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An update: Seven easy pieces for crypto regulation

March 15, 2025 | Client Update | 7-minute read

The SEC has moved with stunning alacrity to put crypto regulation on a sustainable footing. Even as Congress continues to work on a market structure bill, there is still room for additional thoughtful SEC action.

Like many close observers of the Securities and Exchange Commission, we harbored significant concerns in the last few years over the agency's enforcement-first posture towards crypto. We instead advocated for a more rules-based and transparent approach that we thought could benefit investors, entrepreneurs and businesses alike.

On Nov. 6, 2024, a day after the presidential election, we published a client update outlining seven suggestions that the incoming acting SEC chair could immediately take following the Jan. 20, 2025 inauguration that would, in our view, begin to bring regulatory clarity and fairness to this nearly $3.0 trillion industry.

Fast-forward a mere two months, and we are encouraged to see that our suggestions have either already been achieved or appear well along a path to implementation.

To recap, we suggested Day One action to:

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	DPW recommendation	Status
1.	**Withdraw SAB 121**, the 2022 accounting policy that required a public company with responsibility for safeguarding crypto assets to reflect those assets on its balance sheet.	? Within 72 hours of Inauguration Day, the SEC staff dic that with the release of SAB 122.
2.	**Withdraw the Framework for "Investment Contract" Analysis of Digital Assets**. We noted that with more than 60 suggested "considerations" that supposedly make a crypto asset more or less likely to be a security, the SEC staff's most significant piece of guidance had proven impossible to interpret and apply in a manner that yields consistent results.	? On Feb. 21, Commissioner Hester Peirce announced one of the first tasks of the SEC's newly established Cry Task Force would be to "make it easier for investors, ma participants, and the Commission to categorize crypto a and crypto asset transactions."
3.	**Place a moratorium on enforcement threats against intermediaries based on activities involving tokens they did not issue.** In the last few years the SEC brought or threatened high-profile enforcement actions against crypto trading platforms, market makers and other intermediaries for operating without registering as a broker-dealer or securities exchange, despite a distinct lack of clarity that such registration was required. We argued that until there existed a thoughtful regulatory solution, the SEC should stop harassing businesses who meet this vast market's daily liquidity needs.	? In recent weeks, intermediaries and the SEC itself hav started to announce the wind-down of these ill-considere enforcement actions.
4.	**Stop holding up crypto company IPOs**. Frustrated by our first-hand experience watching crypto clients languish in the SEC registration review process for years at a time, we argued that the acting chair should direct the Corporation Finance staff to treat crypto natives like companies in every other industry, and provide comments on a regular timetable that would facilitate a crypto company's ability to go public in 3 to 4 months rather than 3 to 4 years (or never).	? Although most have not yet been publicly announced, many of the crypto IPOs we are working on, we are hap see the CorpFin staff issuing and clearing comments in customary cadence.
5.	**Exercise leniency for registration violations that involved no fraudulent conduct**. We noted that 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 complied with Securities Act registration requirements. But in the absence of fraudulent conduct, we suggested that the SEC exercise some prosecutorial discretion in view of the persistent regulatory uncertainty.	? In its Staff Statement on Meme Coins issued on Feb. the agency took this suggestion a step further and gave market broad assurances that it would not assert jurisdic over a corner of the industry that, just a few months ago would almost certainly have been squarely in its enforce sights.
6.	**Publish the staff's Howey analysis for bitcoin and ether**. We noted with some frustration that the SEC staff had never revealed its own analysis explaining why current transactions in bitcoin and ether are not securities transactions, and that this omission had facilitated an enforcement program where the SEC could take a spaghetti-against-the-wall approach as to what constitutes an investment contract.	? The topics before the Crypto Task Force, as laid out i Commissioner Peirce's statement, demonstrate that the is aware of this dynamic and is committed to fixing it. Inc the Crypto Task Force is hosting a roundtable on the top next week.
7.	**Take the proposed amendments to rule 3b-16 off the rulemaking agenda**. In 2022 the SEC proposed rule amendments that would redefine certain terms used in the statutory definition of "exchange" in a manner that could sweep in various types of crypto activity, including decentralized finance or DeFi, effectively shutting these activities down.	? In a speech on Mar. 10 before the Institute of Internati Bankers, Acting Chairman Mark Uyeda succinctly noted "in light of the significant negative public comment recei on the definition of exchange with respect to crypto, I ha asked SEC staff for options on abandoning that part of t proposal."

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The speed and scope of the fresh leadership's overhaul of the SEC's approach to crypto demonstrates, if anything, the peril the agency takes on when relying primarily on enforcement activity to stake out jurisdiction over a nascent industry using novel and contentious interpretations of long-ago enacted statutes. In particular, the SEC's repeated attempts to stretch the boundaries of what sorts of instruments and activities are covered by the term "investment contract," which met with mixed success in the federal district courts, appear on track to die an unlamented death.

A policy program based on notice-and-comment rulemaking with broad public input might instead have yielded better investor protection, more certainty for the industry, and a more permanent regulatory achievement. We believe there's a lesson here as the SEC plans its next steps.

Looking ahead

Congress is considering legislation that would comprehensively overhaul the federal approach to crypto regulation, but it's probably too early to predict when definitive market structure legislation will be enacted and signed into law. (Prospects for near-term stablecoin legislation, however, appear much brighter.)

Federal legislation could of course ultimately supersede SEC rulemaking, but the SEC need not wait for Congress to act before adopting comprehensive and durable rules to reform the regulatory landscape. This is because the SEC possesses (but seldom uses) "general exemptive authority" under the principal federal securities laws. This power allows it to exempt "any class or classes of persons, securities, or transactions" from the scope of the federal securities laws, conditionally or unconditionally.

It's not too optimistic to expect that the SEC will use this powerful authority—which it last deployed in a far-reaching and much-applauded manner in 2005 when reforming the securities offering process—to address the urgent and unmet need for sensible crypto regulation.

And in doing so, the SEC need not be constrained by concepts and constructs rooted in 80 years of caselaw interpreting the term "investment contract."

Those endeavors featured inquiries into whether or not a given instrument or transaction involves the "efforts of others," which has led to angels-on-pinheads debates about whether or not particular blockchain protocols exhibit "sufficient" degrees of decentralization—a complex and inherently subjective facts-and-circumstances question that could continue to confound ex-ante determinations of a token's security status.

The SEC could instead acknowledge the fact that its existing disclosure and market structure regimes focus almost exclusively on the capital-raising needs of businesses and investors in those businesses, and that the instruments used for these purposes almost exclusively represent legal or contractual claims on the assets, revenues and profits of those businesses. The federal securities laws were thus always bound to be a poor fit for instruments—like most crypto assets—that don't represent a legal or contractual claim on a business, regardless of the level of control a person or group may exert over the associated protocol and regardless of the level of decentralization it exhibits.

On the challenge of applying existing securities laws to crypto, we are strongly encouraged by Commissioner Peirce's suggestion that the SEC may consider providing "temporary prospective and retroactive relief for coin or token offerings for which the issuing entity or some other entity willing to take responsibility provides certain specified information, keeps that information updated, and agrees not to contest the Commission's jurisdiction in the event of a case alleging fraud in connection with the purchase and sale of the asset."

A formal exemptive approach like this would result in legal certainty for the non-security status of those tokens, providing clarity to issuers as well as market participants and intermediaries. In addition, the disclosures required could be better tailored to the information relevant to crypto markets than those required for corporate issuers.

And such a construct need not be temporary (unless mooted by Congressional action); instead, it could form the basis for a longer-term, more limited, role for the SEC in the crypto markets.

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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