When Wallets Route Into Registered Funds: Section 404 and the Routing Problem in the CLARITY Act Compromise

By Yunjie Fan

A user opens her wallet, taps to route 500 USDC into Franklin's OnChain U.S. Government Money Fund, and signs. Is that signature a yield event Section 404 prohibits, or a securities transaction Section 404 leaves alone?

On May 1, 2026, Senators Thom Tillis (R-N.C.) and Angela Alsobrooks (D-Md.) released the long-awaited compromise text on stablecoin yield within the Digital Asset Market Clarity Act. Section 404 prohibits "covered parties" from paying rewards on a stablecoin balance "in a manner that is economically or functionally equivalent to the payment of interest or yield on an interest-bearing bank deposit." It preserves "activity-based or transaction-based rewards." It directs the SEC, CFTC, and Treasury Secretary to draw the line by joint rulemaking within one year. Senators Tillis and Alsobrooks confirmed the text as final on May 5, and the Senate Banking Committee announced on May 8 that it will mark up the bill on Thursday, May 14.

The political question is settled. The interpretive question is not. A coalition of six banking trade associations sent a joint letter to Senate Banking leadership on May 8 reading the prohibition expansively, urging that "incentives that act like yield" be swept in by the statutory text or by the joint rulemaking that follows. Crypto firms read the activity-based carve-out as the operative center of the provision. The agencies will have to decide a question the text does not answer on its face: when does a routing transaction that delivers a NAV-based return to a stablecoin user fall within Section 404, and when does it fall outside?

The question has a settled doctrinal home. The family-resemblance test of *Reves v. Ernst & Young* asks structurally identical questions about who bears principal risk and which regulatory regime governs — and answers them in a way that is already implicit in the statute the registered tokenized money market funds operate under.

The Routing Problem

Two SEC-registered tokenized money market funds are in operation in the regulated U.S. market: Franklin's FOBXX and WisdomTree's WTGXX. Both are mutual funds registered under the Investment Company Act of 1940 (the "1940 Act"). Both hold short-dated government instruments. Both issue shares represented as blockchain-recorded tokens. Neither pays interest. Each shareholder receives a NAV-based return on her investment in the fund. The retail and intermediary distribution pathways differ between the two products, but the regulatory architecture is the same.

The hard case arises when a wallet, exchange, or other intermediary integrates a fund of this kind into a user-facing stablecoin balance. The user holds stablecoin. The user authorizes a routing transaction. The intermediary moves the user's stablecoin into shares of a registered fund. The NAV-based return is reported back into the wallet, denominated in stablecoin. From the user's perspective, this can look indistinguishable from a deposit account that pays interest.

The question is whether it should be treated as one. The user is a shareholder in a registered fund, exposed to fund-level principal risk, with the statutory protections and disclosures the 1940 Act provides. The operator is licensed under separate regulatory regimes — broker-dealer, transfer agent, investment adviser. No party is in a deposit relationship with the user, and no party is paying anything that resembles interest on a deposit.

Section 404's prohibition runs to "covered parties" — digital asset service providers and their affiliates. Permitted payment stablecoin issuers and registered foreign issuers are excluded, because the GENIUS Act already prohibits them from paying any form of interest or yield directly. The architecture is layered: Section 4(a)(11) of the GENIUS Act covers issuers; Section 404 of the CLARITY Act covers the wallet and platform layer that issuers do not control. The compromise text does not purport to repeal or override either the 1940 Act or the broker-dealer framework. The interpretive question is whether the user's routing into a registered fund is conduct that Section 404 prohibits, or conduct Section 404 leaves to the regimes that already govern it.

The Maximal Reading and Its Cost

The banking trades' May 8 letter presses for the broadest possible construction of the statutory phrase. On that reading, any arrangement that delivers a periodic return on a stablecoin balance is captured, regardless of whether the return originates in interest, fund distributions, or something else. The reading has rhetorical force: it draws a bright line.

It also asks Section 404 to do more work than the GENIUS Act. The GENIUS Act, enacted as Pub. L. No. 119-27 in July 2025, prohibits permitted payment stablecoin issuers from paying "any form of interest or yield … solely in connection with the holding, use, or retention of such payment stablecoin." The OCC's pending implementation rule builds on that prohibition by presuming the issuer has violated it when the issuer arranges for an affiliate or related third party to pay yield to holders. Section 404 of the CLARITY Act sits alongside this architecture, not above it. It addresses a distinct family of arrangements at the wallet and platform layer, not a wholesale rewrite of how registered products meet stablecoin interfaces.

A maximal "deposit-equivalent" reading swallows the registered tokenized money market fund. The user who routes stablecoin into FOBXX or WTGXX receives a NAV-based return that, viewed only from the user's wallet, can resemble interest. Under the maximal reading, the wallet operator becomes a "covered party" paying "deposit-equivalent" yield, and the routing transaction is prohibited.

Section 404 was not drafted to override the 1940 Act. The provision delegates the line-drawing task to three agencies for a reason: the line is not self-executing. An interpretation that prohibits routing into instruments already registered under, and supervised through, a parallel federal framework cannot be the reading Congress directed the agencies to adopt. The agencies' job under the joint rulemaking is to mark the boundary at the right place. The prohibition should reach disguised yield on stablecoin reserves. Arrangements already governed by the 1940 Act should remain governed by it.

The Statutory Hinge: "Solely"

The textual hinge is the word "solely." Section 404 prohibits payment that is the functional equivalent of deposit interest "solely in connection with the holding" of a stablecoin balance. The structure presupposes a category of arrangements where the user's express act — routing, transacting, providing liquidity — is the operative step that the payment compensates. That category is the textual home of the routing transaction. A maximal reading collapses "solely" into nothing, and reads the prohibition as if Congress had simply written "in connection with the holding." Congress did not write that, and the agencies should not rewrite it.

The *Reves* Anchor

Reves v. Ernst & Young asks, on its terms, when a "note" is a "security" under Section 3(a)(10) of the Securities Exchange Act of 1934. Section 404's prohibition addresses the form of compensation, not the classification of an instrument. The questions are not coextensive. But the *Reves* four-factor analysis works in either direction. It asks the right structural questions about who bears principal risk and which regulatory regime governs — and those are exactly the questions the Section 404 "economically or functionally equivalent" inquiry requires. The Court built *Reves* around four factors: the parties' motivation, the plan of distribution, the public's reasonable expectations, and whether some other regulatory scheme significantly reduces the risk of the instrument such that application of the securities laws is unnecessary. The fourth factor expressly contemplates the deposit/security line: *Reves* itself cited *Marine Bank v. Weaver*, where the Court held that a federally insured bank CD was outside the securities laws because the federal banking framework — including but not limited to FDIC insurance — already did the regulatory work.

Apply those factors to a routing transaction into a registered tokenized money market fund. *Motivation*: the user is seeking a return on assets put at risk in a registered fund. The user is not parking money for transactional convenience. *Plan of distribution*: the fund's shares are offered to the public under a 1940 Act registration statement; the routing transaction is a securities sale, not a banking transaction. *Public expectation*: the user is acquiring shares in a fund whose offering documents disclose securities-style risk and whose returns are NAV-based. *Alternative regulatory scheme*: the fund operates under the 1940 Act, the operator under broker-dealer or transfer-agent registration, and the custody under SIPC. The fourth factor in *Marine Bank* asked whether FDIC supervision made the securities laws unnecessary; here the question runs the other way, and the answer is that the 1940 Act framework makes the deposit-law analogue unavailable. The FDIC/SIPC asymmetry is structural, not technical. FDIC insures principal; SIPC protects custody but assumes the customer bears market risk. That asymmetry is the structure *Reves* uses to allocate arrangements to one regime or the other.

The four factors agree. The routing transaction is a securities-law return delivered through a stablecoin-denominated interface. It is not deposit-equivalent.

What the Joint Rulemaking Should Do

Section 404 directs joint rulemaking by the SEC, CFTC, and Treasury Secretary. Before the agencies reach the harder questions about rewards programs that involve no registered fund at all, they should confirm that a routing transaction into a 1940 Act-registered fund is outside the prohibition.

A workable safe harbor needs no new doctrine. Where the user has expressly authorized, at the transaction level, a routing of stablecoin balances into shares of a fund registered under the 1940 Act, the resulting NAV-based return is not "economically or functionally equivalent" to deposit interest. Recognizing the safe harbor does not require new statutory authority. It requires the agencies to recognize what the 1940 Act framework already does. The user is a shareholder; the operator is licensed under a separate regime; the return is the return on a registered security; and *Reves*' fourth factor tells the agencies which regime governs.

A short clause in the Committee Report would do the operational work for the agencies. Something close to:

> *"The Committee does not intend Section 404 to disturb the operation of registered investment companies. A user-authorized routing transaction into shares of a fund registered under the Investment Company Act of 1940 is not, by virtue of being denominated or settled in a payment stablecoin, a payment 'economically or functionally equivalent' to interest on a bank deposit within the meaning of this prohibition."*

That single sentence, anchored in *Reves* and the existing 1940 Act framework, would close the registered-fund margin without giving an inch on the disguised-yield margin the banking trades' letter is actually worried about.

The safe harbor is narrow by design. It does not cover programs in which the operator commits to a particular rate regardless of fund performance. It does not cover programs that pool user balances into operator-controlled positions without per-user transparency. It does not cover programs that obscure who the issuer is. Those are the cases the banking trades' letter targets, and those are the cases Section 404 should reach. The harder definitional work for the agencies sits at the margin between rewards calibrated to continued stablecoin holdings and rewards earned in exchange for an asset-character transformation. The routing transaction into a registered fund is not that margin. It sits comfortably on the securities side of the line *Reves* draws. The Committee Report accompanying the May 14 markup should say so; the joint rulemaking should confirm it when its time comes.

Yunjie Fan is an Independent Researcher. She develops the operational and quantitative framework that complements this doctrinal argument in [Narrowing the Section 404 Prohibition], a working paper posted on SSRN.