

Publications

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Beyond the Blockchain: What's Next for Digital Assets After Explosive Growth in 2024

Web3 represents the next evolution of the internet, characterized by decentralized networks and blockchain technology, enabling user-centric platforms and applications with enhanced security and data ownership. Digital assets, a cornerstone of Web3, include cryptocurrencies, non-fungible tokens (NFTs) and other blockchain-based assets, offering novel methods of value exchange, investment and digital ownership. Every other week, Polsinelli puts out its BitBlog Bi-Weekly,¹ which breaks down the biggest legal developments in the blockchain, Web3 and crypto industry over the two preceding weeks.

2024 was a landmark year for the Web3 industry, with its usage reaching all-time highs in volume and growing in total market cap from \$1.7 trillion at the beginning of 2024 to roughly \$3.5 trillion at the time of this writing. As we look back through 2024, the Web3 legal developments from the past year emphasize the critical need for clarity and balance in how laws and regulations intersect with emerging technologies.

Looking forward to what's next, a picture emerges of what legal trends companies looking to explore blockchain-enabled technologies and existing Web3 industry participants should pay close attention to in 2025.

Expected Shift in U.S. Regulatory Environment

With the change in presidential administrations, many are expecting to see a shift in how regulatory agencies and legislative efforts approach blockchain-enabled technologies. At the Securities and Exchange Commission (SEC), Chair Gary Gensler has announced his resignation, as has Commissioner Jaime Lizárraga; both voted to reject an application for a Bitcoin exchange-traded fund (ETF) before its eventual approval after the D.C. Circuit ruled the SEC's rejection was arbitrary and capricious. That leaves just Commissioners Peirce (seen as pro-crypto), Uyeda (pro-crypto) and Crenshaw (seen as anti-crypto, but on an expired term) left until new commissioners are appointed by President-elect Donald Trump and approved by Congress, including Paul Atkins, whom Trump has announced is his pick for next SEC chair.

Trump has also indicated he plans to shift certain administrative priorities involving digital assets away from the oversight of the SEC and under the umbrella of the Commodity

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Futures Trading Commission (CFTC). This indicates that the incoming administration believes most digital assets should be regulated as commodities instead of securities.

It also appears that David Sacks, who was announced to be the administration's artificial intelligence and cryptocurrency "czar," will have a significant role in the incoming administration's coordination of digital asset policies across agencies. It is unclear what that means for pending lawsuits brought by the SEC against major digital asset exchanges and how those existing enforcement actions will be handled with this shift in enforcement priorities.

Equally important will be whom Trump taps to lead the Department of the Treasury and to key positions in the Department of Justice. Already, Jay Clayton has been announced as the pick to lead the U.S. Attorney's Office for the Southern District of New York, with a corresponding announcement from the office's co-chief of the securities and commodities fraud task force that digital asset-related prosecutions are expected to be deemphasized in 2025.

On the legislative front, there is a real possibility for various digital asset legislative efforts to be passed in 2025. In 2024 the Financial Innovation and Technology for the 21st Century Act (FIT 21) passed in the House of Representatives with a substantial bipartisan 279-136 vote. There is a chance for comprehensive digital asset regulations to pass in the upcoming Congress, but it is expected the industry will advocate for something closer to the Safe Harbor proposal of Pierce (Proposed Securities Act Rule 195) rather than rushing to comprehensive legislation like FIT 21, which may have unanticipated downstream effects on future developments. There is also the expected legislation over "stablecoins" (digital assets pegged to the U.S. dollar), discussed below, and various banking laws that are expected to come under scrutiny in the incoming Congress. All these changes are expected to help grow the digital asset industry in the United States, which had been shrinking in terms of market share in recent years due to various legal uncertainties and the risk of seemingly arbitrary enforcement actions.

Stablecoins Go Mainstream in 2025

A stablecoin is a type of cryptocurrency that is designed to provide the benefits of other cryptocurrencies (e.g., Bitcoin and Ethereum), such as fast transactions and decentralization, while maintaining a stable value over time and minimizing the volatility that is generally associated with cryptocurrencies. This stability is a result of the stablecoin being "pegged" (i.e., having its market value linked to an external reference) to a reserve asset, including fiat currencies (e.g., the United States dollar) or commodities (e.g., gold or silver). This pegging is what differentiates stablecoins from other cryptocurrencies, which are not backed by reserve assets and can greatly fluctuate.

Although there are various types of stablecoins, the most common types fall into the following three categories:

- Fiat-collateralized stablecoins in which the stablecoin is backed by a corresponding amount of fiat currency (e.g., USD or other traditional currency);
- Crypto-collateralized stablecoins in which the stablecoin is backed by other cryptocurrencies;
- Algorithmic stablecoins in which the stablecoin relies on complex algorithms to adjust supply based on market demand.

In addition to the reduced volatility that stablecoins offer, the use of stablecoins has several additional advantages, such as faster and cheaper cross-border transactions, access to financial services in regions with unstable currencies, easier access to the

crypto ecosystem and freeze and seize functionality to combat illicit financing. However, the use of stablecoins is not without risk. The centralized reserve assets or entities still have their own underlying risk and could become compromised or mismanaged, there is regulatory uncertainty surrounding the use of stablecoins, and stablecoins may not offer the same level of privacy as some other cryptocurrencies.

Looking forward to 2025, due to stablecoins' transformative functionalities noted above, we expect the notion that "stablecoins" are simply a fad to disappear entirely and the adoption of real-world use cases to pick up momentum as 2025 progresses. In 2024, stablecoins already represented nearly a third of daily crypto usage, and we expect that to grow in 2025 as more and more commodity traders, producers, importers, shipping companies and other corporations will turn to stablecoins to solve certain business challenges related to fixing supply inefficiencies, speeding up global remittance flows, and resolving inefficient cross-border payment corridors between developed and underdeveloped markets.

Cryptocurrency Mergers and Acquisitions in 2025 and Beyond

Stripe, a payment processing behemoth, recently acquired stablecoin platform Bridge for \$1.1 billion. Bridge, which was founded in 2022, is an alternative payment method that allows businesses to store and accept stablecoins as payment and/or gives businesses the ability to issue their own unique stablecoin.

Stripe's acquisition of Bridge will likely have substantial impacts on the stablecoin market in the United States, such as:

- Lowering the cost of using stablecoins as a payment method, which will attract more businesses and consumers;
- Increasing competition in the stablecoin market, resulting in market pressure for other stablecoin-based companies to improve existing products or create new offerings;
- Creating the need for United States regulators to enact clearer guidelines around the use and acceptance of stablecoins as a payment method.

As noted above, we expect the use and acceptance of cryptocurrency to continue its U.S. growth in 2025 and beyond under the new, pro-crypto presidential administration, including a drastic increase in mergers and acquisitions in the stablecoin realm. This expectation is based on Trump's recent announcement that he intends to appoint Atkins chair of the SEC. Atkins is a strong proponent of cryptocurrencies and will likely play a key role in form-fitting regulation of the cryptocurrency industry and shaping key pro-business regulations that will support the growth of the cryptocurrency industry.

Privacy Rights Take Center Stage With Zero-Knowledge Proofs and Crypto Mixing

A zero-knowledge proof (ZKP) is a cryptographic technique that helps ensure privacy by enabling one party (the prover) to prove to another party (the verifier) that a value or statement is true without revealing any additional information apart from the fact that the specific value is true. For example, a ZKP can be used to prove a person is 18 without revealing the prover's identity or other unnecessary details. In a cryptocurrency context, ZKPs allow cryptocurrency users to make pseudonymous transactions on the blockchain while still retaining the ability to prove they meet certain eligibility requirements (like age, nationality or domicile) for those transactions.

Crypto mixing is a cryptographic technique that aims to obscure the transaction history of cryptocurrencies by combining various cryptocurrency users' coins into a pool and then redistributing the coins to new digital wallets, resulting in the enhancement of privacy for

cryptocurrency users. Although there are obvious reasons to want financial privacy even over entirely legal transactions (would you want your bank account information to be publicly available?), crypto mixing is regularly associated with illegal activities due to the ability to use crypto mixing to conceal the source of illicit funds. The legality of crypto mixing varies by country and jurisdiction. In August 2022, the United States Treasury Department's Office of Foreign Assets Control (OFAC) sanctioned digital asset mixing software "Tornado Cash" for the alleged use of the software by illicit actors in laundering more than \$7 billion of virtual currency. Although the U.S. Court of Appeals for the 5th Circuit overturned the OFAC sanction on November 26, 2024, (based on the 5th Circuit's interpretation of federal law that OFAC overstepped its authority to regulate "property" by attempting to regulate crypto mixing, which does not constitute "property"), it is clear that the use of crypto mixing will continue to be aggressively monitored under both the current and next administrations.

In 2025, under the new administration, we expect the use of ZKPs to become more accepted in highly confidential industries such as health care and financial services, where highly sensitive electronic data is at stake and where ZKPs can make it harder for hackers to obtain that confidential information. We expect crypto mixing will continue to be under a closely watched microscope, as the benefits of financial privacy may be overshadowed by the ability of illicit actors to conceal funds through use of such technologies.

Private Industry Litigation Continues to Rise

In our 2024 predictions, we said that "a new wave of private litigation is occurring and likely to increase," which turned out to be correct. According to the Blockchain Association, the digital asset industry has spent over \$430 million in litigation costs² in just actions brought by the SEC. While the change in leadership at the SEC is expected to dramatically reduce that administrative agency legal spend, at least some of those costs can be expected to shift to those incurred in private litigation.

In the past year, there were class action lawsuits brought against NFT marketplaces and issuers, arguing those digital asset sales constituted unregistered securities transactions. There were bankruptcy-related actions regarding disputes dating back to the collapse of digital asset exchange FTX and related circumstances from 2022. Individuals brought lawsuits against decentralized autonomous organizations (DAOs), claiming participation in such organizations creates partnership liability for the actions of the DAO. These actions, and a host of other actions brought by individuals and entities regarding digital asset matters, demonstrate a rising trend of private litigation. Industry participants should be prepared to address these litigation risks ahead of time with well written agreements that properly account for the technical nuances of the underlying technology and through conscious decisions on legal structuring. While these lawsuits will primarily involve traditional contract, statutory and tort legal issues, which are not unique to digital assets, the knowledge of an attorney who is familiar with these assets and their unique features will be an essential factor in efficiently and successfully managing, addressing and resolving disputes involving blockchain-enabled products and services.

Conclusion

It is clear that 2024 marked a pivotal year for Web3, with unprecedented growth and transformative legal developments shaping the industry's trajectory. The anticipated regulatory shifts, burgeoning adoption of stablecoins, increased focus on privacy technologies like zero-knowledge proofs and a rise in private litigation are all signals of an evolving landscape. Companies exploring blockchain-enabled technologies and established players in the Web3 space must stay ahead of these trends to navigate the opportunities and challenges of 2025 effectively. With thoughtful legal frameworks, strategic planning and proactive compliance, the Web3 ecosystem is poised to continue

its expansion, redefining how we think about digital assets, data ownership and the internet itself. Polsinelli's BitBlog Bi-Weekly will remain your go-to resource for tracking these critical developments in the year ahead.

[1] <https://www.polsinelli.com/polsinelli-bitblog/category/bi-weekly-update>

[2] <https://theblockchainassociation.org/regulation-by-enforcement/>