April 15, 2025

SEC Clarifies Stance on Disclosures Relating to Crypto Assets

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What You Need To Know:

On April 10, the Securities and Exchange Commission's (SEC) Division of Corporation Finance (the Division) issued a comprehensive statement providing guidance on the application of federal securities laws to offerings and registrations of securities with respect to crypto asset markets (the Guidance). While the Guidance does not address whether certain crypto assets are securities, it may be helpful for a company that is issuing securities and is:

- Developing a blockchain network or protocol or a related service
- Registering the offering of an investment contract in connection with an initial coin offering
- Issuing a crypto asset that is itself a security because, for example, it provides a revenue stream based on the issuer's performance
- Integrating nonfungible tokens into video games or other media

Specifically, the Guidance addresses disclosure requirements and common issues identified during reviews, aiming to protect investors, facilitate capital formation, and promote fair, orderly, and efficient markets.

Summary of Key Disclosure Categories

The Guidance provides the Division's views regarding certain disclosure requirements under Regulation S-K, specifically with respect to disclosures contained within Form S-1 (registration statements), Form 10-K (reporting requirements), Form 20-F (private foreign issuers), and Form 1-A (Regulation A offerings). The Guidance specifically addresses the inclusion and treatment of crypto assets as they pertain to disclosures of the description of the company's business, risk factors, description of securities, directors, officers, key employees, financial statements, and exhibits.

Description of Business

As issuers should already be aware, disclosures should be tailored to their businesses and present clear and concise language without overreliance on technical jargon. For example, among other things, issuers should provide disclosures relating to the material aspects of their businesses instead of blockchain networks generally. The Division also notes the importance of clearly disclosing whether security or crypto assets have any function in the operation of the issuers' intended businesses, including whether such assets will be used in the associated network or application.

With respect to the development of the underlying network, application, or protocol, the Division reminds issuers to disclose their specific development timelines and road maps for future business lines and disclosures relating to whether their products and business lines are fully developed. When describing such products and services, issuers should disclose information including, but not limited to:

- Milestones needed to achieve full functionality of the products and/or services
- Descriptions of software architecture, cryptographic key management, and functionality
- Whether the company's technology is proprietary or derived from open-source software, and the intellectual property rights related thereto
- If applicable, descriptions of the consensus mechanism deployed and material details of such consensus mechanism, including the block size, transaction speed, gas fees, and reward mechanisms, if any
- The various roles that exist or will exist as they relate to the network and/or application, such as users, developers, validators, governance participants, and on-chain and off-chain service providers
- Descriptions of network or application security

Risk Factors

Issuers are required to discuss material factors that make an investment speculative or risky. Examples of risks that should be disclosed include:

- Technology and Cybersecurity: Risks related to the development, implementation, and security of the issuer's technology and business operations
- Characteristics of the Security: Risks associated with the security's features, such as price volatility, limited rights of holders, valuation, and liquidity risks
- Legal and Regulatory: Potential registration requirements with various regulatory authorities, including the Financial Crimes Enforcement Network, state financial services agencies, federal or state banking regulators, and the Commodity Futures Trading Commission

Description of Securities

Issuers must provide a "materially complete" description of their securities. Examples of disclosures in the context of describing a security in the crypto asset markets include:

- Rights, Obligations, and Preferences: Detailed explanations of the rights, obligations, and preferences of holders, including dividends, payments, profit sharing, distributions, and voting rights
- Technical Specifications: Information about the network or application associated with the security or crypto asset, including technical requirements for holding, accessing, and transferring the security
- Supply Rules: Rules governing the total supply of the security or crypto asset, including minting methods, supply creation, and any processes for redeeming, retiring, freezing, or burning the asset
- Market Arrangements: Disclosure of any arrangements with market makers or similar firms to distribute and/or provide liquidity for the security or crypto asset

Directors, Executive Officers, and Significant Employees

Generally, issuers must disclose the identity of those managing the issuer and/or its business. The Guidance also provides that the rules require disclosure of not only persons who hold formal titles or positions but also of persons who perform similar functions. For example, the Division has observed certain trusts of a spot crypto exchange-traded product disclose the sponsors of such trusts because they have similar functions as officers and directors. Although compensation may vary, disclosing fees paid to third parties for performing such functions may be required.

Takeaways

As more crypto asset-related companies are electing to become reporting issuers or other registered entities, the standards and requirements for disclosures will continue to evolve. Crypto asset-related companies that have filed or intend to file registration statements or ongoing reporting should ensure that their disclosures provide clear, concise, and **specific** descriptions of the companies' activities with respect to crypto assets.

Important Caveats

The Division's statements in the Guidance should not be construed as a rule, a regulation, or guidance from the SEC and do not alter or amend applicable law. The Guidance creates no new or additional obligations for any person. Additionally, the Guidance does not address all material disclosure items, with the SEC recommending that each issuer should "consider its own facts and circumstances when preparing its disclosures." See here for the complete statement.

Contacts

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