



A Way Forward for the SEC and Crypto: The SEC’s History of Tailoring Regulatory Frameworks for Nontraditional Securities

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The SEC Chair has stated that in his view, the “vast majority” of cryptoassets are securities, meaning that these products—and market participants—are subject to the federal securities laws and SEC rules.¹ This poses a conundrum: Compliance with aspects of the securities laws and existing SEC rules is not attainable for cryptoasset securities,² absent further regulatory or Congressional action.³

This is because the existing regulatory framework was developed with traditional securities in mind—mostly equities, and to a lesser extent, bonds and other products. The existing framework, for example, generally mandates disclosure of information relevant to *operating company issuers*—*i.e.*, information that does not exist for most issuers of cryptoasset securities.⁴ It also assumes the operations, trading practices and market structure of traditional securities markets, and thus it has proven essentially impossible for crypto companies to satisfy various requirements associated with broker-dealer, exchange and other categories of SEC registration.⁵

The good news is that the fundamental investor and market integrity protections of the federal securities laws *can* be applied to cryptoasset securities, provided that the SEC continues its long-standing practice of tailoring their application to the structural features, uses and risks of nontraditional securities—and makes efforts to do so for cryptoasset securities.

It bears emphasizing that “tailoring” does not mean widescale exemptions. On the contrary, it commonly involves imposing heightened, additional and/or substitute requirements relevant to the characteristics and risks of nontraditional securities.

Sentiments that “there are already adequate rules and protections in place” and notions of there being a “one-size-fits-all”⁶ approach to securities regulation are inconsistent with the SEC’s traditional practices—and would leave important investor protection gaps.

A brief review of the SEC’s historical approach in this regard is instructive.

A History of Tailoring the Regulatory Regime for Different Products

The SEC has long recognized that different types of securities have varying characteristics and uses, and therefore implicate different investor protection considerations and risks.

Over the decades, the SEC has successfully applied the investor and market integrity principles of the federal securities laws to novel and nontraditional securities, accounting for their unique features and risks. Take asset-backed securities, for example. The agency has issued tailored reporting requirements and disclosure guidance, correctly recognizing (1) the differences between asset-backed securities and other fixed-income securities (*e.g.*, there is no business or management of an issuing entity to describe for asset-backed securities), and (2) that certain conditions in SEC rules are “not relevant or practical” for asset-backed securities.⁷

The SEC’s recognition of the need to treat products differently extends beyond securities registration and disclosure and into its regulation of market participants.⁸ For instance, the SEC has established customized requirements for the marketing and sale of complex products and options, including working with FINRA to establish heightened marketing and disclosure requirements for the sale of options to retail investors.⁹

Another example is the security-based swaps regime that the SEC stood up following the passage of the Dodd-Frank Act. That legislation expanded the definition of “security” to include “security-based swaps,” bringing a range of products and activities under the federal securities laws and existing SEC rules.

Over a decade-long process, the SEC constructed a custom framework for security-based swaps. A key aspect of this work was the Commission’s acknowledgement that the expansion of what constitutes a “security” raises “certain complex issues of interpretation,” thus requiring close evaluation of how existing regulations governing “securities” apply to security-based swap activities.¹⁰ Ultimately, the agency crafted and curated an effective regulatory framework, benefitting from the Commission’s solicitation of public feedback and careful navigation of various technical issues, including through the use of temporary and permanent exemptions concerning targeted aspects of the existing framework for traditional securities.¹¹

Moving Forward Constructively

To be sure, the examples cited above are not perfectly parallel to the current situation for cryptoassets. But the foundational principle holds: When confronted with new or nontraditional securities, the SEC has historically used its authorities to design and implement workable regulatory approaches that fulfill the core goals of the federal securities laws.

The Commission has also recognized—as reflected in its approaches to asset-backed securities, options, security-based swaps and other products—that regulation designed for traditional securities does not necessarily address all of the unique attributes and risks of nontraditional securities. This is why the Commission has commonly imposed heightened requirements and protections to address the idiosyncratic characteristics of certain product classes.

Crypto is not going away. And it is unclear if or when Congress may adopt crypto legislation on this topic (which would be ideal). In any case, investors and the market generally would benefit if the SEC would begin the necessary—and inevitable—work of systematically evaluating and developing a regulatory regime for cryptoasset securities. This will be a multi-year process that will be extraordinarily complex, difficult and labor-intensive. A common sense starting place would be the issuance of a series of concept releases to solicit public input on a topic-by-topic basis—e.g., disclosure and securities registration, intermediaries, infrastructure, trading and investment management.

Not only would this foster a workable regime that protects investors in a manner consistent with the federal securities laws, but it would enhance confidence and trust in the regulatory system.

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¹ See, e.g., Chair Gary Gensler, “Kennedy and Crypto” (Sept. 8, 2022).

² In this essay, I use the term “cryptoasset security” to refer to any asset natively issued and/or transferred using distributed ledger technology that is deemed a security. The term is not intended to refer to traditional securities that are tokenized or otherwise represented on distributed ledger technology. In writing this essay, I am not expressing a view on the threshold question of the proper legal categorization of a given cryptoasset (or any cryptoasset generally) as a security. The proper legal categorization of various cryptoassets (and related transactions) is the subject of much debate and currently before the courts. See, e.g., Memorandum of Law in Support of Coinbase’s Motion for Judgment on the Pleadings, SEC v. Coinbase, Inc., No. 23-cv-4738 (S.D.N.Y., filed Aug. 4, 2023); Defendants’ Notice of Motion and Motion to Dismiss, SEC v. Payward, Inc.; Payward Ventures, Inc. [Kraken], No. 3:23-cv-06003 (N.D. Cal., filed Feb. 22, 2024).

³ For a useful discussion of how compliance with aspects of the federal securities laws and existing SEC rules is not attainable (or in some cases virtually impossible) for cryptoasset securities, see Coinbase Petition for Rulemaking (July 21, 2022), *available at* <https://www.sec.gov/files/rules/petitions/2022/petn4-789.pdf>.

⁴ See *id.* at 15 (“[T]he Commission’s disclosure requirements . . . are designed for traditional corporate entities that typically issue and register equity and debt securities. The disclosure requirements under the federal securities laws focus on disclosure about companies, their management and their financial results—topics that poorly fit the decentralized and open-source nature of blockchain-based digital asset securities.”)

⁵ See *id.* at 17-29.

⁶ See, e.g., Chair Gary Gensler, “Statement on the Denial of a Rulemaking Petition Submitted on Behalf of Coinbase Global, Inc.” (Dec. 15, 2023) (stating his view that the “existing securities regime appropriately governs crypto asset securities.”).

⁷ See, e.g., Asset-Backed Securities, 70 FR 1506 (Jan. 7, 2005). The SEC has also established a specialized registration form and tailored disclosure requirements for certain real estate companies. See, e.g., SEC Form S-11.

⁸ The Commission has also issued targeted exemptions to address provisions that are unworkable for certain products or otherwise conflict with other regulations, including a recent order exempting certain fixed-income securities from SEC Rule 15c2-11. See Order Granting Broker-Dealers Exemptive Relief, Pursuant to Section 36(a) and Rule 15c2-11(g) Under the Securities Exchange Act of 1934, From Rule 15c2-11 for Fixed-Income Securities Sold in Compliance With the Safe Harbor of Rule 144A Under the Securities Act of 1933, 88 FR 75342 (Nov. 2, 2023).

⁹ See, e.g., Exchange Act Rule 9b-1 (generally precluding broker-dealers from accepting a standardized option order from a customer unless the broker-dealer has furnished the customer with an options disclosure document that meets certain requirements); FINRA Regulatory Notice 21-15 (discussing FINRA rules concerning options account approval, supervision and margin requirements).

¹⁰ See, e.g., Order Granting Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection With the Pending Revision of the Definition of “Security” To Encompass Security-Based Swaps, and Request for Comment, 76 FR 39927 (July 7, 2011).

¹¹ See, e.g., Order Granting a Limited Exemption From the Exchange Act Definition of “Penny Stock” for Security-Based Swap Transactions Between Eligible Contract Participants; Granting a Limited Exemption From the Exchange Act Definition of “Municipal Securities” for Security-Based Swaps; and Extending Certain Temporary Exemptions Under the Exchange Act in Connection With the Revision of the Definition of “Security” To Encompass Security-Based Swaps, 84 FR 863 (Jan. 31, 2019).

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