Davis Polk

Seven easy pieces for the new SEC chair

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Crafting a comprehensive regulatory framework for crypto will take time. But there are a few steps that the new SEC chair can immediately take to get the ball rolling.

Tuesday's election results signal a definitive end to the enforcement-only philosophy that for the last four years has characterized the SEC's posture towards the crypto industry. It's not realistic to think Congress and regulators will now simply adopt a hands-off attitude towards this $2.5 trillion industry; debacles like FTX and Celsius prove that even if traditional securities regulation is not an appropriate fit for crypto, federal market and consumer safeguards are urgently needed.

Up until now, the SEC's "just come in and register" approach has meant the agency has largely excused itself from the debate over what these safeguards should look like, and most if not all serious policy thinking has been focused on efforts in Congress.

That will change on January 20, 2025.

But developing and implementing a comprehensive federal regulatory framework for this complex and dynamic industry will not happen overnight—the federal government has a lot of catching up to do. We expect many months (possibly years) of dialogue involving both houses of Congress, regulators such as Treasury, the SEC, the CFTC and the banking agencies, industry participants, industry competitors and consumer watchdogs.

When the new administration is sworn in, the position of SEC chair will likely pass either to Commissioner Hester Peirce or Commissioner Mark Uyeda on an acting basis until a permanent chair is appointed and confirmed by the Senate.

The SEC chair is not merely first among equals; the chair has unilateral power to direct the activities of the SEC's staff. Although the chair cannot adopt new rules or initiate or settle enforcement actions without the assent of a majority of the commissioners, there are several steps the new SEC chair can take to begin rationalizing the agency's current dysfunctional approach to crypto assets.

Our (non-exhaustive) suggestions for Day One tasks include the following:

1. **Withdraw SAB 121**, the 2022 accounting policy that requires a public company with responsibility for safeguarding crypto assets to recognize liabilities for those assets on its balance sheet. While there may be some logic to this staff-promulgated directive, the SEC is not the nation's accounting standard-setter. That task falls to the FASB, who approaches its remit thoughtfully and with due process and broad public input as opposed to simply announcing a full-blown major GAAP policy change via press release.
2. **Withdraw the Framework for "Investment Contract" Analysis of Digital Assets**. Although well-intentioned, this 2019 staff effort has created years of confusion over the securities status of individual crypto assets. Is the crypto asset itself a security, or is it instead only a thing sold as part of a broader securities transaction? The answer to this basic question has a profound impact on all parties active in the crypto markets. But with more than sixty suggested "considerations" that supposedly make a crypto asset more or less likely to be a security, the guidance has proven impossible to interpret and apply in a manner that yields consistent results. What could help replace this guidance? See #6 below.
3. **Place a moratorium on enforcement threats against intermediaries based on activities involving tokens they did not issue**. This goes hand-in-hand with withdrawing the staff's Framework. If a trading platform, market maker or

other intermediary did not itself issue a particular crypto asset, then the intermediary did not deploy the token in a primary capital-raising transaction and its activities do not implicate the fundamental policy concerns of the Securities Act of 1933. Until we have designed and implemented a thoughtful regulatory solution, the SEC should stop harassing businesses that are meeting this vast market's daily liquidity needs.

4. **Stop holding up crypto company IPOs**. The chair should direct the Corporation Finance staff to treat companies in the crypto asset industry trying to go public just like companies in every other industry—and provide comments on a regular timetable that will facilitate the company's ability to go public in 3 to 4 months, rather than 3 to 4 years (or never).
5. **Exercise prosecutorial discretion for registration violations that involved no fraudulent conduct**. In cases where a company in fact used crypto assets to carry out an unregistered public capital-raising transaction, it may still be appropriate for the SEC to investigate whether the transaction violated Securities Act registration requirements. The SEC has settled numerous activities involving similar conduct. In the absence of fraudulent conduct – such as knowingly providing false or misleading information about the token or transaction to investors – the SEC staff can and should consider whether there was any investor harm or intentional misconduct that warrants SEC attention—given the longstanding uncertainty over crypto's regulatory status (uncertainty that the SEC itself helped foster; see above). Even where it determines to recommend such a case, the staff should consider, for example, not insisting on civil penalties for these violations or requiring that all tokens held by the issuer be destroyed, and freely granting the necessary waivers to allow companies to continue using private capital-raising safe harbors.
6. **Publish the staff's *Howey* analysis for bitcoin and ether**. Shockingly, despite its oft-repeated insistence that market participants are responsible for analyzing individual crypto assets in order to determine whether or not they are securities, the staff has never revealed its own detailed analysis explaining why current transactions in bitcoin and ether are not securities transactions. Its failure to make its analysis public has made room for an enforcement approach where, depending on the case, the agency can sometimes claim that a crypto asset "embodies" an investment contract, and other times claim that they aren't taking the position that lines of computer code by themselves constitute a security. This also prevents market participants from evaluating the status of other assets that may share similarities to bitcoin and ether.
7. **Take the proposed amendments to rule 3b-16, as they relate to crypto assets, off the rulemaking agenda**. In 2022 the SEC proposed but has not yet adopted amendments that would redefine certain terms used in the statutory definition of "exchange." While initially aimed at traditional securities markets, the SEC confirmed that the proposed rules would also sweep in various types of crypto activity, including decentralized finance or DeFi—in a manner that would effectively shut these activities down. With Congress and now the SEC and other regulators soon to embark on a comprehensive crypto regulatory project, the proposed rule amendments, as they relate to crypto assets, should be tabled and not be allowed to front-run this process.

Of course, there are a lot of other crypto issues that will require significant commission and staff attention, including establishing workable rules for crypto asset custody. But these Day One steps would go a long way towards putting the SEC on the right path.

Resources
Crypto Regulation Hub

Visit our Crypto Regulation Hub for links to congressional proposals related to the regulation of crypto assets and other helpful materials.

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