Why Self-Custody Wallet Platforms Are Not Brokers Under the Securities Exchange Act of 1934

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ABSTRACT

   Self-custody wallet platforms ("SCWPs") serve as a gateway for users to send, receive, and access digital assets. On top of these basic features, many SCWPs enable users to exchange digital assets, connect to Decentralized Finance ("DeFi") protocols, and convert digital assets to fiat money. Unlike custodial wallet platforms, users are responsible for securely storing their private keys and third parties may not act on the behalf of the user without their approval. None of the more than 55 existing SCWPs are registered as a broker under the Securities Exchange Act of 1934 ("Exchange Act") and none have complied with any of the Exchange Act's disclosure requirements.

   This Note will address these concerns and conclude that SCWPs are not unregistered brokers because the receipt of transaction-based fees by connecting buyers or sellers to a decentralized exchange ("DEX") without transferring custody through a SCWP is not, by itself, sufficient to designate a SCWP as a broker, but rather fits within a "finder's exemption." Existing justifications of broker regulation under the Exchange Act do not apply with equal force to SCWPs. Thus, Congress should legislate new authority to an agency with greater expertise - the Department of Treasury - to oversee the technological, financial, and national security risks of SCWPs.

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INTRODUCTION

   Former SEC Chairman Gensler remarked at the Practicing Law Institute in September of 2022, that "[n]othing about the crypto markets is

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incompatible with the securities laws."[1] On June 6, 2023, the day that the SEC commenced their action against Coinbase Wallet, a self-custody wallet platform ("SCWP"), Chairman Gensler stated that "[t]here's been clarity for years" and that "[t]hese intermediaries need to come into compliance."[2] Although this allegation was ultimately dismissed in court on March 27, 2024,[3] the SEC continued to aggressively pursue SCWPs, notably filing a lawsuit against Consensys and issuing a Wells Notice to Uniswap, which have since been dismissed or agreed to be dismissed under Acting SEC Chairman Mark Uyeda.[4] All three cases involve nearly identical legal questions: whether a SCWP is a broker under the Securities Exchange Act of 1934 ("Exchange Act").

Transactions using decentralized finance ("DeFi") require a "wallet," which has two parts: a private key and a public key (also colloquially referred to just as a "wallet"). A private key is an alphanumeric code, akin to a password, that is used to authorize transactions.[5] A public key, by contrast, is created from a private key and serves as a public depository address for digital assets.[6] Anyone can view the contents of a public key and send digital assets, but only the owner of the private key can access its contents and perform functions.[7] SCWPs are essential to the DeFi ecosystem because they enable users to access their digital assets through a private key.[8] As they are

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[1] Nikhilesh De, *Crypto Doesn't Need More Guidance, SEC Chair Gensler Says*, COINDESK (May 11, 2023, 12:57 PM), https://www.coindesk.com/policy/2022/09/08/crypto-doesnt-need-more-guidance-sec-chair-gensler-says [https://perma.cc/VKD5-YTEM].

[2] Jack Shickler & Elizabeth Napolitano, *U.S. Doesn't 'Need More Digital Currency' Because It Has the Dollar, Says SEC's Gensler*, COINDESK (Jun. 6, 2023, 1:22 PM), https://www.coindesk.com/policy/2023/06/06/us-doesnt-need-more-digital-currency-because-it-has-the-dollar-says-secs-gensler [https://perma.cc/A2YV-WEF2].

[3] SEC v. Coinbase, Inc., No. 23-4738, 2024 U.S. Dist. LEXIS 56994, at *3 (S.D.N.Y. Mar. 27, 2024) ("the Court agrees with Defendants that they are entitled to dismissal of the claim that Coinbase acts as an unregistered broker"). On February 27, 2025, the SEC dismissed the remaining allegations against Coinbase with prejudice and without imposing fines or admission of wrongdoing. Joint Stipulation to Dismiss, SEC v. Coinbase, Inc., 1:23-cv-04738-KPF (S.D.N.Y. Feb. 27, 2025).

[4] Complaint at 1, SEC v. Consensys Software, Inc., No. 24-4578, 2024 U.S. Dist. LEXIS 185757 (E.D.N.Y June 28, 2024) (available at https://www.sec.gov/files/litigation/complaints/2024/comp26039.pdf) [https://perma.cc/87HQ-HKVQ]. On February 27, 2025, Consensys announced that the SEC has agreed to drop the lawsuit against the company. *SEC to Drop All Claims Against Consensys*, CONSENSYS (Feb. 27, 2025), https://consensys.io/blog/sec-to-drop-all-claims-against-consensys [https://perma.cc/5XPS-39KP]. Uniswap Labs, Wells Submission on Behalf of Uniswap Labs (May 21, 2024) (available at https://blog.uniswap.org/wells-notice-response.pdf)[https://perma.cc/7FAM-SA77]. On February 25, 2025, Uniswap announced that the SEC has officially closed its multi-year investigation into the company. Uniswap, *A Win for DeFi – SEC Closes Investigation into Uniswap Labs*, BLOG (Feb. 25, 2025), https://blog.uniswap.org/a-win-for-defi [https://perma.cc/BA52-4WUF].

[5] *Private Key: What It Is, How It Works, and Best Ways to Store*, INVESTOPEDIA (May 23, 2024), https://www.investopedia.com/terms/p/private-key.asp [https://perma.cc/5888-KLNC].

[6] *Id.*

[7] *What Are Public Keys, Private Keys and Wallet Addresses?*, BITPANDA, https://www.bitpanda.com/academy/en/lessons/what-are-public-keys-private-keys-and-wallet-addresses/ [https://perma.cc/YME8-GU3R] (last visited Nov. 11, 2024).

[8] *See Off-Ramp and On-Ramp Crypto, What You Need to Know*, ROCKWALLET, https://www.rockwallet.com/blog/off-ramp-and-on-ramp-crypto-what-you-need-to-know [https://perma.cc/D6TS-BLNE] (last visited Nov. 11, 2024).

not centralized or custodial wallet platforms, they do not store digital assets.[9] Users, rather than third parties, maintain full responsibility for safeguarding their private key.[10] Once a user has a wallet running on their web browser through their SCWP, users can then submit their public wallet address, akin to a depository box, to interact with DeFi platforms. These platforms will then submit the user's transaction to a "node" whereby competing validators will work to authenticate and process the transaction. Once the transaction has been validated, it is accepted as a "block" and added to the chain of blocks ("blockchain").

DeFi platforms are as varied as they are evolving with technological change, but they all share a commonality in that they utilize a distributed ledger to communicate economic transactions.[11] Borrowing, lending, and investing are quintessential services that DeFi platforms provide. Without SCWPs users will not be able to access this emerging ecosystem in finance. SCWPs, such as MetaMask and Coinbase, also provide access to decentralized exchanges ("DEXs") where users may purchase or sell digital assets.[12] Because SCWPs are free to access, most SCWPs provide the functionality to exchange digital assets within their own platform for a small transactional fee that rewards the SCWP.[13] SCWPs also enable the user to select the price range the purchaser or seller is willing to accept, called "slippage," and passes down a network fee collected by the validators, called "gas."[14]

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[9] *Cryptocurrency Wallet: What It Is, How It Works, Types, Security*, INVESTOPEDIA (June 28, 2024), https://www.investopedia.com/terms/b/bitcoin-wallet.asp [https://perma.cc/899C-KSGV] (discussing how only centralized or custodial wallet platforms retain possession of the user's digital assets).

[10] *What is Self-Custody?*, METAMASK, https://learn.metamask.io/lessons/what-is-a-self-custody-wallet [https://perma.cc/G8ZP-J69R] (last visited Nov. 11, 2024).

[11] *See generally* Rakesh Sharma, *What Is Decentralized Finance (DeFi) and How Does It Work?*, INVESTOPEDIA (Oct. 25, 2024), https://www.investopedia.com/decentralized-finance-defi-5113835 [https://perma.cc/8W8W-VKR8].

[12] *See generally You're in Control When You Access, Store and Swap Your Tokens*, METAMASK, https://metamask.io/swaps/ [https://perma.cc/33B4-DG3P] (last visited Nov. 11, 2024) (discussing that users on the MetaMask interface can either exchange digital assets on the platform or connect to the interface of a DEX, using the MetaMask browser extension); *How to Swap Tokens with Coinbase Wallet*, COINBASE, https://www.coinbase.com/learn/wallet/how-to-swap-tokens-with-coinbase-wallet [https://perma.cc/APL4-XZJS] (last visited Nov. 11, 2024) (same).

[13] *See, e.g.*, *You're in Control When You Access, Store and Swap Your Tokens*, METAMASK, https://metamask.io/swaps/ [https://perma.cc/33B4-DG3P] (last visited Nov. 11, 2024) ("A service fee of 0.875% is automatically factored into each quote"); *Trust Wallet FAQs: Mastering the Basics of Your Blockchain Wallet*, TRUST WALLET (Sept. 27, 2024), https://trustwallet.com/blog/trust-wallet-faqs [https://perma.cc/CKU7-V7H3] ("You can adjust the slippage tolerance . . . . Users, however, are required to pay the network fee (also known as gas fees)").

[14] *See, e.g.*, *Trust Wallet FAQs: Mastering the Basics of Your Blockchain Wallet*, Trust Wallet (Sept. 27, 2024), https://trustwallet.com/blog/trust-wallet-faqs [https://perma.cc/CKU7-V7H3] ("You can adjust the slippage tolerance . . . . Users, however, are required to pay the network fee (also known as gas fees)"); *see also* James Howell, *Slippage in DeFi – Know Everything*, 101 BLOCKCHAINS (Nov. 30, 2023), https://101blockchains.com/defi-slippage-explained/ [https://perma.cc/ZR6L-R8M7]; *Gas (Ethereum): How Gas Fees Work on the Ethereum Blockchain*, INVESTOPEDIA (June 12, 2024), https://www.investopedia.com/terms/g/gas-ethereum.asp [https://perma.cc/HC5L-94GJ].

Brokers, on the other hand, act as agents for customers investing in securities and may earn commissions on each transaction.[15] They may also provide investment advice and research for their customers.[16] Custody is a quintessential characteristic of brokerage activity. Brokers require customers to deposit money into an account managed by the broker.[17] This act of handing over assets to a third-party creates inherent risks that various regulations have been designed to mitigate, such as insurance requirements, net capital rules, and customer protection rules.[18]

This Note will be organized as follows: Part I will analyze the jurisprudence of the definition of broker under the Exchange Act, offer an application of the caselaw to a typical SCWP, and examine how regulatory requirements for brokers are unfit for SCWPs, and Part II will offer policy proposals for a more appropriate regulatory approach to SCWPs to address the technological, financial, and national security risks of these platforms.

I.   ANALYSIS

A. Jurisprudence of the Definition of "Broker" Under the Exchange Act

The Exchange Act defines a broker as "any person engaged in the business of effecting transactions in securities for the account of others."[19] It is unlawful for a broker to make use of the mails or any means or instrumentality of interstate commerce to effect transactions in any non-exempt security unless the broker is registered with the SEC.[20] The agency may also conditionally or unconditionally exempt any broker by rule or order as deemed consistent with the public interest and the protection of investors.[21]

A separate question for analysis is whether any of the underlying assets that a broker may trade is a security. A finding that the underlying asset is not a security foregoes registration under the Exchange Act.[22] However, the purpose of this analysis is to focus on whether the definition of a broker applies to SCWPs, not an individual inquiry into each underlying asset a platform may transact.[23] Thus, the remainder of this Note will proceed on

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[15] Tim Smith, *Broker: Definition, Types, Regulation, and Examples*, INVESTOPEDIA (Aug. 16, 2024), https://www.investopedia.com/terms/b/broker.asp [https://perma.cc/RA5Y-AHF6].

[16] *Id.*

[17] *Id.*

[18] *See If a Brokerage Firm Closes Its Doors*, FINRA (May 15, 2023), https://www.finra.org/investors/insights/if-brokerage-firm-closes-its-doors [https://perma.cc/W56L-6CY9].

[19] 15 U.S.C. § 78c(a)(4)(A).

[20] 15 U.S.C. § 78o(a)(1).

[21] 15 U.S.C. § 78o(a)(2).

[22] 15 U.S.C. § 78c(a)(4)(A) (if a broker does not effectuate transactions in "securities," then registration is not applicable).

[23] The question of whether a digital asset that was initially issued as an investment contract remains a security when it is traded on a secondary exchange has been the subject of recent litigation. *See* SEC v. Ripple Labs, Inc., 682 F. Supp. 3d 308, 328 (S.D.N.Y. 2023) (finding that the blind bid/ask "Programmatic Sales" transactions on the secondary market were not sales of securities because the buyers of the defendant's token could not have known if their payments went to the defendant or any other seller of the token); Plaintiff's Memorandum of

the assumption that at least one sort of digital asset traded via SCWPs is a security.

The determination of whether a person or entity is a broker depends on various factors. Many Federal District Courts and Courts of Appeals cite to the *Hansen* factors for a rough guideline but are not beholden to those factors.[24] In *SEC v. Hansen*, the SEC alleged that the defendants acted as unregistered broker-dealers.[25] Relying on scholarly literature, the Southern District of New York announced six factors to determine whether an individual acted as a broker: if that entity (1) is an employee of the issuer, (2) received transaction-based income as opposed to a salary, (3) sells or sold securities of other issuers, (4) is involved in negotiations between the issuer and investors, (5) offers investment advice, and (6) is an active finder of investors.[26] Alongside these commonly-cited factors is whether there is a "certain regularity of participation in securities transactions at key points in the distribution."[27]

Courts tend to find a "regularity of participation" based on (1) the frequency of sales of securities, (2) the value (in dollars) of the securities sold, and (3) the extent of advertisement and investor solicitation.[28] Courts also place varying emphasis as to whether transaction-based compensation is a signature feature of broker activity. Some courts have emphasized the potential for abusive sales practices if entities that receive transaction-based compensation for effectuating a transaction are not regulated and give additional weight to this factor.[29]

Law in Opposition to Defendants' Motion for Judgment on the Pleadings at 6, SEC v. Coinbase, Inc., 726 F. Supp. 3d 260 (S.D.N.Y. 2024) (available at https://assets.ctfassets.net/o10es7wu5gm1/1ZKDobPXkJE4rQH5AE3hXH/d5812a6c57f6d0efdd4180f7cfb1532b/2023.10.03_-_Dkt._069_-_Memorandum_of_Law_in_Opp_to_Motion_for_Judgment_on_the_Pleading.pdf) [https://perma.cc/35JB-DQBB] (alleging that transactions on the secondary market are subject to the same investment contract analysis as by the primary issuer because Congress intended to regulate all securities, not drawing a distinction on where or how the instruments were made). Nevertheless, SCWPs permit users to connect to a DEX to trade any digital asset interoperable with that blockchain and supported by that DEX. This may include thousands of various digital assets. It is likely that at least one of these digital assets is a security, such that the SCWP would enable transactions in securities. Even in the alternative that a digital asset traded on a secondary market is not a security, SCWPs may provide the capability to connect to a primary issuer to purchase a security.

[24] *See e.g. Coinbase*, 726 F. Supp. 3d at 305–06 (discussing nine factors, six of which are cited in *SEC v. Hansen*); SEC v. Murphy, 50 F.4th 832, 841 (9th Cir. 2022), *reh'g en banc denied*, Nos. 21-55178, 21-55180, 2023 U.S. App. LEXIS 1920 (9th Cir. Jan. 25, 2023), *cert. denied sub nom.* Murphy v. SEC, 144 S.Ct. 344 (2023) (applying eight factors, six of which are cited in *SEC v. Hansen*).

[25] SEC v. Hansen, No. 83 Civ. 3692, 1984 WL 2413, at *10 (S.D.N.Y. Apr. 6, 1984).

[26] *Id.*

[27] Mass. Fin. Servs., Inc. v. Sec. Inv. Prot. Corp., 411 F. Supp. 411, 415 (D. Mass.), *aff'd*, 545 F.2d 754 (1st Cir. 1976), *cert. denied sub nom.* Sec. Inv. Prot. Corp., v. Mass. Fin. Servs., Inc., 431 U.S. 904 (1977).

[28] *See* Quantum Cap., LLC v. Banco de los Trabajadores, No. 1:14-CV-23193-UU, 2016 WL 10536988, at *6 (S.D. Fla. Sept. 8, 2016) (citing SEC v. Kenton Cap., Ltd., 69 F. Supp. 2d 1, 12–13 (D.D.C. 1988)).

[29] *See* Cornhusker Energy Lexington, LLC v. Prospect St. Ventures, No. 8:04CV586, 2006 WL 2620985, at *6 (D. Neb. Sept. 12, 2006); Landegger v. Cohen, No. 11-cv-01760-WJM-CBS, 2013 WL 5444052, at *5 (D. Colo. Sept. 30, 2013); SEC v. Kramer, 778 F. Supp. 2d 1320, 1334–35 (M.D. Fla. 2011).

However, other courts have recognized a "finder's exception" for excluding transaction-based compensation that permits certain activities such as "locating potential buyers or sellers, stimulating interest, and bringing parties together" to not rise to the level of "effecting transactions."[30] Brokers, by contrast, can be said to "bring the parties to an agreement on particular terms," which rises to a level of discretion beyond that allowed under the finder's exception.[31] This exemption is not found in the Exchange Act and is not an affirmative defense, but is rather a narrow set of activities that do not meet the definition of a broker.[32]

B. Self-Custody Wallet Platforms Do Not Meet the Definition of Broker

There is no one-size-fits-all analysis of whether a SCWP must register as a broker under the Exchange Act. Each wallet platform, as well as interactions the platform has had with users, third-parties or other participants must be scrutinized individually in a fact-based inquiry to determine if registration is required. However, wallet platforms share basic commonalities that, unlike custodial intermediaries, may neither require registration nor be subject to the plethora of regulations affecting brokers. Nevertheless, a SCWP may plausibly fit into a "finder's exemption," thus placing the activity of a SCWP outside of the requirements for regulating brokers.

Using a hypothetical SCWP named JBWallet as an illustrative example of an industry standard product, its features include the ability for users to send, receive, and store digital assets on the Ethereum blockchain. It also offers the ability to exchange digital assets within the platform for a 0.5% transaction fee, connects with DeFi applications and advertises its services to the public. JBWallet does not offer any other service except for the routine administration of its product. JBWallet is not registered as a broker under the Exchange Act. It also does not contest that some of its transactions involve the sale or purchase of securities.

As compared to the six *Hansen* factors, JBWallet is in many regards distinguishable from brokers who have been required to register as a result of a court decision. JBWallet is not an employee of an issuer, is not involved in negotiations between an issuer and investor, and does not offer investment advice. Consequently, none of these factors are applicable to JBWallet.

Courts have found, as in *SEC v. Nutra Pharma* and *SEC v. George*, that a person who directed communication, such as by calling and recruiting investors, mailing invitations to promotions, and attending promotional pitches, is a securities broker.[33] Although JBWallet solicits the participation of customers in its platform through the advertisements of its services,

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[30] SEC v. Mine Shaft Brewing LLC, No. 2:21-cv-00457-DBB-JCB, 2023 WL 6163956 at *12 (D. Utah Sept. 21, 2023) (quoting Rhee v. SHVMS, LLC, No. 21-cv-4283 (LJL), 2023 WL 3319532, at *8 (S.D.N.Y. May 8, 2023)).

[31] Train v. Ardshiel Assocs., Inc., 635 F. Supp. 274, 279 (S.D.N.Y.), *aff'd sub nom.* Train v. Ardshiel Assoc., 805 F.2d 391 (2d Cir. 1986).

[32] *Mine Shaft Brewing*, 2023 WL 6163956, at *12.

[33] SEC v. Nutra Pharma Corp., 450 F. Supp.3d 278, 291 (E.D.N.Y. 2020); SEC v. George, 426 F.3d 786, 797 (6th Cir. 2005).

generalized communication to a broad audience is different than targeted inducements of the broker's services. Advertisement of JBWallet's services is a mere requirement to be a profitable business, no different than advertisement for any other software platform.

Similarly, a history of selling securities of other issuers is not quite applicable in the context of a SCWP. In *SEC v. Collyard*, the defendant was found to still be a broker when he had been a registered broker for 27 years before his license was revoked and thereafter sold securities without registration.[34] It would be odd to equivocate the defendant's undisputed history of selling securities as a registered broker in *Collyard* with, for example, JBWallet's short transactional history without determining the status of its prior activities. JBWallet does not sell securities, rather it connects the buyer or seller of a digital asset with a DEX and never holds custody of the digital asset. Nor has JBWallet ever asserted that it has enabled the trading of securities, unlike the defendant in *Collyard*.

The only *Hansen* factor that is most clearly satisfied is receiving transaction-based income, because JBWallet charges 0.5% on its exchanging services. However, finding in favor of a plaintiff's argument that JBWallet is operating as an unregistered broker without the presence of any of the other *Hansen* factors would fundamentally reshape the long-established framework of using all factors in one holistic analysis, rather than one above all others.

A regularity of participation may also fail to capture JBWallet's activities as a broker. Some courts have placed emphasis on the size and frequency of the transactions, such as the defendant in *SEC v. Kenton Capital* collecting $1,745,000 from investors.[35] Conversely, other courts have emphasized active participation by the defendant in aiding the purchase of securities, such as by the defendant in *SEC v. Murphy* directing the purchase of securities with the investor's capital.[36] Although JBWallet may have enabled a substantial volume of trades, JBWallet never holds custody of any of its users' assets at any stage of the transaction, nor directs any transaction without the user selecting which assets to exchange, the applicable gas fees, or slippage rates. JBWallet is merely connecting two parties on their own agreed terms.

The closest analogy of JBWallet in terms of existing caselaw, is within a "finder's exemption" for entities that facilitate two parties coming together for a transaction. The Court in *Antares Management v. Galt Global Capital* found that the plaintiff merely "stimulating general investment interest" was not sufficient, by itself, to label the plaintiff as a broker; the court therefore found the fee at issue to be a finder's fee, rather than a brokerage fee, and

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[34] SEC v. Collyard, 861 F.3d 760, 762, 768 (8th Cir. 2017).

[35] SEC v. Kenton Cap., Ltd., 69 F. Supp. 2d 1, 13 (D.D.C. 1998).

[36] SEC v. Murphy 50 F.4th 832, 845 (9th Cir. 2022), *reh'g en banc denied*, Nos. 21-55178, 21-55180, 2023 U.S. App. LEXIS 1920 (9th Cir. Jan. 25, 2023), *cert. denied sub nom.* Murphy v. SEC, 144 S. Ct. 344 (2023).

denied defendants' motion to dismiss.[37] Finders, like the plaintiff in *Antares Management*, do not finalize a transaction between two parties. Similarly, JBWallet's platform may stimulate general investment interest through the ability of a user to connect to DEXs and swap digital assets, but no more than at an abstract level for any particular digital asset, and without any direct interaction with the counterparty.

Even more on point is the Court in *Dervan v. Gordian Group* holding that transaction-based compensation by itself is insufficient to deem an entity as a broker.[38] The services that JBWallet provides by connecting a buyer or seller to a DEX to consummate a transaction while being paid a small percentage of each transaction can more broadly be characterized as a "finder's fee" rather than a broader term encompassing greater managerial activity at various stages of investing, such as broker.Beyond the considerations that underly the various factors that courts have used to determine whether an entity is a broker, there are important distinctions between SCWPs and custodial intermediaries that courts have not considered in great detail. With SCWPs, money does not move through the hands of a custodial intermediary to reach an exchange.[39] While these SCWPs serve as gatekeepers for users to access DeFi, they do not possess other properties – most notably temporary possession and control over terms – that characterize custodial intermediaries. The wallet platform simply connects the user to a DEX where one digital asset is exchanged for another, and the terms of the agreement are set by the exchange rate, gas fees, and slippage rates.[40] The wallet platform plays no active role in negotiating the rates and fees that the user pays, besides for the uniform transaction fee it receives.[41]

Another complication indicating that SCWPs should not be considered brokers comes from the open source nature of blockchain technology, where all activity is open to the public to view, including code. Turning back to JBWallet, it is assumed that the primary users of JBWallet are not the developers of JBWallet. However, anyone can create and deploy their own code, including a SCWP with the same interface as any other platform, but to the exclusion of other members of the public.[42] Companies now offer

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[37] Antares Mgmt. LLC v. Galt Glob. Cap., Inc., No. 12-CV-6075(TGP), 2013 WL 1209799, at *9 (S.D.N.Y. Mar. 22, 2013).

[38] Dervan v. Gordian Grp. LLC, No. 16-CV-1694 (AJN), 2017 WL 819494, at *11 (S.D.N.Y. Feb. 28, 2017) (the notion that transaction-based compensation "militates, perhaps strongly, in favor of" finding a party to be a broker "is not a categorical rule").

[39] Daniel Bowden, *What is a Self-Custody Wallet & Why Do You Need One?*, XVERSE (Sept. 25, 2023), https://www.xverse.app/blog/self-custody-wallet [https://perma.cc/DXD4-J7N6].

[40] A leading example of this function is with MetaMask. The platform offers slippage protection, gas-efficient trading routes, and gathers data from decentralized exchange aggregators, market makers and decentralized exchanges to offer the user the best price for a digital asset exchange. *How to Use MetaMask's Swap Feature to Get What You Want*, METAMASK (July 17, 2023), https://metamask.io/news/latest/how-to-use-metamasks-swap-feature-to-get-what-you-want/ [https://perma.cc/6M3U-F5YG].

[41] *See id.* (again using MetaMask as an example, the software operates by "gathering data," rather than negotiating with third parties).

[42] *See generally What Is a White Label Crypto Wallet, and How Does It Work*, ALPHAPOINT (Oct. 23, 2023), https://alphapoint.com/blog/white-label-crypto-wallet/ [https://perma.cc/F5DY-LJWL].

white label crypto exchanges, which deploy pre-developed protocols offering highly customizable wallet platform services to clients for their specific tailored needs.[43] It would be perplexing, at minimum, to require privately used platforms to register through the SEC's disclosure-based regime when the only beneficiary of the disclosure would be the creator of the platform or a company and not the broader public.

C. Regulatory Requirements for Brokers are Incompatible with Self-Custody Wallet Platforms

A finding that SCWPs are brokers under the Exchange Act, notwithstanding an exemption, would subject these platforms to voluminous regulatory requirements ill-suited for SCWPs and fail to disclose the risks of using their software. Both the registration process and ongoing requirements are time consuming, resource intensive and necessitate specialized experts to assist with compliance.[44] Each individual stage in the process can have its own section on how a SCWP may or may not fit into the existing framework for brokers, however, for purposes of convenience, special attention will be devoted to highlighting three unique issues with regulatory compliance: the Bank Secrecy Act (BSA), net capital rule, and customer protection rule.

The BSA, its implementing regulations, and Rule 17a-8 under the Exchange Act require brokers to file reports or retain recordings relating to suspicious transactions, identity of customers, large cash transactions, cross-border currency movement, and foreign bank accounts, among others.[45] This places SCWPs in a perilous position by transforming them from a neutral observer into a police watchdog. Due to the pseudo-anonymity of each transaction that a wallet platform may help facilitate, wallet platforms have limited tools to identify who the person is behind the public address that is utilizing their platform.[46]

Exchange Act Rule 15c3-1 (the "Net Capital Rule") requires a broker to have at all times enough liquid assets to satisfy customer claims in the event that a broker goes out of business.[47] The minimum capital levels depend on the types of securities activities that they conduct and financial ratios.[48] This rule operates under the presumption that an intermediary holds the funds of a customer for at least some period of time. But this is antithetical to how

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[43] *See Crypto Wallet in USA*, WALLET FACTORY, https://walletfactory.com/en-us/industries/crypto-wallet-blockchain [https://perma.cc/UJ7Q-AAGG] (last visited Nov. 21, 2024).

[44] *See* Daniel Aisen, *Obtaining a Broker-Dealer License*, MEDIUM (July 22, 2020), https://medium.com/prooftrading/obtaining-a-broker-dealer-license-e49d10030978 [https://perma.cc/3WDU-NJ37] (one illustrative example of broker registration is that it took nearly a year and around $100,000 to register as a broker-dealer).

[45] Div. of Trading & Mkts., *Guide to Broker-Dealer Registration*, U.S. SEC (Apr. 2008), https://www.sec.gov/about/reports-publications/investor-publications/guide-broker-dealer-registration [https://perma.cc/ZRR2-AJQ9].

[46] *See generally The Era of Digital Identity*, METAMASK, https://learn.metamask.io/lessons/the-era-of-digital-identity [https://perma.cc/DN5R-496B] (last visited Nov. 21, 2024) (offering no direct response to the question "[w]hat are the ways we can ensure a wallet belongs to its rightful owner and represents a unique individual?").

[47] 17 C.F.R. § 240.15c3-1 (2023).

[48] *Id.*

SCWPs work. The wallet platform does not store the private keys of its users nor do any of its user's digital assets move through the accounts of the platform.[49] It is impossible for these platforms to comply with this rule unless they wish to cease their operations and create a custodial platform.

Exchange Act Rule 15c3-3 (the "Customer Protection Rule") requires that brokers have possession or control of all fully paid or excess margin securities held for customers' accounts, and that they determine compliance daily.[50] The rule is intended to prevent brokers from using customer funds to finance their business.[51] However, there is little to no value applying this requirement to SCWPs. The wallet platform never has access to its users' digital assets, unlike custodial intermediaries, and has no ability to exploit the assets of its users without their permission.[52] Compliance would transform a SCWP into a custodial wallet platform, creating the technical ability to accomplish what this rule attempts to avoid.

The aforementioned categories are not exclusive of all the potential issues that SCWPs may face if they attempt to register as a broker. The disclosure-based regime of the SEC as it has been applied to brokers operates under the assumption that brokers act as a custodial intermediary between an issuer, underwriter or customer, and an exchange, such that it is capable of effectuating transactions in securities for the accounts of others. Holding that SCWPs must register with the SEC will not adequately address the unique issues investors face with these wallet platforms. Alternative solutions must be considered.

II.   POLICY PROPOSAL

The 118th Congress (2023-2024) expressed great interest legislating in the field of blockchain technology.[53] The Financial Innovation and Technology for the 21st Century Act ("FIT") sponsored by Representative Thompson, the Digital Asset Market Structure and Investor Protection Act ("DAMS") sponsored by Representative Beyer, and the Lummis-Gillibrand Responsible Financial Innovation Act ("Lummis-Gillibrand") sponsored by the aforementioned Senators offered the most comprehensive views into regulating blockchain technology.[54] These bills addressed wide ranging

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[49] Bowden, *supra* note 39.

[50] 17 C.F.R. § 240.15c3-3(b)(1), (d) (2023).

[51] Div. of Trading & Mkts., *supra* note 45.

[52] Bowden, *supra* note 39.

[53] There have been various proposals legislating blockchain activity including federal government disclosures, securities, commodities, currencies, anti-money laundering, national security, and tax. Cryptocurrency Accountability Bill, H.R. 5050, 118th Cong. (2023); Digital Asset Anti-Money Laundering Act of 2023, S. 2669, 118th Cong. (2023); Lummis-Gillibrand Responsible Financial Innovation Act, S. 2281, 118th Cong. (2023); Clarity for Payment Stablecoins Act of 2023, H.R. 4766 118th Cong. (2023); Financial Innovation and Technology for the 21st Century Act, H.R. 4763, 118th Cong. (2023); Digital Asset Market Structure and Investor Protection Act, H.R. 5745, 118th Cong. (2023); Crypto-Asset National Security Enhancement and Enforcement Act of 2023, S. 2355 118th Cong. (2023).

[54] Lummis-Gillibrand Responsible Financial Innovation Act, S. 2281, 118th Cong. (2023); Financial Innovation and Technology for the 21st Century Act, H.R. 4763, 118th Cong. (2023); Digital Asset Market Structure and Investor Protection Act, H.R. 5745, 118th Cong. (2023).

issues relating to securities, commodities, and anti-money laundering, but none offered specific guidance as to how SCWPs should be regulated. Such guidance should be a priority for the new 119th Congress.

The Department of Treasury may be best suited for regulating SCWPs to accomplish goals relating to cybersecurity, illicit finance, tax and more. Shifting authority away from the SEC pertaining to SCWPs does not stem from a "deregulatory" approach, but rather an approach meant to increase regulatory clarity and promote innovation. The Treasury contains two important divisions: the Financial Crimes Enforcement Network (FinCEN) and the Office of Cybersecurity and Critical Infrastructure Protection (OCCIP).[55] FinCEN is tasked with oversight and enforcement of money laundering, terrorism financing, and sanctions compliance laws as applied to financial institutions.[56] OCCIP, by contrast, coordinates the Treasury's efforts to enhance the security and resilience of critical infrastructure in financial services and reduce risk.[57]

These divisions may offer a more appropriate place in the regulatory puzzle as to who should regulate SCWPs. OCCIP can offer guidance and oversight where the SEC does not have expertise — cybersecurity. Although OCCIP does not have rulemaking authority and may need more from Congress, it does offer guidance as to the best practices of protecting cybersecurity infrastructure.[58] Likewise, FinCEN may be tasked with overseeing SCWPs' compliance with money laundering, terrorism financing and sanctions, however it would need authority it does not already have.[59] This offers a more formidable alternative to SEC regulation, but it raises the

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[55] *Mission*, FIN. CRIMES ENF'T NETWORK, https://www.fincen.gov/about/mission [https://perma.cc/RDQ9-TE8G] (last visited Nov. 21, 2024); *Financial Institutions*, U.S. DEP'T OF THE TREASURY, https://home.treasury.gov/about/offices/domestic-finance/financial-institutions [https://perma.cc/RB8L-6R6Q] (last visited Nov. 21, 2024).

[56] FIN. CRIMES ENF'T NETWORK, *supra* note 55.

[57] U.S. DEP'T OF THE TREASURY, *supra* note 55.

[58] *See* REBECCA RETTIG, ET AL., GENUINE DeFi AS CRITICAL INFRASTRUCTURE: A CONCEPTUAL FRAMEWORK FOR COMBATING ILLICIT FINANCE ACTIVITY IN DECENTRALIZED FINANCE 36–38, (Jan. 29, 2024) (available at https://dcfintechweek.org/wp-content/uploads/2024/09/Paper-Genuine-DeFi-as-Critical-Infrastructure.pdf)[https://perma.cc/9CKV-X9GK].

[59] The BSA, which FinCEN is in charge of enforcing, only applies to "financial institutions." A money transmitter business, which is defined as a "'person wherever located doing business, whether or not on a regular basis or as an organized or licensed business concern, wholly or in substantial part within the United States,' operating directly, or through an agent, agency, branch, or office, who functions as, among other things, a 'money transmitter.'" FinCEN further defines the term "money transmitter" to include a "person that provides money transmission services," or "any other person engaged in the transfer of funds." A "money transmission service" means the "acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means." However, a person who "provides the delivery, communication, or network access services used by a money transmitter to support money transmission services" is exempt. This likely exempts SCWPs because they are "communication" services. FIN. CRIMES ENF'T NETWORK, FINCEN GUIDANCE FIN-2019-G001, APPLICATION OF FINCEN'S REGULATIONS TO CERTAIN BUSINESS MODELS INVOLVING CONVERTIBLE VIRTUAL CURRENCIES (May 9, 2019), at 3–4, 9 (available at https://www.fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf) [https://perma.cc/3FJM-J874] (emphasis deleted); *see also supra* note 58 at 8.

question of whether it is the correct DeFi participant to regulate. Either way, the Treasury must be granted additional authority from Congress before it can build more appropriate regulatory solutions, while still maintaining the benefits of decentralized technology.

One solution is to subject the remote procedure call nodes ("RPC"), which connect DeFi platforms to nodes, rather than SCWPs, to the more intrusive requirements because the RPC is where the transaction is finalized before it is broadcasted to nodes and many RPC-node-as-a-service offerings already implement safeguard requirements.[60] Although users can create their own node, these RPC-node-as-service providers may present a better avenue to tackle the ills of DeFi, while still encouraging the technological innovations of SCWPs.[61] Another possibility is to adopt zero-knowledge proofs that are capable of proving that a given statement is true without revealing identifying information of that party.[62] Whatever the details of the solution encompasses, the Treasury, given their expertise, should play the lead role in paving this way.

III. CONCLUSION

Contrary to the statements of former SEC Chairman Gensler, crypto markets are not perfectly suited for the existing federal securities laws. One court has already ruled that a SCWP is not a broker,[63] and this defeat likely stretches to the vast majority of SCWPs, and for good reason: SCWPs, if regulated as brokers, would be subject to voluminous requirements ill-fitted for open source software platforms that do not operate as intermediaries. The existing framework has worked for intermediaries that exercise substantial control over a customer's funds and can easily verify the identity of their customers. However, subjecting SCWPs to requirements intended for custodial intermediaries is an ineffective approach to mitigate the risks associated with their software and will stifle innovation. Instead, a better solution involves granting greater authority to the Department of Treasury, specifically OCCIP and FinCEN to oversee cybersecurity infrastructure of SCWPs and protect against illicit financial activity.

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[60] *Supra* note 58, at 14, 17.

[61] *See id.* at 17.

[62] Veridise, *Zero Knowledge for Dummies: Introduction to ZK Proofs*, MEDIUM (Aug. 24, 2023), https://medium.com/veridise/zero-knowledge-for-dummies-introduction-to-zk-proofs-29e3fe9604f1 [https://perma.cc/NC22-EDLE].

[63] SEC v. Coinbase, Inc., No. 23-4738, 2024 U.S. Dist. LEXIS 56994, at *3 (S.D.N.Y. Mar. 27, 2024).