

The Distributed Ledger

Blockchain, Digital Assets and Smart Contracts

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Democratic DeFi Proposal Highlights Competing Visions for Crypto Asset Market Structure Regulation

Executive Summary

- **What's new:** Senate Democrats have introduced a DeFi proposal that creates a new regulatory framework for decentralized finance platforms, focusing on preventing illicit finance and regulatory arbitrage by applying existing securities market requirements to DeFi.
- **Why it matters:** The DeFi proposal would significantly expand regulatory oversight of DeFi platforms and front-end applications, impacting developers, operators and intermediaries in the digital asset and cryptocurrency sectors.
- **What to do next:** Companies and organizations involved in DeFi should closely monitor legislative developments, assess their exposure to new regulatory definitions, and prepare for potential registration, compliance and risk management obligations.

Key Points

- A new Democratic counterproposal on DeFi regulation highlights several policy differences over how to regulate digital asset market structure in the U.S. Due to policy disagreements, lawmakers remain at odds over the timeline for drafting a comprehensive market-structure bill and its eventual passage.
- This proposal is the third cryptoasset market structure regulatory framework to come out of Congress. In September, the Senate Banking committee released its proposal, and the CLARITY Act passed the House in July.
- All three proposals seek to leverage existing regulatory frameworks to create a crypto market structure and show Congress' instinct to retrofit the current system rather than design one built for crypto.
- The Democratic proposal, however, would require DeFi front-end applications to register with the SEC or CFTC and bring them under rigorous KYC rules and Treasury oversight, marking a clear expansion of federal control over decentralized platforms.
- With a lack of alignment on key issues, the Senate Banking Committee has paused digital market structure meetings, while the Senate Agriculture Committee is likely to release its own draft bill in October. It's unclear whether procedural and policy disagreements will prevent the Senate from passing crypto market structure legislation in 2026.

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Senate Democrats recently produced a counteroffer to Republicans' decentralized finance (DeFi) and cryptocurrency legislative agendas. The Democrats' DeFi proposal (DeFi Proposal) focuses on preventing illicit finance and regulatory arbitrage through decentralized finance platforms. It attempts to achieve this objective by creating a regulatory framework that incorporates many existing regulatory requirements for securities markets participants and applying them to DeFi.

The DeFi Proposal, which has not been drafted into legislative text, covers a wide-range of DeFi applications and platforms in a new regulatory regime overseen by the Department of the Treasury (Treasury), the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC). The DeFi Proposal comes on the heels of the House's passage of the CLARITY Act in July 2025 and the Republican-led Senate Banking Committee's Responsible Financial Innovation Act (RFIA) draft bill that was released on September 9, 2025.

While the DeFi Proposal tracks the RFIA in certain respects, several provisions seek to advance an alternative approach to crypto market structure regulation.

Role of the Treasury

The DeFi proposal takes a unique position and gives Treasury a key role in the market structure process and grants it the authority to determine whether a protocol is sufficiently decentralized. Additionally, the DeFi Proposal treats any DeFi project whose controllers generate revenue from users, exercise significant influence in the project, and maintain concentrated voting power as a "money-services business," though Treasury would be able to expand that definition.

Like the RFIA and the CLARITY Act, the DeFi Proposal assigns Treasury a central role in preventing illicit financial activity in digital assets but its approach differs. The RFIA and the CLARITY Act each task Treasury with drafting rules applicable to BSA and anti-money laundering obligations to certain digital asset service providers and intermediaries. By contrast, the DeFi Proposal empowers Treasury to create a restricted list of DeFi projects and apps that have been used for money laundering or other illegal purposes. It further allows Treasury to determine whether an individual or a group of individuals has enough control over a DeFi platform to be labeled as a "digital asset intermediary" for purposes of the DeFi Proposal and the BSA. These entities would also be classified as Virtual Asset Service Providers under U.S. law and be subject to applicable regulatory requirements.

Digital Asset Market Structure

All three proposals leverage existing regulatory frameworks for persons that perform essential functions in the digital asset markets ecosystem and subject them to varying degrees of regulatory oversight. The CLARITY Act contains significant exemptions for DeFi projects from most SEC or CFTC regulations (but *not* antifraud, antimanipulation or false reporting rules) if they are merely verifying blockchain transactions, supplying computing power, building blockchain interfaces or developing trading software and wallets. The RFIA adopts the GENIUS Act's definition of digital asset service providers, which contains less-sweeping exemptions. The RFIA also calls for the creation of a public-private partnership to allow participants to test new tokens and other DeFi or crypto projects within a closely watched joint SEC-CFTC sandbox.

The DeFi Proposal, however, creates a new layer of potential regulatory oversight by explicitly extending obligations to front-end applications in an attempt to close perceived regulatory gaps. The DeFi Proposal deems any person or entity that designs, deploys, controls or operates a front-end service for a DeFi protocol, or materially benefits from a DeFi protocol that facilitates covered activities such as trading, custody, settlement and lending, to be a digital asset intermediary. As a result, they would be required to register as brokers with the SEC, or as futures commission merchants or digital commodity brokers with the CFTC, unless another category of registrant is more appropriate to their activities. The DeFi Proposal requires digital asset intermediaries to implement a full risk management program, conduct regular stress tests and ensure any underlying code is independently audited. It also mandates that they monitor for fraud, manipulation, sanction evasion, money laundering and other illicit finance activities.

Investment Contracts and Ancillary Assets

Compared to the CLARITY Act and RFIA, the DeFi Proposal offers little in the way of developing clearer rules of the road for digital assets that may be deemed to be investment contracts that currently fall under the SEC's jurisdiction. Both the CLARITY Act and the RFIA would create a unified regulatory framework for digital assets and currencies, but where the CLARITY Act sought to classify digital assets into three distinct buckets and make the CFTC the premier U.S. crypto regulator, the RFIA makes the SEC the primary regulator over what it calls "ancillary assets" — digital assets distributed in connection with an investment contract — when traded in primary markets, such as for the purpose of raising capital. Ancillary assets traded in the secondary market would

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not be considered securities under the RFIA, and it requires the SEC to issue joint regulations with the CFTC regarding margins, swaps, futures, options and digital commodities. The Senate Agriculture Committee is expected to soon release its own draft bill that would outline the CFTC's authority.

Importantly, the RFIA also requires that the SEC define "investment contract," which could modify or codify the test for such contracts from the Supreme Court's *SEC v. Howey* decision. Because Senate Democrats hope the DeFi Proposal will be just one part of a more comprehensive market-structure bill, the DeFi Proposal does not contain a requirement that the SEC define investment contracts. Notably, Sen. Elizabeth Warren (D-Mass.), the ranking member of the Senate Banking Committee, has publicly opposed changes to the Howey test and the creation of a category of ancillary assets.

Legislative Path Forward

Because of policy disagreements, lawmakers remain at odds over the timeline for drafting a comprehensive market-structure bill and its eventual passage. Republican senators have asked Democratic senators to set a date to mark up the bill, but Democrats have refused to do so until both sides can agree on its content. This stalemate has led the Senate Banking Committee to pause its meetings on the bill, while the Senate Agriculture Committee is expected to release its own bill outlining the CFTC's authority. It's unclear whether these procedural and policy disagreements will simply delay or ultimately derail Congress's efforts to pass crypto market structure legislation in 2026. A bipartisan compromise will likely be required for any crypto market-structure bill to clear the Senate's 60-vote threshold.