



1177 Avenue of the Americas, 5th Floor
New York, NY 10036

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By Electronic Submission

Vanessa A. Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Regulation Crypto Assets, Release Nos. 33-11434; 34-106150; File No. S7-2026-27 – Supplemental Comment on Functionality

Dear Ms. Countryman:

Ava Labs, Inc. is please to submit this second comment letter on proposed Regulation Crypto Assets (“Reg Crypto”). Our prior letter proposed a narrower definition of crypto asset.¹ We write this new letter because the FAQs published on September 25 (as revised on September 28), combined with language from the preamble of the Reg Crypto proposing release and the March 2026 Joint Interpretation with the CFTC, set a clear path for an additional rule in Subpart D of Reg Crypto concerning functionality and the termination of covered investment contracts (“CICs”).

In particular, we recommend that the Commission, as part of Reg Crypto, adopt Rule 401 and accompanying definitions providing that a CIC ceases to exist once the associated crypto network or associated crypto application is functional and not controlled. New Rule 401 would not replace or modify proposed Rule 400, but would codify analysis and conclusions the Commission has already drawn.

Across the 3 statements and releases referenced above, the Commission has explained why a functional crypto system without a controlling central party does not support a reasonable expectation of profits derived from the essential managerial efforts of others. It has defined functionality, and it has defined the absence of control. Given the already-settled state of its views, codification is the natural next step. Because we recommend an additional rule, we begin this letter with the proposed text.

¹ Letter from Ava Labs, Inc., File No. S7-2026-27 (Sept. 2026).

Subsequent section provide the background, rationale and discussion. We appreciate this opportunity to present further comments and propose Rule 401, based on the Commission's hard work.

I. Proposed Text

The proposed text would add two new definitions ("functional" and "not controlled") and new Rule 401 applying those definitions to create a test for the termination of a CIC and the separation of the underlying crypto asset therefrom.

The proposed text draws directly from the Commission's prior statements and releases. The definition of "functional" is taken from the March 2026 Joint Interpretation with some wordsmithing to conform to rule text conventions. "Not controlled" adapts the definition of "decentralized" from the same release, with added language to make it a test of control by a central party, as further described in Section IV.B.

The "functionality without control" test uses the Commission's own statements on the separation question in the Reg Crypto proposing release preamble and the staff's usage of that same standard in its September 25 FAQs. Section II discusses and quotes those materials in detail. Our proposal adds disclosure and certification mechanisms as means to publicize termination of the CIC and separation of the crypto asset.

In Rule 100, add the following definitions:

Functional. *An associated crypto network or associated crypto application is "functional" if the subject crypto asset can be used on such network or application in accordance with such crypto asset's programmatic utility for such network or application.*

Not controlled. *An associated crypto network or associated crypto application is "not controlled" if it functions and operates autonomously, with no person, entity, or group of persons or entities having operational, economic, or voting control over the custody of assets, the ordering, modification or finality of transactions, or changes in balances.*

In Subpart D, add the following rule:

§ 228.401 Cessation upon functionality without control.

(a) Cessation. *A covered investment contract ceases to exist, and the crypto asset that was subject to it does not constitute or represent nor is it subject to that investment contract for purposes of section 2(a)(1) of*

the Securities Act (15 U.S.C. 77b(a)(1)) and section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)), when the associated crypto network or associated crypto application is functional and not controlled. Neither a public statement under paragraph (b) of this section nor a certification under paragraph (e) of this section is a condition to cessation under this paragraph (a).

(b) Public statement. Any of the following persons may publish on a publicly available website a statement that the conditions in paragraph (a) of this section are satisfied:

- (1) the issuer or an affiliate of the issuer;*
- (2) a person that developed or maintains the software for the associated crypto network or associated crypto application;*
- (3) a foundation, association, or decentralized autonomous organization organized to support the associated crypto network or associated crypto application;*
- (4) an exchange, broker, dealer, or other venue, or the equivalent of any of the foregoing, in each case regulated by the Commission, by the Commodity Futures Trading Commission, or by a State, that makes the subject crypto asset available for trading; or*
- (5) a person that operates validation or consensus infrastructure for the associated crypto network or associated crypto application.*

(c) Contents of a public statement. A statement published under paragraph (b) of this section must identify the subject crypto asset and the associated crypto network or associated crypto application; identify the publisher and the capacity in which it publishes; state the date on which each condition in paragraph (a) was satisfied; and briefly describe how functionality was achieved and the circumstances establishing that the network or application is not controlled.

(d) Effect of a public statement. A statement published in accordance with paragraphs (b) and (c) of this section creates a rebuttable presumption that the conditions in paragraph (a) were satisfied as of the date stated. A person who is neither the publisher nor an affiliate of the

publisher may rely on that presumption absent knowledge that the statement is materially false or misleading, or awareness of a conflicting public statement by one or more of the persons identified in paragraph (b) rebutting or calling into question the material conclusions of the statement published in accordance with paragraphs (b) and (c) of this section.

(e) Optional certification. An issuer or an affiliate of an issuer may file a transition report on Form TR certifying that the conditions in paragraph (a) of this section are satisfied and containing the information in paragraph (c) of this section.

(f) No effect on other liability. Cessation under this section does not affect liability under the antifraud or antimanipulation provisions of the Federal securities laws.

In plain terms, Rule 401 does three things. It codifies another route to cessation, one that turns on the condition of the network or application rather than the conduct or promises of a person. It makes that route self-executing, so that a crypto asset does not remain subject to an investment contract merely because no one filed a form or published information. Finally, it makes disclosure optional but meaningful, by giving a public statement legal weight without making it a precondition to cessation.

The balance of this letter explains why each of those choices follows from what the Commission has already said.

II. The Commission Has Supplied the Analysis and Standards for Rule 401

A. A functional crypto system without a central party defeats Howey. In Section III of the March 2026 Joint Interpretation, the Commission resolved the question of reasonable expectations directly:

A functional crypto system does not have a central party that oversees participation or distributes rewards to users. As a result, the value of a digital commodity is intrinsically linked to the programmatic functioning of the associated functional crypto system. Therefore, given that a digital commodity is associated with a functional crypto system, a purchaser would not reasonably expect to profit based on the essential managerial efforts of others.²

² *Application of the Federal Securities Laws to Certain Types of Crypto Assets and Certain Transactions Involving Crypto Assets*, Securities and Exchange Commission and Commodity

The preamble to proposed Reg Crypto applies the same reasoning to the separation of the crypto asset from the investment contract. The Commission explains that once the network or application is functional, services to “secure, maintain, improve, or enhance” it, or to “facilitate network effects,” do not constitute essential managerial efforts, and that representations or promises to provide such services after functionality “would not satisfy the *Howey* test.”³ As the preamble explains, the asset by then derives its value “from the programmatic operation of the associated crypto network or associated crypto application, as well as the market’s supply and demand dynamics.”⁴ The release then directly draws the contrast with a prefunctional network or application: “Prior to functionality, however, such services are provided or coordinated by the issuer and likely constitute essential managerial efforts.”⁵

In addition to the March 2026 Joint Interpretation and the language of the preamble to Reg Crypto, on September 25 (supplemented on September 28), the staff of the Division of Corporation Finance reaffirmed the analysis and confirmed which sense of the word “functionality” governs it. Restating the proposing release’s conclusion, the staff explained in a footnote that the analysis “is based on the crypto system being ‘functional,’” and that for those purposes “the term ‘functional’ has the meaning ascribed to such term in Section III of the [March 2026 Joint Interpretation].”⁶ The operative standard for functionality and lack of control that defeats *Howey* is therefore the Commission’s, not the issuer’s.

The staff then applied the same principle twice more, and in doing so made the two-element (functional and not controlled) character of the test explicit. Asked whether an issuer’s later statements could create a new investment contract, it answered that “[o]nce a functional crypto system has no central party,” such statements “likely would not create a new investment contract because neither the issuer nor any other person has control of the functional crypto system that would allow them to take any action which would affect the failure or success of the crypto system.”⁷ Asked

Futures Trading Commission, Release Nos. 33-11412; 34-105020; File No. S7-2026-09 (Mar. 17, 2026), 91 FR 13714 (Mar. 23, 2026) (“March 2026 Joint Interpretation”), section III.A.

³ Proposing Release at 56-57, 91 FR at 54525.

⁴ *Id.* at 57.

⁵ *Id.* at 58.

⁶ SEC Div. of Corp. Fin., *Frequently Asked Questions on the Application of the Federal Securities Laws to Certain Types of Crypto Assets and Certain Transactions Involving Crypto Assets* (Sept. 25, 2026) (“FAQs”), Question 2.3 and n.2.

⁷ FAQs, Question 2.4.

whether announcing a buyback program constitutes a representation or promise to undertake essential managerial efforts, it drew the line in the same place: “[w]here a crypto system is functional and has no central party,” such an announcement “would not constitute a representation or promise to undertake essential managerial efforts,” while “[w]here a crypto system is not functional,” it “could.”⁸

The second of those answers is worth focusing on because of the September 28 revision that added the words “and has no central party.”⁹ The amendment confirms that the pairing is deliberate. In the staff’s considered view, which echoes the Commission’s own statements in the Reg Crypto preamble, the conclusion rests on both elements together.

Across the March 2026 Joint Interpretation, the preamble to this proposal, and three staff answers, functionality together with the absence of control is treated as determinative of the *Howey* question. This consistency deserves the status of a rule, not merely guidance and interpretation.

B. By defining and applying both terms, the Commission has laid the groundwork for Rule 401. In the March 2026 Joint Interpretation, the Commission explained that “a crypto system is ‘functional’ if the system’s native crypto asset can be used on the system in accordance with the programmatic utility of the system.”¹⁰ In the adjacent footnote, it explained that “a crypto system is ‘decentralized’ if the crypto system functions and operates autonomously with no person, entity, or group of persons or entities having operational, economic, or voting control of the crypto system.”¹¹

What distinguishes these definitions from the standard in proposed Rule 400(a) is that they describe the condition of a network rather than the conduct or intentions of a person. A market participant can evaluate them by examining the protocol and its operation. They do not require reconstructing an issuer’s public statements, they do not turn on what a particular issuer meant by a word it used in marketing materials, and they produce the same answer regardless of who is asking.

⁸ FAQs, Question 2.5 (as revised Sept. 28, 2026).

⁹ The staff noted the change as “Updated Sept. 28, 2026, to add ‘and has no central party.’” A comparison to the prior version is available at <https://www.sec.gov/files/frequently-asked-questions-application-federal-securities-laws-certain-types-crypto-assets-certain.pdf>.

¹⁰ March 2026 Joint Interpretation, at n.49.

¹¹ *Id.* at n.50.

In Request for Comment 131, the Commission asks whether there is “a more objective standard” available for use in Rule 400(a).¹² We read that question as an indication that the Commission is open to objectivity in this area, and we believe the Commission has already written the standard it was looking for. It has provided the definitions and explained the analysis. Proposed Rule 401 is the logical outcome.

III. Our Proposed Rule 401 Adds to Rule 400 Rather Than Changing It

We want to be clear that we are not asking the Commission to modify proposed Rule 400(a), to drop the transition report requirement in Rule 400(b), or to revise Form TR's existing structure. Our recommendation is a nonexclusive addition that would sit beside Rule 400.

The reason is simple. Rule 400 measures what an issuer promised and whether the issuer delivered. Rule 401, using the Commission's own definitions and analysis, is independent and rests on objectively observable technological parameters about the condition of the network or application: once a crypto system is functional and no one controls it, there are no essential managerial efforts from which a purchaser could reasonably expect to profit. A rule codifying that conclusion is therefore doing different work than proposed Rule 400.

In other words, proposed Rule 400 operationalizes one aspect of the Commission's analysis, while our proposed Rule 401 operationalizes the other. The staff confirmed the separation of the two inquiries on September 25, explaining that the Commission's definitions “are not relevant to whether an issuer has fulfilled its representations or promises.”¹³ Request for Comment 125 invites recommended changes to Rule 400, and we offer this proposal as a nonexclusive addition to Subpart D rather than a change to the rule the Commission has proposed.¹⁴

IV. Applying the Conditions

A. Functionality. The definition we propose tracks footnote 49 of the March 2026 Joint Interpretation verbatim, adapted only to the defined terms used in proposed Reg Crypto. It asks a single question: can the subject crypto asset be used on the network or application in accordance with that network's or application's programmatic utility? That question is answered by observing the network.

¹² Proposing Release, Request for Comment No. 131.

¹³ FAQs, Question 1.1.

¹⁴ Proposing Release, Request for Comment No. 125.

B. Not Controlled. The Commission describes this element in several ways: as the absence of a “central party,” as a system that is “decentralized,” and as the absence of “operational, economic, or voting control.” We build on the last of these because it is the one the Commission defined in more detail. Footnote 50 describes control without identifying what must be controlled, and supplying that detail preserves the Commission’s formulation while making it possible to apply consistently. It is the one place where we suggest adding to the Commission’s language rather than adopting it as written. We propose specifying control over the custody of assets, the ordering, modification¹⁵ or finality of transactions, or changes in balances. Applied to the situations market participants encounter most often:

- **A foundation holding 20% of the token supply** would not result in a controlled network or application, unless such large holding confers power over custody, ordering, modification, finality, or balances.
- **A retained upgrade key** would not make for a controlled network or application unless it allows for the altering of custody, ordering or finality of transaction, or changes in balances. If, for example, it reaches only a fee parameter or a peripheral module, the network or application would not be controlled.
- **A four-of-seven multisig** would constitute control if it governs the token contract’s mint function, which could change balances, but not if it governs grants from a DAO treasury.

Each of these questions can be answered by examining the code and the distribution of keys and validators. None requires information that only the issuer possesses, which means an exchange, a custodian, or a holder can reach the same conclusion objectively, consistently and independently. Rather, the hallmarks can be assessed through reasonably available technical and operational evidence, allowing independent participants to support a conclusion without depending on the original issuer’s cooperation or accounts of its statements across various sources.

It is worth noting what this formulation excludes. Concentration of holdings, standing alone, does not constitute control. We believe that is the correct result.¹⁶ *Howey* asks whether purchasers reasonably expect profits to be derived from the essential managerial efforts of others, and a large holder who cannot direct the network is not

¹⁵ Modification refers to changing a transaction that a user has submitted.

¹⁶ We have discussed these points in a blog post, available at <https://www.avalanchepolicy.com/en/articles/defi-governance-is-a-question-of-concentration-not-decentralization/>.

performing managerial efforts. Concentration may raise market-structure questions, but those are distinct from the classification question that termination of the CIC is meant to resolve.

V. Self-Execution and Optional Disclosure

An investment contract exists, or does not, because of the economic reality of the arrangement. It does not come into being because a document was filed, and it should not persist merely because one was not. The Commission has identified a related concern in Request for Comment 134, which asks whether parties will decline to use the safe harbor because doing so may require “a tacit admission that the crypto asset previously was subject to an investment contract and that the party relying on the safe harbor was the issuer for such investment contract.”¹⁷ A rule keyed to the condition of the network asks for no concession about the past, and so presents no such obstacle.

One might suggest that making cessation self-executing means the rule would operate silently and unlike the Commission’s purpose for Form TR to “apprise investors, the Commission, and the public.”¹⁸ This is not the case for two reasons. First, the requirements are objectively observable, as discussed above. Second, our proposal includes a disclosure route.

Any of the persons listed in paragraph (b) may publish a statement that the conditions are met, identifying itself and the capacity in which it publishes, and publication gives rise to a rebuttable presumption on which unaffiliated participants may rely. That creates a strong incentive to disclose, because a public statement is what allows intermediaries, users and others to act with confidence, while ensuring that an asset with no one left to speak for it is not stranded.

The presumption is safe because the underlying conditions are independently verifiable. Every eligible publisher has an interest in cessation having occurred, but none can manufacture it, and anyone relying on a statement can check the code, the keys and the validator set. The proposal also recognizes that contradictory public statements may exist. Such a situation does not change cessation of the CIC, but does change the ability to rely on the public statement claiming cessation.

¹⁷ Proposing Release, Request for Comment No. 134.

¹⁸ *Id.*, section II.D.2, at 166.

VI. Why This Belongs as a Rule

Rule text has binding, lasting effect. An interpretation, a preamble discussion, and a staff FAQ do not. The FAQs say as much themselves, stating that they have “no legal force or effect, do not alter or amend applicable law, and do not create any new or additional obligations for any person.”¹⁹ A future Commission may set aside a preamble discussion or a staff position without notice and comment; amending or eliminating a rule requires adherence to the Administrative Procedure Act.

The Commission recognizes this distinction in the Reg Crypto proposal. Rather than leave the separation standard just in the March 2026 Joint Interpretation, it proposes that Rule 400 “codify this portion of the 2026 Interpretation in a safe harbor.”²⁰ And where it has expressed a view outside the rules, it has asked whether that view should be codified.²¹ Having already done the analytical work and supplied the definitions, the Commission should take the same step with the termination of a CIC.

Nor does our proposal require additional authority. Proposed Rule 400 would deem a crypto asset “not to constitute or represent or to be subject to that investment contract for purposes of section 2(a)(1) of the Securities Act . . . and section 3(a)(10) of the Exchange Act.”²² We propose Rule 401 as a companion trigger for that determination, based on the Commission’s own reasoning and definitions.

VII. A Note on Terminology

Adopting this recommendation would place the term “functional” in the rules, and we encourage the Commission to resolve a related ambiguity at the same time.

The word already carries two meanings in the Commission’s discourse. In footnote 49 of the March 2026 Joint Interpretation, it describes an objective characteristic of a crypto system, defined by the Commission and applied by it in the analysis discussed above. In footnote 96 of the same release, it describes whatever a particular issuer meant by the word: “if the issuer represents or promises to achieve certain functionality for a crypto asset and its associated crypto network, whether the issuer has achieved functionality would be based on how the issuer defined or otherwise

¹⁹ FAQs, introductory note.

²⁰ Proposing Release, section II.D.1, at 164.

²¹ *Id.*, Request for Comment No. 45.

²² Proposed 17 CFR 228.400.

described functionality, not a general market conception of what constitutes functionality.”²³

The staff confirmed that the two inquiries are distinct, explaining that the Commission's definitions “are not relevant to whether an issuer has fulfilled its representations or promises.”²⁴

Under the text we propose, those two inquiries would sit in neighboring provisions of Subpart D, and an issuer that promised to “achieve functionality” would present both at once.

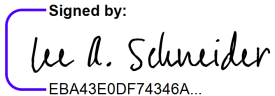
We recommend that the Commission reserve “functional” for the technology analysis, and use different language for analyzing what an issuer undertook to do. For example, the Commission could refer to the issuer’s “represented development objectives” instead of functionality. We further recommend that the Commission confirm, in both directions, that an issuer’s use of the word in its marketing materials does not bear on whether a network is functional for purposes of Rule 401. Making the two provisions genuinely independent is what allows each to do its own work.

VIII. Conclusion

The Commission has done the analytical and definitional work. It has concluded that a functional crypto system without a central party does not support a reasonable expectation of profits derived from the essential managerial efforts of others, and it has defined both elements of that condition. What remains is to give those conclusions effect in the rules. The text we have proposed would do that, and would do it without altering anything the Commission has proposed.

We appreciate the Commission’s consideration and welcome the opportunity to discuss these recommendations further.

Respectfully submitted,

Signed by:

EBA43E0DF74346A...
Lee A. Schneider
General Counsel
Ava Labs, Inc.

²³ March 2026 Joint Interpretation, at n.96.

²⁴ FAQs, Question 1.1.