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Regulatory Update

SEC and CFTC Provide New Toolkit for Determining When a Digital Asset Is a Security

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The question of whether or when a digital asset is a security or a transaction involving a digital asset constitutes an offer and sale of a security has been contested by financial regulators and market participants, litigated in courts with seemingly conflicting results and debated by Congress across multiple legislative sessions. On March 17, the Securities and Exchange Commission (SEC) [issued an interpretation](#) addressing those questions, with the Commodity Futures Trading Commission (CFTC) joining to provide coordinated guidance. The interpretation is intended to serve as a bridge for entrepreneurs and investors while Congress works to codify a comprehensive market structure framework for digital assets into statute.

SEC Chairman Paul S. Atkins [said](#) “this interpretation will provide market participants with a clear understanding of how the Commission treats crypto assets under federal securities laws. This is what regulatory agencies are supposed to do: draw clear lines in clear terms.” Chairman Atkins added that “[i]t also acknowledges what the former administration refused to recognize – that most crypto assets are not themselves securities. And it reflects the reality that investment contracts can come to an end.” For his part, CFTC Chairman Michael S. Selig said “[f]or far too long, American builders, innovators, and entrepreneurs have awaited clear guidance on the status of crypto assets under the federal securities and commodity laws,” and “[t]oday’s joint agency action reflects a shared commitment to developing workable, harmonized regulations for the new frontier of finance.”

The interpretation incorporates many views long held by digital asset market participants and securities law practitioners, but nonetheless represents one of the most significant regulatory statements on crypto asset classification since the SEC’s [2019 guidance](#), which the interpretation supersedes. The interpretation is currently effective but the SEC is soliciting public comment and may refine, revise or expand upon it or propose specific SEC rules based on the feedback received.

Key Takeaways

- The interpretation defines four categories of non-security crypto assets: (1) digital commodities, (2) digital collectibles, (3) digital tools and (4) payment stablecoins excluded from the definition of security under the GENIUS Act and covered stablecoins as defined in a [prior SEC release](#).
- A financial instrument that meets the definition of a security remains a security even if recorded on a blockchain.

- Digital commodities are defined as assets that do not have intrinsic economic properties such as generating passive yield or conveying rights to future income, but may provide holders with technical rights such as participation in staking, governance voting and payment of gas fees.
- Notably, digital commodities are defined to require the absence of a “central party.”
- In addition to the established category of stablecoins, the SEC introduced the concept of “digital tools” and “digital collectibles” as non-security categories.
- An investment contract can arise in connection with an offer and sale of a non-security digital asset based in large part on the issuer’s representations and promises made prior to or contemporaneously with the sale but terminates when those representations and promises have been fulfilled or have been expressly or clearly abandoned.
- Whether a digital asset that was initially sold as part of an investment contract continues to be subject to that investment contract in secondary market transactions depends on whether purchasers at the time of those transactions would reasonably expect the issuer’s representations and promises to remain connected to the asset.
- Certain proof-of-work mining activities and solo, self-custodial, custodial and liquid staking arrangements on proof-of-stake networks, as well as certain “wrapping” and airdrop transactions, are not deemed to involve the offer and sale of a security.

Five Categories of Crypto Assets

The interpretation establishes a taxonomy for crypto assets. Four are not securities and the interpretation lists examples of specific digital assets that are not securities.

Category	Key Characteristics	Security
Digital Commodity	<ul style="list-style-type: none"> • Intrinsically linked to and derives its value from the programmatic operation of a functional crypto system as well as supply and demand dynamics. • A crypto system is “functional” if (1) the system’s native crypto asset can be used on the system in accordance with the programmatic utility of the system and (2) it does not have a central party that oversees participation or distributes rewards. • A “central party” is defined as “a person, entity or group of persons or entities having operational, economic or voting control of a crypto system,” but “control” is not separately defined. • May convey certain rights, such as participating in the system’s consensus mechanism by staking, engaging in governance or paying transaction fees. • Does not generate passive yield. 	No
Digital Collectible	<ul style="list-style-type: none"> • Designed to be collected and/or used or serves as a digital representation or reference to internet memes, characters, current events or trends. • May convey rights to artwork, music, videos, trading cards or in-game items; others may have limited or no functionality (e.g., typical meme coins). • Does not generate passive yield or convey rights to future income, profits or assets of a business promisor or obligor. • Existence of a creator royalty does not convert a digital collectible into a security. • Fractionalized interests could constitute the offer or sale of a security. 	No

Digital Tool	<ul style="list-style-type: none"> • Performs a practical function such as a membership, ticket, credential, title instrument or identity badge. • Often non-transferrable or soul-bound. • Does not generate passive yield. 	No
Stablecoin	<ul style="list-style-type: none"> • Payment stablecoins issued by a permitted payment stablecoin issuer under the GENIUS Act are excluded from the definition of a “security.” • Also includes other stablecoins that are designed to maintain a stable value relative to the U.S. dollar on a one-for-one basis, can be redeemed for U.S. dollar on a one-for-one basis and are backed by assets held in a reserve that are considered low-risk and readily liquid with a U.S. dollar-value that meets or exceeds the redemption value of the stablecoins in circulation. • Stablecoin issuer cannot pay yield solely in connection with the holding, use or retention of the payment stablecoin. 	No
Digital Security (Tokenized Security)	<ul style="list-style-type: none"> • A financial instrument enumerated in the definition of “security” formulated as or represented by a crypto asset, where the record of ownership is maintained in whole or in part on a crypto network. 	Yes

How a Non-Security Crypto Asset Becomes Subject to an Investment Contract

Any non-security crypto asset can be offered and sold as part of an investment contract security. The SEC’s prior [2019 guidance](#) on investment contract analysis for digital assets is superseded by the interpretation.

A non-security crypto asset becomes subject to an investment contract security when an issuer offers it by inducing (1) an investment of money, (2) in a common enterprise, (3) with representations or promises of essential managerial efforts from which a purchaser would reasonably expect to derive profits. The interpretation does not purport to supersede or replace *Howey*, which remains binding legal precedent.

When a Non-Security Crypto Asset Becomes Subject to an Investment Contract	
Source	<ul style="list-style-type: none"> • The issuer must be the source of the representations or promises creating the expectation of profits. • Statements made by unaffiliated third parties do not count (unless authorized by the issuer).
Timing	<ul style="list-style-type: none"> • Representations or promises must be conveyed prior to or contemporaneously with the issuer’s offer or sale. • Post-sale statements are not relevant to a prior sale (but presumably could affect concurrent or subsequent transactions).
Medium	<ul style="list-style-type: none"> • Reasonable for a purchaser to expect profits based on representations in written or oral agreements, the issuer’s website or official social media accounts, direct private communications between issuer and purchasers, regulatory filings or documents clearly attributable to the issuer (e.g., a whitepaper). • Representations communicated outside these channels are assessed for how widely disseminated they are, the specific means of communication and the issuer’s established communication practices.

Specificity	<ul style="list-style-type: none"> • Explicit, unambiguous representations containing: (1) details on the essential managerial efforts to be undertaken; (2) a timeline and milestones; (3) funding and resource plans; and (4) an explanation of how holders will profit, likely create reasonable profit expectations. • Vague statements lacking milestones, funding plans or an actionable business plan are less likely to create an investment contract.
Nature of the Efforts	<ul style="list-style-type: none"> • Only “essential managerial efforts” that affect the failure or success of the enterprise satisfy Howey’s third prong. • Administrative, ministerial or technical activities are not essential managerial efforts.
Primary vs. Secondary Market Transactions	<ul style="list-style-type: none"> • A token that was sold as part of an investment contract in a primary offering does not remain subject to that investment contract in secondary market transactions if purchasers would not reasonably expect the issuer’s representations or promises to remain connected to the asset. • If, on the other hand, purchasers would still reasonably expect those representations or promises to remain connected to the asset, secondary market offers and sales remain securities transactions subject to the Securities Act. • This means a single token can be a security in its primary offering and a non-security in later secondary market transactions, depending on the state of the issuer’s representations or promises at the time of each transaction.

How the Investment Contract Terminates

A non-security crypto asset that was subject to an investment contract does not remain subject to it in perpetuity. Separation occurs, and the investment contract ceases to exist, when purchasers can no longer reasonably expect the issuer’s representations or promises to engage in essential managerial efforts to remain connected to the asset. After separation, secondary market offers and sales of the asset are not securities transactions (unless the issuer creates a new investment contract). Importantly, separation does not eliminate the issuer’s potential liability for prior securities law violations occurring during the existence of the investment contract.

When an Investment Contract Terminates	
Fulfillment of Issuer’s Representations or Promises	<ul style="list-style-type: none"> • The investment contract terminates once the issuer has completed the essential managerial efforts it represented or promised it would undertake, even if the issuer continues to provide non-essential activities (e.g., open-source maintenance, administrative support). • Completion may be determined based on how the issuer itself defined or described the efforts (e.g., achieving decentralization as the issuer defined it, not a general market conception). • Upon delivery in an immediate offering (ICO) or delayed offering (SAFT), separation may occur at or shortly after delivery if the issuer has publicly disclosed completion of essential efforts and purchasers would not reasonably expect further managerial efforts to remain connected to the asset.
Failure to Satisfy Issuer’s Representations or Promises (Abandonment)	<ul style="list-style-type: none"> • Separation occurs when purchasers would not reasonably expect the issuer to be able to fulfill or continue to engage in the essential managerial efforts it represented or promised. • Examples include: (1) a sufficiently long period of inactivity after which it has become clear the issuer has neither performed nor signaled intent to perform; or

	(2) a widely disseminated and unambiguous public announcement that the issuer is abandoning development.
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Protocol Mining, Protocol Staking and Airdrops

The interpretation also excludes certain proof-of-work and proof-of-stake activities from constituting an offer and sale of a security and supersedes prior staff statements on staking. The interpretation does not expressly address deposit of crypto assets with a custodian or cross-chain bridge, like liquidity pool staking or rewards or other token distribution models.

Activity	Type	Key Considerations
Protocol Mining (Proof-of-Work)	Self (Solo) Mining. Miner contributes own computational resources to validate transactions and mine new blocks.	<ul style="list-style-type: none"> • Mining activities are administrative or ministerial in nature. Rewards are payments for services provided to the network, not profits from third-party managerial efforts.
	Mining Pool. Miners combine computational resources; pool operator coordinates and distributes rewards proportionally.	<ul style="list-style-type: none"> • Miners earn rewards from their own computational contributions, not from pool operator’s essential managerial efforts. • Pool operator activities are administrative or ministerial. • Exception. If miners passively rely on the operator to provide computational resources, that may constitute essential managerial efforts.
Protocol Staking (Proof-of-Stake)	Self (Solo) Staking. Owner directly operates a validator node.	<ul style="list-style-type: none"> • Stakes its own assets and maintains full ownership and control. • Rewards derive from the operator’s own validation activities.
	Self-Custodial Staking With Third Party. Owner retains custody of assets and delegates validation rights to a node operator.	<ul style="list-style-type: none"> • Owner retains custody and control. • Validation services are administrative or ministerial. • Node operator does not guarantee or set rewards (but may deduct fees).
	Custodial Arrangement. Owner transfers custody of assets to a third-party staking service.	<ul style="list-style-type: none"> • Custodian does not decide whether, when or how much to stake. • Owner retains beneficial ownership. • Custodian does not guarantee or set reward amounts (but may deduct fees).
	Liquid Staking. Owner deposits assets into a liquid proof-of-stake staking protocol and receives a receipt token representing the staked position.	<ul style="list-style-type: none"> • Receipt token issued on a one-to-one basis for deposited non-security crypto assets. • Provider does not decide whether, when or how much to stake; acts as agent. • Provider does not guarantee or set reward amounts (but may deduct fees).
	Ancillary Services. Service providers may offer slashing	<ul style="list-style-type: none"> • Each ancillary service is administrative or ministerial in nature and does not constitute essential managerial efforts.

	coverage and alternate reward payment schedules.	
Wrapping	Wrapping of a Non-Security Crypto Asset. Holder deposits a non-security crypto asset with a custodian, smart contract, bridge or similar arrangement and receives a wrapped or representative crypto asset intended to reflect the deposited asset on a one-to-one or other specified basis.	<ul style="list-style-type: none"> • The wrapped token provider must not directly or indirectly offer any return, yield, profit opportunity or additional good or service, and the deposited asset must be held for holders' benefit and cannot be transferred, lent, pledged, rehypothecated or otherwise used while the wrapped token is outstanding. • If those conditions are met, the offer and sale of a redeemable wrapped token that is a receipt for a non-security crypto asset that is not otherwise subject to an investment contract does not involve the offer and sale of a security. • By contrast, a wrapped token that is a receipt for a digital security or for a non-security crypto asset that is itself subject to an investment contract is a security.
Certain Airdrops of Non-Security Crypto Assets	Covered Airdrop Scenarios. Crypto asset issuers disseminate their non-security crypto assets in exchange for no or nominal consideration.	<ul style="list-style-type: none"> • No money, goods, services or other consideration provided by recipients to the issuer in exchange (i.e., no "investment of money"). • The previous provision of consideration to the issuer is permitted so long as that prior consideration was not provided in exchange for the airdropped asset. • Interpretation does not address airdrops of digital securities.

The interpretation provides market participants with a useful framework for understanding the current views of the SEC and CFTC through a set of clearer sorting principles, but the *Howey* test and related case law remain unchanged. Determination of factors like whether efforts are "essential managerial assets" "administrative, ministerial or technical in nature, whether a "central party" exists or whether representations and promises have been met, may be subject to varying interpretations. Digital asset and transaction-specific facts-and-circumstances analysis will continue to be essential in determining how the federal securities laws apply to evolving digital asset innovations.

The jurisdictional lines drawn in the interpretation will affect how digital asset entrepreneurs approach the launch and development of digital asset ecosystems, the specific frameworks used by market intermediaries to determine which digital assets to support, and influence the strength of pending and future enforcement actions involving digital assets, as well as the defenses available to market participants who structure their activities in reliance on the interpretation's categories and principles.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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