statutes and Regulations*, <https://www.sec.gov/rules-regulations/statutes-regulations> (last visited Apr 21, 2025).

²⁷ Stout, *supra* note 2, at 23.

²⁸ *Id.* at 21.

²⁹ *Id.* at 24-25.

passage marked the sudden and wholesale removal of centuries-old legal constraints on speculative OTC derivatives trading.³⁰ By expressly authorizing the trade of derivatives without delivery obligations and making such contracts legally enforceable, the CFMA effectively dismantled the delivery requirement that had long served as a legal check on speculative excess.

The CFMA signed into law on Dec. 21, 2000, overhauled U.S. financial regulations in response to rapid growth in OTC derivatives. CFMA clarified the roles of the CFTC and the SEC in regulating an expanded range of futures contracts. It also authorized clearing facilities for OTC derivatives, and legalized single stock futures.³¹

Understanding Commodity Futures Modernization Act (CFMA)

Before CFMA, U.S. financial regulation vested oversight of securities trading with the SEC and of commodity futures with the CFTC. The rules did not address derivatives not tied to physical commodities, and rapid adoption of these instruments had placed a growing proportion of the financial arena beyond the regulatory reach of either agency.

CFMA largely followed the recommendations made in 1999 by the President's Working Group on Financial Markets, a roundtable of regulators that included SEC, CFTC, the Federal Reserve, and the U.S. Treasury. The SEC and CFTC had set aside past jurisdictional disputes, agreeing to exempt non-commodity OTC derivatives traded by financial institutions from regulation by CFTC, and to share oversight of single-stock futures.³²

CFMA put an end to fears OTC derivatives could be challenged or invalidated on the grounds they were illegally traded futures.³³ It also barred state-level regulation. The law encouraged the creation of clearing houses for OTC derivatives.³⁴

Following the CFMA's passage, the OTC derivatives market experienced exponential growth. By 2008, the notional value of OTC derivatives contracts had reached nearly \$700 trillion globally.

³⁰ *Id.* at 4.

³¹ Cong. Rsch. Serv., *The Commodity Futures Modernization Act* (P.L. 106-554), at 4–6 (2001), <https://crsreports.congress.gov/product/pdf/RS/RS20560>.

³² Congressional Research Service, *The Commodity Futures Modernization Act* (P.L. 106-554), at 1-5.

https://www.everycrsreport.com/files/20030203_RS20560_ec4c1688a4ffd270164ce8cfb96de3ab63ae7ac4.pdf

³³ *Id.* at 2-3

³⁴ *Id.* at 4.

³⁵ Specifically, CDS grew from \$900 billion in 2000 to over \$60 trillion by 2008. ³⁶ This massive expansion occurred without requirements for collateral, capital reserves, or margin to offset risks. ³⁷

In the wake of the 2007-2008 global financial crisis, the Financial Crisis Inquiry Commission authorized by the U.S. Congress concluded that the pre-emption of derivatives regulation by CFMA "was a key turning point in the march toward the financial crisis." ³⁸

Belated Remedies Act After the Subprime Crisis Exploded

The joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues was established in 2010 by the CFTC and SEC to develop recommendations on emerging and ongoing issues relating to both agencies. ³⁹ The formation of the joint advisory committee was one of the 20 recommendations included in the agencies' harmonization report issued in 2009. Subjects the joint advisory committee was created to address included the identification of emerging regulatory risks, assessment and quantification of the impact of such risks and their implications for investors and market participants, and the agencies' efforts on regulatory harmonization. However, the joint advisory committee has been inactive since 2014. ⁴⁰

Dodd-Frank Act

In the wake of the crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), Title VII of the Act is devoted to turning back the regulatory clock by restoring legal limits on speculative derivatives trading outside of a clearinghouse. ⁴¹

³⁵ Rosalind Z. Wiggins & Andrew Metrick, *The Lehman Brothers Bankruptcy G: The Special Case of Derivatives*, *Jou 1 J. Fin. Crises* 151, 158 (2019), 151, 158 (2019), <https://elischolar.library.yale.edu/journal-of-financial-crises/vol1/iss1/8>.

³⁶ Janet L. Kaminski Leduc, *CREDIT DEFAULT SWAPS AND COLLATERALIZED DEBT OBLIGATIONS*, (Dec 2008), https://www.cga.ct.gov/2008/rpt/2008-R_.

³⁷ *Id.*

³⁸ Fin. Crisis Inquiry Comm'n, *The Financial Crisis Inquiry Report*, at xxiv (2011), <https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

³⁹ Edmund Mokhtarian & Alexander Lindgren, *Rise Of The Crypto Hedge Fund: Operational Issues And Best Practices For An Emergent Investment Industry*, 23 *Stan. J.L. Bus. & Fin.* 112, 132 (2017).

⁴⁰ CFTC-SEC Joint Advisory Committee (Inactive), *Commodity Futures Trading Commission*, <https://www.cftc.gov/About/AdvisoryCommittees/CFTC-SEC> (last visited Apr 20, 2025).

⁴¹ Stout, *supra* note 2.

Before Dodd-Frank, most hedge fund managers avoided SEC registration under the Investment Advisers Act by using a “private adviser exemption” for advisers with fewer than fifteen clients.⁴² Dodd-Frank eliminated this exemption, requiring most hedge fund managers to register with the SEC and comply with rules on reporting, custody of client assets, and disclosures. It also limited performance fees to “qualified clients” and required performance-based fees to follow a fair, benchmark-linked structure.⁴³ This brought hedge fund managers under tighter federal oversight, even as their funds often remained exempt under the Investment Company Act.⁴⁴

The Dodd-Frank Act did not directly amend the Investment Company Act of 1940’s exemptions for hedge funds but significantly expanded regulatory oversight over their activities. Under the Investment Company Act, entities classified as “investment companies” are subject to strict limitations on practices like short selling, the use of leverage, and other high-risk trading strategies, restrictions that are fundamentally incompatible with typical hedge fund operations.⁴⁵ To avoid these limitations, most hedge funds rely on exemptions under Section 3(c)(1) or Section 3(c)(7), which exclude funds with no more than 100 beneficial owners or those owned exclusively by qualified purchasers, respectively, provided they do not engage in public offerings.⁴⁶ While these exemptions remain intact, Dodd-Frank indirectly tightened the regulatory framework by requiring many hedge fund managers to register as investment advisers with the SEC and comply with enhanced reporting, disclosure, and systemic risk oversight obligations.⁴⁷ As a result, hedge funds continue to avoid the direct restrictions on short selling, leverage, and trading activities imposed by the Investment Company Act, but operate under increased federal supervision through other provisions introduced by Dodd-Frank.⁴⁸

The Dodd-Frank Act intended to curb such excesses, authorized CFTC to regulate swaps dealers, and to move the trading of standardized derivatives to regulated exchanges or swap execution facilities to improve transparency.⁴⁹ It expanded the CFTC authority by bringing nearly all swaps, derivatives, and commodity-based financial products under its regulation through the

⁴² Mokhtarian & Lindgren, *supra* note 42, at 132.

⁴³ *Id.* at 133.

⁴⁴ *Id.* at 132-36.

⁴⁵ *Id.* at 136.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.* at 135-36.

⁴⁹ *Id.* at 139-41.

CEA.⁵⁰ This gave the CFTC oversight of previously unregulated markets, including clearing, reporting, and trading rules for derivatives.⁵¹ However, crypto funds trading only in commodity tokens (like Bitcoin, treated as commodities rather than securities) often fall outside CFTC regulation because their trades typically involve physical delivery contracts, not swaps or derivatives covered by the CEA.⁵²

The hedge fund and derivatives investment market lately focus on betting on cryptocurrency and its derivatives. Since cryptocurrency markets lack the liquidity, stability, and regulatory certainty of traditional securities markets, crypto funds generally have a far greater burden of disclosure to investors than a traditional hedge fund. On the regulatory end, crypto funds face significantly less regulation because, unlike traditional hedge funds, they trade exclusively in cryptocurrencies that do not qualify as securities. As a result, they are permitted to solicit investment from a far broader swath of investors and have more flexibility in setting their fees, thus granting them a significant competitive advantage against other hedge funds. Thus, Cryptocurrencies are more speculative than many of the instruments, such as stocks and bonds, which traditionally have to go through stringent compliance and qualification test. Yet institutional trading of cryptocurrencies offers less barriers to market entry, including less regulation, lower start-up costs, and easier fundraising.⁵³ 17 The crypto fund thus represents a new class of financial institution with significantly more risk, higher upside, and fewer barriers to entry than a traditional modern hedge fund. At 117-19

The Cryptocurrency And Its Deviation Give rise to Regulation Reform

In the last decade, few financial assets have generated returns comparable to those of cryptocurrencies. For example, Bitcoin, the largest cryptocurrency by market capitalization, has risen over 500,000,000% in value between its creation in January 2009 and January 2018, and 4,328% between December 2014 and December 2017.⁵⁴ Ether, the third largest cryptocurrency by market capitalization, has risen 34,876% in value since its inception in 2015.⁵⁵

⁵⁰ *Id.* at 138-39.

⁵¹ *Id.* at 149.

⁵² *Id.* at 139-41.

⁵³ Mokhtarian & Lindgren, *supra* Note 41, at 119.

⁵⁴ *Id.* at 116.

⁵⁵ *Id.*

Sarcastically, the origin of crypto, Bitcoin itself is not regulated. Because it is recognized as a currency, a decentralized, peer-to-peer network with no central authority, so no government or institution controls Bitcoin directly. ⁵⁶Bitcoin is a currency commodity and not regulated by CFTC or SEC, except its derivatives or there is fraud arises. ⁵⁷ However, governments regulate how people and businesses use Bitcoin within their jurisdictions.

Evolution of Bitcoin And More Complicated Ideas

Newer types of cryptocurrencies do much more than act like regular money. Some can automatically carry out agreements using computer programs, called “smart contracts.” ⁵⁸ Others support decentralized apps, like online voting systems. ⁵⁹ Some are mainly used to help companies raise money in ways that avoid the more complicated process of offering private or public securities. ⁶⁰

A key issue for financial institutions is whether a cryptocurrency is considered a security or not. This matters because many investors have jumped into the cryptocurrency market, hoping to make huge profits, and some investment funds focus only on trading cryptocurrencies. If a fund only trades cryptocurrencies that aren’t classified as securities, it can avoid most of the rules that traditional hedge funds have to follow. ⁶¹

The SEC regulates digital asset classified as securities. SEC has distinguished between cryptocurrency tokens qualifying as securities, and those which are virtual currencies. ⁶² The latter are for regulatory purposes treated as general commodities, and are not subject to the SEC rules. ⁶³

The CEA was passed in 1936 and has been amended several times, it designs to regulate the trading of commodity futures in the United States. The CEA establishes the statutory framework

⁵⁶ *Id.* at 117.

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.* at 139.

⁶² *Id.* at 150.

⁶³ *Id.* at 139.

under which the CFTC operates. Under this Act, the CFTC has authority to establish regulations that are published in Title 17 of the Code of Federal Regulations.⁶⁴

The CEA gives the CFTC authority to regulate commodity pool operators (CPOs), commodity trading advisers (CTAs) and commodities exchanges.⁶⁵

I. CFTC on Commodity and Digital Asset

Under the CEA and CFTC interpretations, a commodity is typically understood as a fungible, standardized goods capable of being traded in bulk or through futures contracts on organized exchanges.⁶⁶ The term “fungible” means that an item is interchangeable and replaceable with another of the same type and value.⁶⁷ In other words, one unit of a commodity can be substituted for another without affecting its value or usability. Examples of traditional fungible commodities include crude oil, wheat, and gold.

When applying these definitions to the digital asset space, certain crypto assets qualify as fungible commodities. Bitcoin and Ether are prominent examples. One Bitcoin is identical in value and usability to any other Bitcoin, and the same applies to Ether. These digital assets can be divided into smaller, equal parts, all retaining the same relative value. As a result, they are considered fungible crypto assets within the meaning of the CEA and fall under the CFTC’s oversight when traded in derivatives markets.⁶⁸

Fungible crypto assets can be grouped into three broad categories. The first category includes crypto assets designed to serve as a general medium of exchange.⁶⁹ This group is further divided into those with a corresponding liability, such as stablecoins like USD Coin (USDC), which

⁶⁴ Commodity Exchange Act & Regulations, *Commodity Futures Trading Commission*, <https://www.cftc.gov/LawRegulation/CommodityExchangeAct/index.htm>, (last visited Apr 20, 2025).

⁶⁵ Commodity Exchange Act (CEA), Practical Law Glossary, Item No. 7-386-4483, <https://content.next.westlaw.com/practical-law/document/7-386-4483> (last visited Apr. 20, 2025).

⁶⁶ See 7 U.S.C. § 1a(9); CFTC Glossary.

⁶⁷ FTA Provisions for Fungible Goods, International Trade Administration, <https://www.trade.gov/fta-provisions-fungible-goods> (Last visited Apr, 20, 2025).

⁶⁸ Int’l Monetary Fund, *F.18 The Recording of Fungible Crypto Assets in Macroeconomic Statistics: Crypto Assets Without Corresponding Liability: Background Note on the Proposed Options* (2008).

⁶⁹ *Id.* at 2

represent a claim on the issuer, and those without a corresponding liability, such as Bitcoin and Ether, often referred to as non-liability crypto assets.⁷⁰

The second category consists of crypto assets that function exclusively as a medium of exchange within a particular platform or network. Like the first category, these can either carry a corresponding liability or exist as non-liability assets.⁷¹ The third category includes security tokens, which always involve a counterparty liability and often possess characteristics similar to debt instruments, equity securities, or derivatives. These tokens typically fall under the jurisdiction of the SEC rather than the CFTC.

In contrast to fungible assets, Non-Fungible Tokens (NFTs) are unique digital tokens that represent specific digital or real-world items, such as artwork, collectibles, real estate, or personal identity records.⁷² Because each NFT is unique and not interchangeable with others, it does not meet the CEA's definition of a commodity.⁷³ As a result, NFTs may generally fall outside the CFTC's regulatory authority, unless their trading or issuance involves fraud, market manipulation, or other misconduct that would trigger the CFTC's enforcement powers under federal commodity laws.⁷⁴

CFTC's Regulatory Scope and Limits on Digital Assets

The U.S. CFTC holds regulatory authority in specific areas of the digital asset market. Its jurisdiction is triggered when a virtual currency is involved in a derivatives contract, such as futures or options, or when there is fraud or manipulation involving a virtual currency traded in interstate commerce. In these cases, the CFTC can take enforcement action against wrongdoing. The CFTC's jurisdiction over virtual currency markets is otherwise limited. It does not regulate everyday transactions or spot market trades⁷⁵, meaning direct purchases and sales of

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ Latham & Watkins, *Can It Be a Commodity if It's Not Fungible? Evaluating NFTs Under the Commodity Exchange Act*, Client Alert Commentary, (Feb, 2024), <https://www.lw.com/admin/upload/SiteAttachments/Can-It-Be-a-Commodity-If-It-Not-Fungible-Evaluating-NFTs-Under-the-Commodity-Exchange-Act.pdf>.

⁷⁵ A spot market is a marketplace where assets are exchanged for immediate delivery at the current market price, with no delay or future settlement. In the context of digital assets, platforms like Coinbase operate as spot markets by facilitating real-time purchases and sales of cryptocurrencies, instantly transferring assets between parties. A secondary market platform can function as both a spot market and a secondary market for securities. If the assets being traded are legally classified as securities, those transactions also occur within a secondary securities market, where investors resell assets to one another rather than acquiring them directly from an issuer. This dual nature is central to the legal

cryptocurrencies, unless those activities involve margin, leverage, or financing. This means, for example, that a cryptocurrency spot exchange that does not offer margin trading is not required to register with the CFTC. CFTC is said to have “enforcement jurisdiction” over cryptocurrency and digital assets, but not “registration jurisdiction.”⁷⁶

It cannot, for instance, compel most cryptocurrency spot markets to register as regulated entities unless derivatives trading or unlawful practices are involved.

Court Sided With CFTC To Clarify “Commodity” Apply To Categories of Goods, Not Specific Items.

Importantly, the CFTC’s enforcement authority extends beyond cases of market manipulation. In a landmark decision, the My Big Coin (MBC) case, a federal court endorsed the CFTC’s broad interpretation of its authority under the Commodity Exchange Act (CEA).⁷⁷ The court held that Congress intended the term “commodity” to apply to categories of goods, not to specific individual items.⁷⁸ As a result, virtual currencies, as a class of commodities, fall within the CFTC’s jurisdiction, even when a particular scheme, like MBC, does not involve traditional futures trading or market manipulation.⁷⁹ This decision reaffirmed the CFTC’s authority to pursue enforcement actions against fraudulent practices involving virtual currencies and related derivatives.

The case centered around My Big Coin (MBC) and its promoters, who allegedly orchestrated a fraudulent scheme soliciting over \$6 million from investors by making false claims about MBC’s value, functionality, and backing.⁸⁰ In its decision, the court agreed with the CFTC’s argument that MBC should be treated as a commodity because it belongs to the broader category of virtual currencies, a market where futures contracts are “dealt in”, most notably for Bitcoin.⁸¹ Since Bitcoin futures were actively traded on regulated exchanges, the court found that other

debate in cases like *SEC v. Coinbase*, where the question is whether the digital assets traded on Coinbase’s spot market also constitute securities being resold in a secondary market. See *SEC v. Coinbase, Inc.*, 726 F. Supp. 3d 260, 268 (S.D.N.Y. 2024).

⁷⁶ Cheryl L. Isaac, Keri E. Riemer, Christine Mikhael, *U.S. Asset Management and Investment Funds Alert* (May, 2022),

<https://www.klgates.com/CFTC-and-SEC-Perspectives-on-Cryptocurrency-and-Digital-Assets-Volume-I-A-Jurisdictional-Overview-5-6-2022>

⁷⁷ *CFTC v. My Big Coin Pay, Inc.*, No. 18-10077, at 6 (D. Mass. Sept. 26, 2018), <https://www.cftc.gov/sites/default/files/2018-10/enfmybigcoinpayincmemorandum092618.pdf>.

⁷⁸ *Id.* at 2.

⁷⁹ *Id.* at 9.

⁸⁰ *Id.* at 2.

⁸¹ *Id.* at 6.

virtual currencies, including MBC, fell within the same category for purposes of the CEA's definition of "commodity."⁸²

The court adopted an expansive interpretation of the CEA's definition of "commodity," emphasizing that Congress intended the term to cover broad categories of goods, services, rights, and interests that are subject to futures contracts. This inclusive approach, the court reasoned, aligned with the legislative purpose of providing comprehensive federal oversight of commodity futures markets and protecting market participants from fraud and abuse.

Additionally, the court rejected the defendants' argument that the CFTC's anti-fraud authority should be confined to cases involving market manipulation.⁸³ It held that the CEA's anti-fraud provisions apply broadly to fraudulent conduct involving commodities, regardless of whether market manipulation occurs. This ruling clarified that the CFTC has enforcement jurisdiction over fraudulent schemes involving virtual currencies, reinforcing its ability to police misconduct in this rapidly evolving market.

Spot market

In *CFTC v. McDonnell* clarified CFTC jurisdiction extends to fraud or manipulation in the virtual currency spot market beyond commodity derivatives and futures.⁸⁴

In *CFTC v. McDonnell*, the U.S. District Court for the Eastern District of New York ruled that the CFTC has authority to prosecute fraud involving virtual currencies, even in the spot market, where assets like Bitcoin are bought and sold for immediate delivery, rather than through futures contracts.⁸⁵ McDonnell argued that the CFTC's authority did not extend to spot market transactions. However, the court rejected this argument, holding that virtual currencies are "commodities" under the CEA and that the CEA's anti-fraud provisions apply broadly, not just

⁸² *Id.* at 2.

⁸³ *Id.* at 9.

⁸⁴ *CFTC v. McDonnell*, 332 F. Supp. 3d 641, 651 (E.D.N.Y. 2018).

⁸⁵ *Id.*

to futures and derivatives markets. This decision confirmed the CFTC's power to regulate fraudulent activity in the rapidly evolving virtual currency spot markets.

The CFTC cases are relatively more straight forward, as it concerns about defining commodity, as Bitcoin and Ether were deemed to be commodity under CEA.⁸⁶ Other virtual currency are relatively easy to be categorized as commodity or derivatives of Bitcoin. Also the CFTC jurisdiction on fraud was quite broad, so any misrepresentation, misleading information led to investment not as much controversial as SEC disputes, which argued mainly whether the disputes involve securities due to the ambiguous definition of investment contract.

It is important to note that the “jurisdictional authority of CFTC to regulate virtual currencies as commodities does not preclude other agencies from exercising their regulatory power when virtual currencies function differently than derivative commodities.”⁸⁷ It is interesting to note that the CFTC and SEC jurisdictions may overlap on a particular cryptocurrency, and sometimes you will see one company was being sued almost simultaneously by CFTC and SEC.

In *CFTC v Binance*, the order finds Binance, actively solicited customers in the United States, including quantitative trading firms, who entered into digital asset derivative transactions directly on the Binance platform.⁸⁸

In *SEC v. Binance*, SEC Files 13 Charges Against Binance Entities and Founder, Charges include operating unregistered exchanges, broker-dealers, and clearing agencies; misrepresenting trading controls and oversight on the Binance. US platform; and the unregistered offer and sale of securities.⁸⁹

Jurisdictions over Utility token are overlapped between CFTC and SEC.

There are jurisdiction challenges over whether utility token was commodity in trade or securities in a secondary market, and whether its derivatives are exclusively regulated by CFTC under the

⁸⁶ U.S. Commodity Futures Trading Commission, *Bitcoin Basics*, https://www.cftc.gov/sites/default/files/2019-12/oceo_bitcoinbasics0218.pdf

⁸⁷ Order, *In Re Ifinex Inc.*, CFTC Docket No. 22-05 (Oct. 15, 2021) at n.2, <https://www.cftc.gov/media/6651/enfbfxnaincorder101521>.

⁸⁸ Commodity Futures Trading Commission, *Federal Court Enters Order Against Binance and Former CEO, Zhao, Concluding CFTC Enforcement Action* (Dec. 18, 2023), <https://www.cftc.gov/PressRoom/PressReleases/8837-23>.

⁸⁹ U.S. Securities and Exchange Commission, *SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao*, (Jun, 5 2023), <https://www.sec.gov/newsroom/press-releases/2023-101>

definition of commodity. This topic will later be discussed more in depth when interpreting SEC definition of securities under Howey Test.

Utility token was recommended by digital asset Taskforce Global Markets Advisory Committee GMAC as a digital asset, whether in a primary or secondary sale, must convey an immediately available, non-incidental consumptive use to the buyer, whether that consumptive use is a tangible or intangible product, service, discount, special access or other benefit (collectively referred to as “utility”), which may include certain governance and voting abilities, nascent products and services not yet in existence or the ability to access or use of any of the foregoing in the future.⁹⁰

Virtual asset trading platform involves **utilities** digital asset and **securities** digital asset, the evaluation whether a trading platform falls under jurisdiction of SEC and CFTC is overly complex due to the nuance between the use and purpose of the digital asset trade.

There remains a gray area under CFTC jurisdiction if a digital asset investment is not a derivative, or it does not involve fraud. The SEC then play a key role to determine whether it falls into its jurisdiction by justifying whether digital asset investment is securities.

The trick is that the Digital finance company positions itself and its digital asset as a commodity, in a peer-to-peer transaction, on a spot market trade platform (secondary market trading platform). It makes either CFTC or SEC hard to lay a regulatory hand on it.

II. SEC regulate securities, secondary exchange platform, broker dealer under Howey Scrutiny

Today we are facing the speculative financial medium, cryptocurrency and its derivatives. We will start with two recent controversial and high-profile cases filed by SEC over Ripple and Coinbase, to illustrate how courts recently use Howey’s four prongs test heavily and rigidly without looking at its “economic reality test”.⁹¹

⁹⁰ Commodity Futures Trading Commission, *CFTC’s Global Markets Advisory Committee Advances Recommendation on Tokenized Non-Cash Collateral*, (Nov 21, 2024), <https://www.cftc.gov/PressRoom/PressReleases/9009-24>.

⁹¹ *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946).

Later in this article, indicative factors would be recommended to weigh between utility digital asset and securities digital asset.

SEC v. Ripple Labs Inc, "investment contracts" dispute in peer-to-peer market sales

In July 2023, Judge Analisa Torres of the Southern District of New York issued a summary judgment decision in *SEC v. Ripple Labs Inc.*, addressing whether Ripple’s sales of XRP constituted the sale of investment contracts under the federal securities laws.⁹² In her opinion, Judge Torres held that Ripple’s institutional sales of XRP to sophisticated investors did qualify as investment contracts, as those investors reasonably expected to profit from Ripple’s managerial efforts and were directly exposed to promotional materials and communications from the company.⁹³

However, the court found that Ripple’s programmatic sales of XRP on digital asset exchanges did not meet the definition of an investment contract under the *Howey* test, since it failed the expectation of profits from the efforts of others prong.⁹⁴ Judge Torres reasoned that purchasers in these anonymous secondary market transactions did not know they were buying from Ripple and did not receive promotional statements or promises that could reasonably create an expectation of profits derived from Ripple’s efforts.⁹⁵

SEC v Coinbase, dispute in non-securities trade in secondary market platform

Almost about the same time, the SEC filed its case against Coinbase in 2023, accusing the firm of operating an unregistered securities exchange, broker, and clearing agency for years. Coinbase litigation is fundamentally about the platform’s activities and regulatory classification, though the SEC’s allegations necessarily implicate the underlying assets being traded on that platform because whether Coinbase is illegally operating an unregistered securities exchange depends on whether those digital assets are “securities.”⁹⁶

⁹² *SEC v. Ripple Labs, Inc.*, 682 F. Supp. 3d 308 (S.D.N.Y. 2023).

⁹³ *Id.* at 327.

⁹⁴ *Id.* at 330.

⁹⁵ *Id.*

⁹⁶ *SEC v. Coinbase, Inc.*, 726 F. Supp. 3d 260, 275 (S.D.N.Y. 2024).

In June 2023, the SEC filed a high-profile enforcement action against Coinbase, Inc., alleging that the company had been operating an unregistered securities exchange, broker, and clearing agency in violation of federal securities laws.⁹⁷ The core dispute in this case centers on whether certain digital assets traded on Coinbase's secondary market platform qualify as securities, specifically investment contracts under the *Howey* test.⁹⁸ The SEC's position is that several of these crypto assets meet the definition of investment contracts, and by facilitating their trading without registering as a securities exchange, Coinbase violated the Securities Exchange Act of 1934.⁹⁹ Coinbase, in turn, argues that the SEC is overstepping its statutory authority, asserting that the digital assets in question do not satisfy the *Howey* test and that Congress has not explicitly authorized the SEC to regulate secondary market trades of digital asset commodities.¹⁰⁰ The interlocutory appeal, granted by Judge Katherine Polk Failla in April 2024, permits the Second Circuit to address whether transactions of these digital assets on secondary trading platforms fall within the scope of federal securities laws. While the immediate legal question concerns the platform's regulatory obligations, the answer ultimately hinges on whether the crypto assets it lists are securities. Thus, while procedurally the litigation targets Coinbase's operation of an unregistered exchange, substantively it implicates the nature of the digital assets being traded.

The two high-profile cases brought by SEC, main disputes were about whether the trade asset can be classified as securities. As both cases relied heavily on *Howey*, we will start with *Howey* analyses.

Howey's Test

In 1946, a Supreme Court case, *SEC v. W. J. Howey Co.*, we called it *Howey* test, *Howey* 's Justice Murphy designed a four-prong test, deemed that investment contract should fall under four key criteria: 1) an investment of money, 2) in a common enterprise, 3) with the expectation of profits, and 4) derived from the efforts of others.¹⁰¹ If all four criteria are met, the transaction is

⁹⁷ *Id.*

⁹⁸ *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946).

⁹⁹ Hannah Lang & Chris Prentice, *U.S. Securities Regulator to Drop Lawsuit Against Coinbase, Firm Says*, Reuters (Feb. 21, 2025), <https://www.reuters.com/technology/us-securities-regulator-drop-lawsuit-against-coinbase-exchange-says-2025-02-21>.

¹⁰⁰ *Id.*

¹⁰¹ *SEC v. W. J. Howey Co.*, 328 U.S. 293, 299 (1946).

considered an “investment contract” and is subject to the Securities Act of 1933 definition of securities.¹⁰²

Howey’s Securities Test Evaluation and Analysis:

To define securities under the overly broad federal laws securities definitions, the judicial interpretation factors in a crucial last prong, whether there is a reasonable expectation of profits derived from the efforts of others.

Reasonable expectation of profits

A significant factor contributing to a reasonable expectation of profits is the liquidity of the digital asset and the ease of resale.¹⁰³ If a digital asset is actively traded on secondary markets or is marketed with an expectation of future trading opportunities, this creates profit-taking opportunities for purchasers.¹⁰⁴ The ability to sell or tender the asset for resale is one of the features that strengthens the perception of the asset as an investment vehicle, rather than a tool for immediate consumptive use.¹⁰⁵ Liquidity and resale possibilities naturally foster an expectation that purchasers can realize gains through appreciation of the asset’s value in the marketplace, an essential indicator under the *Howey* analysis. In Coinbase’s spot market and secondary market trade platform, investors of digital assets have shown reasonable expectation to exercise liquidity of the asset due to Coinbase open market, trading population and volume.

From the efforts of others

Who is the “others”? It can be over inclusive to extend to any third party. In order to make the argument of Ripple on whether peer-to-peer market excludes the expectation of profit from key market player, such as issuers, a key term Active Participant (AP) will apply.¹⁰⁶ AP broadly includes the issuer of the digital asset, any affiliated promoters, sponsors, developers, or controlling parties responsible for essential managerial or entrepreneurial efforts.¹⁰⁷ These APs

¹⁰² *Id.*

¹⁰³ U.S. Sec. & Exch. Comm’n, *Framework for “Investment Contract” Analysis of Digital Assets* (July 5, 2024), <https://www.sec.gov/about/divisions-offices/division-corporation-finance/framework-investment-contract-analysis-digital-assets>.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

are distinguished from unaffiliated users or decentralized network participants because their actions directly affect the value and success of the enterprise or network supporting the digital asset.¹⁰⁸

In resale transactions and offers made after the initial distribution, the expectation of profits does not necessarily end with the initial offering (ICO), the status of the asset at the time of later offers or sales, considering whether the AP still performs essential functions, maintains influence over the asset's value, or supports its liquidity should be reevaluated.¹⁰⁹ If the network has matured, become decentralized, and the AP's managerial efforts have ceased to affect the asset's price or marketability, it may no longer meet the definition of a security.¹¹⁰ This sliding scale evaluation recognizes that the legal status of a digital asset can evolve over time based on the totality of circumstances, rather than remaining static.

Howey's Economic Reality Test Should Be Emphasized on Top of Four Prongs

Nevertheless, in *Howey*, Justice Murphy also emphasized "form was disregarded for substance".¹¹¹ The form refers to superficial appearance or label of investment scheme, the substance refers to the real, economic realities of an investment. This principle is also known as an "economic reality" test.¹¹² The subsequent courts relied heavily on the rigid four prongs from *Howey*, but rarely focus on the "economic reality" test.

Utilities Consumption Can Factor in Non-Securities Use.

The courts relied heavily on *Howey*'s prongs, but there are also some factors to demonstrate whether the trade was for investment or utility consumption purpose.

Take utilities token, which was defined as commodity under CEA, as a comparison with securities. Indicative factors to show whether the digital assets were traded for the purpose of

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *SEC v. W. J. Howey Co.*, 328 U.S. 293, 1102-03 (1946).

¹¹² *Id.*

investment contract for the expectation of profits, should include the relationship between the value or quantity of the digital asset and the goods or services for which it can be exchanged.¹¹³

If there is little apparent correlation between the digital asset's buy and sell price and the value of the good or service, this suggests that the asset functions more like a securities token, than utilities tokens.¹¹⁴

Also consider whether the digital asset was typically sold in a practical quantity suitable for ordinary use, this points to a consumptive purpose rather than an investment motive.¹¹⁵ For example, if a token is redeemable for a cup of coffee at a consistent price and is purchased in quantities aligned with realistic consumption patterns, the likelihood of it being treated as a security diminishes.

Such indicators should be added to strengthen the expectation of profits analysis under *Howey*. The subsequent courts applied outdated *Howey* on securities judgment, *Howey* was decided in 1946, and investment market has evolved significantly.

Legislator's Intent on Securities Definitions

Under U.S. federal securities laws, the definition of *securities* appears in both the Securities Act of 1933 (Section 2(a)(1)) and the Securities Exchange Act of 1934 (Section 3(a)(10)).¹¹⁶ Both statutes contain an intentionally broad and inclusive list of financial instruments considered "securities": *"any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights,"* and more.¹¹⁷

Among these categories, the term "investment contract" has played a pivotal role in modern financial and digital asset cases because it acts as a catch-all provision for arrangements that

¹¹³ U.S. Sec. & Exch. Comm'n, *supra* note 104.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ Securities Act of 1933, 15 U.S.C. § 77 (2012); Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10) (2012).

¹¹⁷ 15 USC § 77b(a)(1)

might not fit traditional forms like stocks or bonds, yet still function as securities vehicles. Since the statutes themselves did not squarely define “investment contract”, courts filled in the gap through case law, until the Supreme Court case *Howey* came into play, which set out the four-prong test to qualify an investment contract as we discussed earlier.

The legislator designed the law, and the court explained the law. The ruler intent was not to limit SEC ability to regulate new evolving financial products. Senator Fletcher, a key sponsor of the 1933 Act, advocated for a broad definition of "security" to encompass a wide range of instruments and investments. With his influence, the 1933 Act sought to prevent fraudulent practices and ensure that investors had access to vital information when purchasing securities. To achieve this, the definition of "security" was deliberately made expansive.

That definition is not meant to encompass everything that may be a “security”, as the U.S. Supreme Court has made clear that the definition of “security” is “quite broad”¹¹⁸ and meant to include “the many types of instruments that, in our commercial world, fall within the ordinary concept of a security”.¹¹⁹

If we take this legislator’s intent approach, the interpretation and application of investment contract could not be confused for the purpose of digital asset.

Comment and Summary

This paper compellingly illustrates that U.S. financial regulation has historically struggled to keep pace with the rapid evolution of market instruments. From 19th-century difference contracts to 20th-century derivatives and now to 21st-century digital assets, financial markets have repeatedly exploited regulatory gaps, often precipitating crises before lawmakers and regulators responded. Like an “old wine in new bottles”, each chapter in this regulatory history, from the 1929 stock market crash to the 2008 subprime mortgage crisis, reveals a consistent pattern: systemic risks proliferate when speculative financial products emerge in underregulated environments. The contemporary cryptocurrency market follows this familiar trajectory,

¹¹⁸ *Marine Bank v. Weaver*, 455 U.S. 551, 555-556 (1982)

¹¹⁹ H.R.Rep. No. 85, 73d Cong., 1st Sess., 11 (1933)

combining speculative fervor, fragmented oversight, and legal ambiguity in ways that threaten both market integrity and financial stability.

What makes crypto assets particularly complex is that, unlike historical financial instruments, they serve multiple and sometimes contradictory functions. A single digital asset can act as a means of raising capital, a medium of exchange, a speculative investment, a derivative product, and a consumptive utility. Complicating matters further, there is often no centralized issuer or financial intermediary subject to regulatory supervision. The high liquidity, borderless portability, and pseudonymity of digital assets also make them especially attractive for illicit financial activity, including money laundering, sanctions evasion, and fraud. Despite these risks, U.S. regulators, primarily the CFTC and the SEC have largely adopted a jurisdictional, enforcement-driven approach rather than advocating for comprehensive legislative reform tailored to this unique asset class.

A central weakness in current regulatory practice lies in the superficial, overly rigid application of the *Howey Test*'s four formal prongs while neglecting its foundational principle: the economic reality test. When Justice Murphy authored *Howey* in 1946, he emphasized that substance must prevail over form, requiring courts and regulators to look beyond superficial labels and technical structures to the real economic nature of a transaction. Unfortunately, subsequent court rulings and regulatory actions have too often fixated on a formulaic application of *Howey*'s prongs, neglecting critical indicative factors that could illuminate whether a digital asset truly functions as a speculative security or a consumptive utility. Factors such as the correlation between an asset's market price and the value of goods or services it can purchase, the typical quantity in which the asset is sold relative to its actual use case, and whether the asset's value is driven by market liquidity rather than real economic functionality have been routinely ignored by courts and regulators alike.

This narrow legalistic approach reflects a deeper flaw in the U.S. financial regulatory tradition: a reactionary, crisis-driven legislative culture. Historically, Congress and financial regulators have only acted decisively after systemic failures occur. From the post-1929 enactment of the Securities Act of 1933 to the post-2008 passage of the Dodd-Frank Act, legislative interventions have consistently followed, rather than preempted, major financial market crashes. The same

passivity is evident today. Despite widespread acknowledgment of crypto's growing systemic risk, market opacity, and potential for illicit financial activity, Congress has failed to modernize securities and commodities laws to explicitly address digital assets. Regulators, meanwhile, have acted as passive enforcers rather than proactive market stewards, relying on ad-hoc enforcement cases while avoiding the development of clear, comprehensive regulatory frameworks.

This legal and regulatory inaction carries grave implications for financial stability. As this research persuasively argues, the continued failure to address the unique complexities of digital assets, particularly their hybrid functionality, decentralization, and speculative liquidity, invites the conditions for a 21st-century financial collapse. The unchecked growth of speculative digital markets, operating without coherent regulation, mirrors the unregulated derivatives market of the pre-2008 era. Without decisive legal modernization, speculative excess and systemic vulnerabilities will persist, potentially triggering cascading losses across interconnected financial markets when confidence inevitably falters.

To address these challenges, legislative reform is urgently needed. Congress must modernize the statutory definitions within the Securities Act of 1933 and the Securities Exchange Act of 1934 to explicitly address digital assets and decentralized networks. This should include clear indicia for distinguishing securities tokens from utility tokens, based on factors such as managerial control, market liquidity, promotional conduct, economic functionality, and the actual use patterns of the asset in practice. The Howey Test itself should be statutorily supplemented or updated to codify an economic reality standard specifically tailored to digital finance, providing courts with clearer, commercially relevant guidelines for evaluating modern financial products.

Additionally, financial regulators must be empowered by statute to engage in proactive, risk-based rulemaking for digital assets, moving beyond the current model of reactive enforcement and piecemeal court decisions. This would enable agencies like the SEC and CFTC to issue binding classifications, interpretive guidance, and disclosure standards in advance of market crises, promoting both investor protection and financial market integrity.

Without decisive modernization of the regulatory framework, crypto markets risk becoming the next systemic crisis vector, one that history has repeatedly shown regulators only manage after catastrophic market failures. The cryptocurrency ecosystem today, with its dual potential as a

driver of innovation and a vector for systemic risk, demands a regulatory architecture that is forward-looking, economically grounded, and jurisdictionally coherent. Relying on fragmented enforcement actions, narrow court interpretations, and legislative inertia is a reckless and unsustainable strategy, one that threatens to allow speculative bubbles, illicit finance, and market instability to fester unchecked until the damage is too great to contain.