

MEMORANDUM

To: Crypto Task Force Meeting Log
From: Crypto Task Force Staff
Re: Meeting with Representatives of Dragonfly

On May 23, 2025, Crypto Task Force Staff met with representatives from Dragonfly.

The topic discussed was approaches to addressing issues related to regulation of crypto assets. Dragonfly representatives provided the attached document, which was discussed during the meeting.

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April 14, 2025

BY ELECTRONIC SUBMISSION

Crypto Task Force
U.S. Securities and Exchange Commission
100 F Street, N.E.,
Washington, D.C. 20549

RE: Crypto Task Force Meeting

Dear Commissioner Peirce and Members of the SEC Crypto Task Force:

Dragonfly Digital Management, LLC (“Dragonfly”) respectfully requests the opportunity to meet with the Securities and Exchange Commission (“SEC”) Crypto Task Force to discuss potential cryptocurrency regulatory recommendations. Founded in 2018, Dragonfly is a global, crypto-focused venture investment firm that manages approximately \$3 billion in assets for private funds and institutional clients.

INTRODUCTION

Given Dragonfly’s significant involvement in the cryptocurrency market, we bring a grounded perspective on the practical impacts of current and potential regulations. Our aim for this meeting is not only to share insights from our extensive experience but also to collaborate on developing regulations that support innovation while ensuring market stability and protecting capital. This dialogue will cover crucial topics within the cryptocurrency sector, particularly focusing on the integration and regulation of algorithmic stablecoins and airdrops.

PROPOSALS

I. Algorithmic Stablecoins

A. Self-Regulatory Measures

II. Airdrops

- A. Clarify that Crypto Airdrops are Not a Securities Transaction*
- B. Establish a Regulatory Safe Harbor for Non-Fundraising Use Cases*
- C. Expand Rule 701 to Apply to Participants in a Platform*
- D. Establish a Regulatory Safe Harbor to Grandfather in Prior Airdrops*

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DISCUSSION

I. Algorithmic Stablecoin

Algorithmic stablecoins offer an innovative solution to the challenges posed by volatility in the cryptocurrency market. By leveraging mathematical algorithms to automatically adjust supply and demand, they aim to maintain price stability without relying on traditional collateral.¹ As the technology evolves, algorithmic stablecoins have the potential to become key components of the crypto ecosystem, providing tools for financial stability, decentralized governance, and user empowerment. Their benefits—such as automated supply control, decentralized structures, and resilience during market swings—make them particularly valuable to crypto startups.² To foster responsible innovation, it is essential to establish regulatory frameworks that allow for the development of algorithmic stablecoins paired with safeguards like transparency, auditability, and risk management.

A. Self-Regulatory Measures

Private sector-established standards and rules, often called “Soft Laws,” can be more effective than congressional legislation because they are easier and quicker to update. Specifically, industry standards can more rapidly adapt to changing conditions than formal regulations – making them better suited to keeping pace with rapidly changing fields like cryptocurrency. Algorithmic stablecoins, in particular, should be guided by self-regulatory disclosures rather than agency enforcement or prescriptive legislation.

Self-regulation has been effective in other industries. For example, the payment card industry adheres to the Payment Card Industry Data Security Standard (“PCI DSS”), which mandates compliance for any entity handling cardholder data and is periodically updated.³ Another example is the Service Organization Control 2 (“SOC 2”) compliance standard set by the American Institute of Certified Public Accountants (“AICPA”).⁴ Unlike the PCI DSS, SOC 2 is voluntary, signaling a company’s commitment to data security and privacy, which helps build legitimacy and trust.⁵

¹ Michelle Legge, Algorithmic Stablecoins, KOINLY (Nov. 9, 2023), <https://koinly.io/crypto-glossary/algorithmic-stablecoin/#:~:text=Algorithmic%20stablecoins%20offer%20potential%20benefits,in%20times%20of%20market%20volatility.>

² *Id.*

³ PCI Security Standards Council, PCI SECURITY STANDARDS COUNSEL https://www.pcisecuritystandards.org/about_us/ (last visited Mar. 24, 2025); *PCI DSS Quick Reference Guide*, PCI SECURITY STANDARDS COUNSEL (2018), https://listings.pcisecuritystandards.org/documents/PCI_DSS-QRG-v3_2_1.pdf.

⁴ SOC 2® - SOC for Service Organizations: Trust Services Criteria, AICPA & CIMA, <https://www.aicpacima.com/topic/audit-assurance/audit-and-assurance-greater-than-soc-2> (last visited Mar. 24, 2025); *What Is SOC 2 Compliance, and Why Is It Important?*, U. OF TULSA (Jan. 4, 2024), <https://online.utulsa.edu/blog/what-issoc-2-compliance/>.

⁵ SOC 2® - SOC for Service Organizations: Trust Services Criteria, AICPA & CIMA, <https://www.aicpacima.com/topic/audit-assurance/audit-and-assurance-greater-than-soc-2> (last visited Mar. 24, 2025); *What Is SOC 2 Compliance, and Why Is It Important?*, U. OF TULSA (Jan. 4, 2024), <https://online.utulsa.edu/blog/what-issoc-2-compliance/>.

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Similar to those industries, algorithmic stablecoins should have their own self-regulation standard. At a high level, those standards could be the following:

- **Transparency:** All relevant materials should be made available online to allow for external auditing. This includes full disclosure of the code, operations, and any updates or changes that are made, enabling anyone interested to audit the code and verify that it functions as intended. Such openness not only fosters trust but also encourages community engagement and feedback, which can lead to improvements in the stablecoin's design and functionality.
- **Disclosures:** There should be detailed disclosures concerning the underlying algorithm of the stablecoin. This includes a comprehensive description of its design, functionality, and any specific conditions or triggers that could alter its behavior. Additionally, there must be a clear disclosure of any reserves held to back the stablecoin, including how these reserves are managed and the conditions under which they are used or replenished. This level of detail ensures that all stakeholders have a thorough understanding of how a specific stablecoin maintains its value and manages its reserve assets.
- **Audits:** To maintain and enhance trust among users and investors, there should be regular, independent audits of the stablecoin's code, financial health, and reserve status. These audits help ensure ongoing transparency and build confidence in the stablecoin's operations. Moreover, regular security audits of the technology used in the stablecoin's operations are essential to safeguard against vulnerabilities and protect the interests of all parties involved.
- **Risk Management Standards:** There should be robust procedures in place to identify, manage, and mitigate risks associated with the algorithmic mechanisms driving the stablecoin. This includes preparing for extreme market conditions and ensuring that there are strategies in place to respond effectively to market volatility and other financial stresses.
- **Conflict of Interest Policies:** Clear guidelines should be established to manage and disclose any conflicts of interest that might unduly influence the management of the stablecoin. This policy is crucial to ensuring that decisions are made in the best interest of all stakeholders and maintaining the integrity of the stablecoin's operations.
- **Redress Mechanisms:** There must be straightforward procedures for users to report issues to the community and resolve conflicts regarding the stablecoin's operation or its management. There are decentralized mediation mechanisms available for more decentralized projects. These mechanisms ensure that users feel secure and supported, knowing that there are avenues available for addressing and resolving any concerns or grievances.
- **Regular Testing:** The performance of the stablecoin should be tested periodically under various economic scenarios to ensure that it can maintain stability even under stress. These tests help identify potential weaknesses in the stablecoin's design and operational strategy, allowing for timely adjustments to enhance resilience and reliability.

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II. Airdrops⁶

Airdrops are an essential element of the cryptocurrency ecosystem. They spark excitement and enhance awareness by spurring engagement, distributing tokens, reinforcing tokenomics, and promoting decentralization. They drive adoption by incentivizing usage and fostering engagement. This creates a win-win dynamic—projects gain visibility and user participation while recipients benefit from free tokens—ultimately strengthening the blockchain ecosystem. That is why it’s essential to establish clear parameters around airdrops.

A. Clarify that Crypto Airdrops are Not a Securities Transaction

Airdrops should not be classified as securities transactions. Previously, the SEC has adopted the position that airdropped tokens constitute investment contracts—and therefore unregistered securities—a stance reflected in numerous enforcement actions and informal guidance.⁷ However, unlike traditional securities offerings designed for capital-raising, airdrops are usually intended to promote network engagement by distributing tokens for free.⁸ Therefore, applying securities laws to airdrops mischaracterizes their purpose and places unnecessary regulatory burdens on many blockchain projects.

Under the *Howey* test, airdrops fail to meet key criteria:

1. **No Investment of Money (“Prong 1”)**: A core element of the *Howey* test is an “investment of money” with the intention of generating income or profit, thereby establishing a direct link between the funds invested and the anticipated returns.⁹ However, in the case of airdrops, tokens are distributed without any requirement for recipients to provide financial consideration. Minimal actions, such as registering an account, do not constitute a financial investment, aligning airdrops more closely with promotional activities than securities transactions.
2. **Lack of a Common Enterprise (“Prong 2”)**: For an arrangement to qualify as a security, it must involve a “common enterprise,” which requires a shared financial relationship among participants and a pooling of financial resources among participants. This can manifest as either horizontal commonality—where investors pool their resources into a single venture, tying their fortunes to one another¹⁰—or vertical commonality—where an investor’s financial success is directly linked to the efforts or success of the promoter or

⁶ Jessica Furr et al., *Dragonfly’s State of Airdrops Report 2025*, DRAGONFLY (Mar. 11, 2025), <https://airdropreport2025.dragonfly.xyz/Dragonfly-s-State-of-Airdrops-Report-2025-1b1af13b644180c8aff9c2bd0d222e14>.

⁷ SEC, Statement, Statement on “Framework for ‘Investment Contract’ Analysis of Digital Assets” (Apr. 3, 2019), <https://www.sec.gov/about/divisions-offices/division-corporation-finance/framework-investment-contract-analysis-digital-assets>; Press Release, SEC, SEC Bars Perpetrator of Initial Coin Offering Fraud (Aug. 14, 2018), <https://www.sec.gov/newsroom/press-releases/2018-152>.

⁸ Benjamin Van Adrichem, *Howey Should Be Distributing New Cryptocurrencies: Applying the Howey Test to Mining, Airdropping, Forking, and Initial Coin Offerings*, 20 COLUM. SCI. & TECH. L. REV. 388 (2019).

⁹ SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

¹⁰ Hart v. Pulte Homes of Michigan Corp., 735 F.2d 1001, 1004 (6th Cir. 1984); Salcer v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 682 F.2d 459, 460 (3d Cir. 1982); Milnarik v. M-S Commodities, Inc., 457 F.2d 274, 276 (7th Cir.).

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issuer.¹¹ Airdrops, however, distribute tokens independently, with no pooled financial interest or interdependent risk among recipients, thereby lacking the common enterprise element. Regarding horizontal commonality, airdrops distribute tokens directly to individual recipients without requiring any contribution of funds, effort, or resources from the recipients. There is no pooling of assets or shared risk, as each recipient's fortunes remain entirely independent of others. For vertical commonality, there is no investment by the recipient as they don't pay any money, so there can't be any dependence upon the promoter, given there is no investment in the first place.

3. **No Expectation of Profits (“Prong 3”)**: Securities typically imply an expectation of profit derived from the promoter's or a third party's efforts. In contrast, airdropped tokens are often intended for consumptive use within a platform and not investment purposes. Tokens may grant users access to platform-specific features for participation purposes, such as voting on governance proposals or paying for services. While some recipients may choose to sell them, any potential profit stems from market forces rather than the issuer's active promotion, eliminating this criterion of the *Howey* test.
4. **Non-Reliance on Issuer's Efforts (“Prong 4”)**: Recipients of airdropped tokens are not reliant on the issuer's actions to increase token value. Unlike securities, which often depend on ongoing management to maintain or increase value, airdropped tokens fluctuate based on external market factors, further distinguishing them from securities. Additionally, any efforts that do arise come solely from the individuals receiving the airdropped tokens rather than from the platform or project itself.

B. Establish a Regulatory Safe Harbor for Non-Fundraising Use Cases

Airdrops, in many instances, differ fundamentally from traditional fundraising mechanisms such as initial public offerings (“IPOs”) or Initial Coin Offerings (“ICOs”). Rather than being used to raise capital, airdrops are often employed to generate a “flywheel effect,” building momentum and attracting a user base for a new technology or ecosystem. The goal of airdrops is to encourage community participation, engagement, and early adoption rather than financial gain. Given these unique characteristics, there is an opportunity to establish a safe harbor for airdrops based on network effects.

We propose a regulatory safe harbor specifically tailored for airdrops that are not intended as fundraising tools. This safe harbor would support projects where the airdrop serves distinct purposes, such as:

- **Decentralizing Ownership**: Airdrops should distribute tokens across a broad range of addresses to encourage decentralization and prevent concentrated control over the network.

¹¹ There are two types of vertical commonality: ‘broad vertical commonality’ and ‘strict vertical commonality’. For ‘broad vertical commonality’, you need to link investors' fortunes to the promoter's *efforts*. See *Long v. Shultz Cattle Co., Inc.*, 881 F.2d 129, 140-41 (5th Cir. 1989). For ‘strict vertical commonality’, you need to establish that investors' fortunes are linked to the promoter's *fortunes*. See *Brodt v. Bache & Co., Inc.*, 595 F.2d 459, 461 (9th Cir. 1978).

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- **Consumptive Use – Not Investment:** Mirroring the SEC’s approach in instances like TurnKey Jet¹² and Pocket Full of Quarters,¹³ tokens that are intended for consumptive use rather than investment would be eligible. Examples include tokens redeemable for specific services like air charter or video game-related purchases.

Additionally, the safe harbor would include the following criteria:

1. **Issuer Disclosure:** Issuers must provide clear, comprehensive information about the tokenomics (e.g., supply, distribution), governance mechanisms, potential risks for recipients, and any restrictions on token use or lock-ups.
2. **Lock-Up for Insiders:** To address potential issues of front-running or insider trading, insiders must adhere to at least a three-month lock-up period.
3. **Consideration:** Tokens should be distributed in exchange for non-monetary contributions, such as services rendered, participation in network activities, or eligibility based on prior holdings. Direct financial transactions for tokens would disqualify the airdrop from safe harbor consideration.
4. **Prohibition of Fraud and Market Manipulation:** Airdrops would be subject to strict rules against fraudulent activities and market manipulation.
5. **No Cap on User Numbers and Airdrop Value:** To ensure broad access and equitable participation, there should be no imposed limits on the number of users or the total value of the airdropped tokens.
6. **Functional Protocol Post-Token Launch:** The underlying platform and token must be operational and functional at the time of the token launch to ensure viability and utility.

Regulators can create a safe harbor that encourages innovation while addressing risks. This adapted approach would recognize the unique role airdrops play in fostering decentralized networks and promoting equitable participation, steering clear of over-regulation that stifles growth.

We’re not alone in recommending a safe harbor. LeXpunk has proposed a “Safe Harbor X” framework that exempts qualifying distributions of autonomous crypto tokens from SEC registration requirements under specific conditions.¹⁴ This approach emphasized transparency, requiring detailed disclosures about token economics, governance mechanisms, and transaction history while mandating a 12-month lock-up period for tokens held by the initial development team.¹⁵

By focusing on free token distributions for participation and development rather than capital-raising, the proposal aims to foster innovation within clear regulatory boundaries. Such

¹² SEC, TurnKey Jet, Inc., Response of the Division of Corporation Finance (Apr. 3, 2019), <https://www.sec.gov/divisions/corpfin/cf-noaction/2019/turnkey-jet-040219-2a1.htm>.

¹³ SEC, Pocketful of Quarters, Inc., Response of the Division of Corporation Finance (July 25, 2019), <https://www.sec.gov/corpfin/pocketful-quarters-inc-072519-2a1>.

¹⁴ *lex-node/SafeHarbor-X*, GITHUB, <https://github.com/lex-node/SafeHarbor-X/>, (last visited Jan. 23, 2025).

¹⁵ *Id.*

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frameworks demonstrate how temporary and targeted exemptions can balance the need for oversight with the flexibility necessary to encourage technological progress.

C. Expand Rule 701 to Apply to Participants in a Platform

Rule 701 of the Securities Act is an exemption that allows private companies not subject to specific public reporting requirements to issue securities as compensation to employees, consultants, and advisors.¹⁶ Traditionally, this rule has been vital for startups and private companies that wish to compensate their service providers with options, restricted stock, and other equity instruments without undergoing the extensive disclosures typically required for public offerings.

One alternative recommendation to our proposed safe harbor is the expansion of Rule 701 to include tokens, particularly those distributed via airdrops or as compensation for service provision by platform workers. This adaptation would address the changing nature of work and compensation in the technology-driven marketplace.

The SEC has already explored the potential for Rule 701’s expansion to cover “platform workers” — individuals who provide services available through a technology-based platform or system—in proposed rulemaking in 2020.¹⁷

The extension of Rule 701 to cover tokens would allow companies to legally distribute these digital assets as part of compensation packages to those who contribute to the creation of the protocol from outside the development company, i.e., those who may not necessarily fit into the traditional employee or consultant categories as currently defined under Rule 701. This would facilitate broader and more equitable participation in the growth and success of technology platforms, aligning the interests of platform participants with those of the company.

D. Establish a Regulatory Safe Harbor to Grandfather in Prior Airdrops

Given the evolving nature of regulatory landscapes, projects that have already conducted airdrops to U.S. persons often face legal uncertainties that could threaten their continued operation and innovation. To address this, Congress should consider establishing a safe harbor that retroactively applies to prior airdrops. This provision would allow projects that have previously distributed digital assets through airdrops to U.S. persons to regularize their status without the risk of enforcement actions, provided they meet certain conditions.

Under this safe harbor, projects would need to demonstrate compliance with a set of basic disclosure and operational standards retroactively. These might include providing historical transaction data, demonstrating the utility of the tokens within their ecosystems, and demonstrating their disclosures. This protection would last for a specified period, during which these projects could align with current regulatory expectations without fearing retrospective penalties. Moreover,

¹⁶ Securities Act of 1933, Rule 701, 17 C.F.R. § 230.701.

¹⁷ Securities Act of 1933, Rule 701, 17 C.F.R. § 230.70; Press Release, SEC, SEC Proposes Amendments to Modernize Framework for Securities Offerings and Sales to Workers (Nov. 24, 2020), <https://www.sec.gov/newsroom/press-releases/2020-294>.

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the SEC has broad statutory authority to exempt securities transactions from registration, which makes no distinction between proactive or retroactive exemptions.¹⁸

Thank you for considering our perspectives on crypto regulation and the evolving web3 industry. We would welcome the opportunity to engage further with the SEC Crypto Task Force and its staff to help shape a practical and forward-looking regulatory framework that fosters innovation and supports the growth of this emerging sector.

Yours sincerely,

Jessica Furr

Jessica Furr
Associate General Counsel

Lindsay Lin

Lindsay Lin
Chief Operating Officer

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Jane Perov

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Legal Intern

¹⁸ 15 U.S.C. § 77z-3.

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Agenda

We are requesting a meeting with the Crypto Task Force to discuss the following topics:

- I. Algorithmic Stablecoins**
- II. Airdrops**

Please see the attached letter for a more detailed discussion of the above-referenced topics.

Attendees

Jessica Furr (Associate General Counsel), Lindsay Lin (Chief Operating Officer), Bryan Edelman (Associate General Counsel), and Jane Perov (Legal Intern)