Paul, Weiss

Client Memorandum

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Q3 2025 U.S. Legal & Regulatory Developments

In This Issue:

The following is our summary of significant U.S. legal and regulatory developments during the third quarter of 2025 of interest to Canadian companies and their advisors.

SEC Statement Permitting Mandatory Arbitration of Securities Law Claims

On September 17, 2025, the U.S. Securities and Exchange Commission (the "SEC") adopted a Policy Statement that the Federal securities laws do not bar charter and bylaw provisions that would impose mandatory arbitration on investor claims against issuers. As a result, SEC staff will no longer consider these provisions in determining whether to accelerate the effectiveness of a registration statement, and instead will focus on the adequacy of the registration statement's disclosures, including disclosure regarding the arbitration provision.

Whether such provisions may be included in a company's organizational documents does remain a question of state corporate law. In that regard, we note that Delaware recently enacted an amendment to the Delaware General Corporation Law that is intended to bar mandatory arbitration of Federal securities law claims for Delaware corporations.

In her dissenting remarks, Commissioner Crenshaw expressed concerns about the impact on investors, who would be foreclosed from securities litigation class action lawsuits by such mandatory arbitration provisions.

For the full text of our memorandum, please see:

- https://www.sec.gov/files/rules/final/2025/33-11389.pdf

For the SEC's Policy Statement, please see:

- https://www.sec.gov/files/rules/final/2025/33-11389.pdf

Exxon's Auto-Voting Plan: Implications for Shareholder Activism and Considerations for Companies

On September 15, 2025, the SEC issued a no-action response stating that it would not recommend enforcement action against Exxon's proposed auto-voting plan for retail investors. Under the plan, Exxon's retail investors (including retail investors who

beneficially own Exxon shares through a bank, broker or plan administrator) may elect to have their shares automatically voted in accordance with the board's recommendations. Shareholders who opt into the auto-voting plan can later opt out by either casting their vote at a shareholder meeting or revoking their auto-voting instructions. Exxon intends to issue annual notices to its retail holders reminding them of their enrollment in the auto-voting program.

Exxon's plan tackles a long-standing dilemma facing companies with a large retail shareholder base. Most retail shareholders do not vote their shares, but when they do, they tend to overwhelmingly vote in favor of management. While the retail base of most large public companies ranges from 15% to 25%, the retail stake in legacy companies that went public decades before the rise of institutional investing can be as high as 40%.

The impact of a large retail base can be particularly consequential in activist campaigns, where a combination of a large retail base coupled with a relatively small actively managed base can meaningfully tilt the outcome of a proxy contest in favor of the company. However, retail holders can be difficult and costly to reach during proxy contests (and for the most part, have been overlooked by both companies and activists in favor of institutional investors). By attempting to "lock in" retail investors in advance, Exxon's auto-voting plan aims to tilt the outcome of future shareholder proposals or proxy contests in the company's favor, and appropriately so, given the high level of support retail holders generally have had for incumbent boards of directors.

We set forth below some considerations for companies as they evaluate whether to adopt similar voting plans for their retail investors.

1. ***Relative Influence of Proxy Advisors***. For most public companies, a significant portion of the shareholder base comprises institutional investors whose voting decisions are influenced by proxy advisory firms. Notwithstanding ongoing regulatory efforts to curtail the influence of proxy advisors, proxy advisors continue to wield significant influence and tend to support dissident slates in approximately half of all proxy contests, making them a critical source of support for activists. By contrast, the largest passive investors generally support management. The growth of pass-through voting programs adopted by passive investors, allowing clients to vote in accordance with proxy advisor policies may only further increase the influence of proxy advisors. While securing the support of retail investors can be helpful, in many situations, retail votes may not offset the votes of investors who vote in accordance with proxy advisor recommendations.

2. ***Retail Base Stability and Composition***. Retail investing has seen noticeable growth in recent years amid the proliferation of online trading tools and social media platforms discussing trading strategies. Retail volumes have doubled during the past decade with more growth expected. Retail investing has also become more volatile, with a growing list of companies finding themselves caught in meme stock trading. An unstable retail base can make it complex, time-consuming and costly to administer an auto-voting plan. While an exception rather than the norm, a retail base with a high level of churn may also be an indicator of a predominance of growth-oriented and/or short-term retail shareholders who could be more inclined to vote with an activist instead of supporting management. For example, activist investor Ryan Cohen successfully rallied the support of retail investors for his campaigns at GameStop and Bed Bath & Beyond.

3. ***Potential Uptake Rate***. The advantage of Exxon's auto-voting plan is that it provides ample time for Exxon to secure the support of retail investors, unlike in proxy contests where even concerted proxy solicitation efforts tend to only attract a fraction of the overall retail base. However, Exxon's auto-voting plan may still prove challenging to administer as retail holders can be difficult to reach and disinclined to vote. Many retail holders do not vote because of the complexities of the proxy voting process. These same retail holders may find an auto-voting plan to be similarly complex and fail to opt in.

4. ***Cost Considerations***. An auto-voting program can be costly to administer both in absolute terms and relative to the benefits reaped. The decision whether to adopt an auto-voting plan should take into consideration factors such as the size of the company's retail base, overall shareholder base composition, historical voting patterns among the company's retail investors, likely receptiveness of retail investors to an auto-voting plan and the ongoing costs and infrastructure required to administer the plan.

Exxon's auto-voting plan can be a useful tool for preemptively mobilizing a supportive but difficult-to-reach retail base. This plan is likely to be most effective at companies with a large and stable retail shareholder base, such as legacy companies with income-oriented investors. For many other companies, it remains to be seen whether an auto-voting plan will have a

meaningful impact in the context of shareholder activism.

The best defense against activism (other than strong performance) remains staying closely attuned to shareholder sentiment and being ready to respond when an activist emerges.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/insights/client-memos/exxon-s-auto-voting-plan-implications-for-shareholder-activism-and-considerations-for-companies

For the SEC's no-action letter, please see:

- https://www.sec.gov/rules-regulations/no-action-interpretive-exemptive-letters/division-corporation-finance-no-action/exxon-mobile-091525

U.S. Antitrust Agencies Continue to Focus on Interlocking Directorates

On September 15, 2025, the Federal Trade Commission (the "FTC") announced that it resolved an enforcement action relating to Section 8 of the Clayton Act. Section 8 generally prohibits a director or officer of one company from serving on the board of a competitor, subject to certain de minimis exceptions and safe harbors.

The FTC's Enforcement Action

As described in the FTC's announcement, three members of the board of Sevita Health were also serving on the board of Beacon Specialized Living Services, Inc. Both companies "provide services, including residential facilities, to individuals with intellectual and developmental disabilities."

The matter was resolved with resignations to remove the interlocks and the issuance of a press release. The FTC did not commence a formal administrative proceeding or require a consent order. This approach is consistent with how Section 8 matters have historically been resolved by the antitrust agencies. In the prior administration, the Antitrust Division of the U.S. Department of Justice (the "DOJ") issued numerous press releases announcing board resignations to resolve interlocking directorate matters.

The announcement does not say how the FTC learned of the particular interlocks at issue. Indeed, there are many ways in which the DOJ and FTC can become aware of interlocks, including proactive monitoring, tips from the public and academic studies. The agencies also uncover evidence of interlocks in the course of merger or conduct investigations. The HSR rules now require that filers provide information about officers and directors that could reveal a potential section 8 issue.

Background on Section 8 of the Clayton Act

Section 8 of the Clayton Act, 15 USC §19, states that, if the corporations are above a certain size, "[n]o person shall, at the same time, serve as a director or [board-appointed] officer in any two corporations . . . that are . . . by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws."

Currently, Section 8 applies where each corporation has capital, surplus and undivided profits aggregating to more than $51,380,000. Section 8 does not apply if the competitive sales of either corporation are less than $5,138,000. Additionally, if the competitive sales of either corporation are less than 2% of that corporation's total sales, or less than 4% of each corporation's total sales, the interlock is exempt. Competitive sales are "all products and services sold by one corporation in competition with the other."

The law provides for a one-year grace period such that a person who was not initially prohibited from serving as an officer or director may continue to serve until one year after the corporations become competitors and the competitive sales exceed the relevant threshold.

Section 8 has been interpreted to cover both "direct" interlocks — i.e., when the same individual serves as a director or officer of competing corporations — and on occasion "indirect" interlocks — i.e., where different individuals serve as directors or officers of competing corporations, but both have been "deputized" to act on behalf of the same third entity (e.g., a private

equity fund). The interlock at issue here appears to be direct. According the FTC, "three individuals [were] serving as directors for both Sevita and Beacon simultaneously."

Action Item

Periodically Review Board Memberships for Potential Competitive Overlap

In the announcement, the director of FTC's Bureau of Competition stated: "We encourage all firms to review their board memberships to avoid any overlaps with competitors—including when new board members are added as a result of investments by private equity firms or other new shareholders."

Potential Section 8 issues can arise when a company appoints new officers and directors. They can also arise as a company's business evolves or as a fund's portfolio—and the businesses within in it—shift and expand. Indeed, companies that are not initially competitors may become competitors as product and service lines change and markets evolve. Therefore, companies and private equity funds should be aware of the prohibitions of Section 8 and periodically evaluate board memberships as part of their ongoing antitrust compliance program.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/insights/client-memos/us-antitrust-agencies-continue-to-focus-on-interlocking-directorates

For the full text of our previous memorandum concerning interlocking directorates, please see:

- https://www.paulweiss.com/insights/client-memos/doj-expresses-concerns-about-interlocking-directorates

For the FTC's announcement, please see:

- https://www.ftc.gov/news-events/news/press-releases/2025/09/three-directors-resign-sevita-board-directors-response-ftcs-ongoing-enforcement-efforts-against

Sixth Circuit Raises the Bar for Class Certification in Federal Securities Fraud Cases

On August 13, 2025, the Sixth Circuit issued a unanimous opinion in *Owens* v. *FirstEnergy Corp.*, No. 23-3940 (6th Cir. Aug. 13, 2025) ("*FirstEnergy*") with significant ramifications for establishing reliance in securities fraud cases and analyzing damages models at the class certification stage. In *FirstEnergy*, the Sixth Circuit limited the applicability of the powerful presumption of reliance set forth in *Affiliated Ute Citizens of Utah* v. *United States* ("*Affiliated Ute*") to cases *primarily* based on omissions—not to those involving a mix of omissions and misrepresentations—and set forth a rigorous two-step analysis to determine the rare instance in which the presumption applies. The Sixth Circuit separately emphasized that district courts must conduct a "rigorous," claim-by-claim analysis to determine whether plaintiffs' proposed damages models can be applied on a class-wide basis as required under the federal rules and Supreme Court precedent. Both aspects of the opinion provide strong arguments that securities fraud defendants can deploy at the class certification stage.

Background

Reliance and Damages at the Class Certification Phase

To certify a class action, plaintiffs must show that there are common questions of law and fact that affect all class members, and that those common questions "predominate" over issues affecting individual members.

Reliance. The Supreme Court has recognized that requiring proof of individualized reliance from every putative class member in a securities fraud suit would effectively prevent securities fraud plaintiffs from proceeding under a class action because individual questions of reliance would predominate. Accordingly, the Supreme Court has established two different reliance presumptions in securities class actions. In *Affiliated Ute*, the Court held that plaintiffs do not need to prove reliance when their case is based on material omissions. Due to the unique difficulty of showing reliance on something that was never said, the Court permitted plaintiffs in cases "involving primarily a failure to disclose" to establish reliance merely by showing that "the facts withheld" were material. 406 U.S. 128 (1972). By contrast, in *Basic Inc.* v. *Levinson* ("*Basic*"), the Supreme Court held that in cases involving "public material misrepresentations"—as opposed to "omissions"—plaintiffs are entitled to a

rebuttable presumption of reliance "on the integrity of the market price" so long as the stock trades in an efficient market and certain other factors are present. 458 U.S. 224 (1988). Defendants in such cases may rebut the presumption by showing, among other things, that the alleged misrepresentations did not impact the issuer's share price. Accordingly, a threshold question at the class certification stage in securities fraud cases is whether plaintiffs' claims are properly characterized as based on omissions—in which case the stronger *Affiliated Ute* presumption applies—or as misrepresentations—in which case the rebuttable presumption under *Basic* applies.

Damages. To certify a class action, plaintiffs must also show that damages are capable of measurement across the entire class, otherwise questions of individual damages calculations will overwhelm the litigation and distract from issues that are common to the class. In *Comcast Corp.* v. *Behrend* ("*Comcast*"), the Supreme Court held that when certifying a class, district courts must conduct a "rigorous analysis" to determine whether the method proposed by plaintiffs to calculate damages is susceptible to class-wide treatment and consistent with their theory of liability. 569 U.S. 27 (2013).

History of the Dispute

In *FirstEnergy*, plaintiffs—a putative class of investors—alleged that FirstEnergy violated the Securities Exchange Act of 1934 (the "Exchange Act") and the Securities Act of 1933 (the "Securities Act") by misleading investors about the company's political activities. The complaint focused on a series of alleged omissions and misrepresentations, including that FirstEnergy did not disclose a lobbying campaign in Ohio, falsely represented that it complied with state and federal lobbying laws, and failed to adequately disclose the risks of engaging in political activities. The United States District Court for the Southern District of Ohio granted plaintiffs' motion for class certification, holding that the mixture of alleged omissions and misrepresentations was entitled to the *Affiliated Ute* presumption of reliance. The district court also held, with little discussion, that the plaintiffs' damages analysis was susceptible to class-wide measurement, applying the same analysis to plaintiffs' non-fraud Securities Act claims and fraud-based Exchange Act claims.

The Sixth Circuit's Decision

The Sixth Circuit reversed the district court on both counts.

On reliance, the Sixth Circuit held that the *Affiliated Ute* presumption does not apply in "mixed cases" where both misstatements and omissions are alleged. The appellate court created a two-step framework for assessing whether the *Affiliated Ute* or the *Basic* presumption of reliance applies:

First, courts must "classify each claim or group of claims as alleging either an omission or a misrepresentation." Notably, the Sixth Circuit held that "half-truths and generic, aspirational corporate statements are misrepresentations," not omissions.

Second, courts must "characterize whether the overall case is primarily based on omissions or on misrepresentations." This requires assessing four factors, namely, whether: "(1) the alleged omissions are only the inverse of the misrepresentations, i.e., the only omissions are the truth that is misrepresented; (2) reliance is in fact possible to prove by pointing to an alleged misrepresentation and connecting it to an injury; (3) the preponderance and primary thrust of the claims involve alleged misrepresentations made by the defendant(s); and (4) the alleged omissions have no standalone impact apart from any alleged misrepresentations." Under this new test, the *Affiliated Ute* presumption will apply only if none of those factors are present; otherwise, the rebuttable *Basic* presumption applies.

Because plaintiffs in *FirstEnergy* focused their arguments on "statements that FirstEnergy *did* make," the investors' claims were not primarily based on omissions and therefore, the *Affiliated Ute* presumption did not apply. Instead, the Sixth Circuit held that the case was "all about misrepresentations," observing that the *Basic* presumption is more appropriate when allegations focus on "half-truths."

On damages, the Sixth Circuit held that the district court failed to "rigorous[ly] analy[ze]" the investors' damages methodology under *Comcast*, because it assessed only whether the proposed damages model appropriately calculated damages under the Securities Act and it did not conduct that same analysis for the Exchange Act claims. Because "the Securities Act and Exchange Act calculate damages entirely differently," the Sixth Circuit held that "a rigorous analysis of the Exchange Act claims demanded much more from the district court than its cursory reference to the analysis of the Securities Act claims." As the Sixth Circuit explained, while the Securities Act provides a statutory formula for calculating damages that may apply uniformly across a class, the Exchange Act presents a "vastly different world" whose text both lacks a damages-calculation formula and explicitly requires proof of loss causation.

Implications

Defendants opposing class certification in securities fraud lawsuits should consider whether they can use the *FirstEnergy* decision and the Sixth Circuit's reasoning to bolster their defense:

Narrowing the *Affiliated Ute* Presumption: The Sixth Circuit joins a growing consensus among federal appellate courts in holding that the *Affiliated Ute* presumption is "strong medicine" reserved for cases truly centered on omissions. Plaintiffs cannot invoke this presumption simply by characterizing misleading statements as "half-truths" or by artful pleading that combines omissions with misrepresentations. Courts must rigorously analyze the nature of the alleged misconduct—and every alleged misstatement and omission—to determine the appropriate presumption of reliance. This raises the question, unanswered by the Sixth Circuit, of how *Affiliated Ute* can be reconciled with the Supreme Court's decision last year in *Macquarie Infrastructure Corp.* v. *Moab Partners, L.P.* ("*Macquarie*"), which we previously discussed here. The Court in *Macquarie* held that "pure omission" claims are not actionable under Rule 10b-5(b), meaning that plaintiffs claiming an "omission" of a material fact under Rule 10b-5(b) must show that the omission rendered statements made by the defendant misleading. We anticipate that future cases may address how, in light of *Macquarie*, *Affiliated Ute* can possibly have any application at all if pure omission claims are both exceedingly rarely pleaded and disallowed under Rule 10b-5(b).

Heightened Scrutiny of Damages Models: The Sixth Circuit cautioned district courts against rubberstamping damages models at the class certification stage, and instead reiterated the Supreme Court's guidance in *Comcast* that courts must conduct a "rigorous analysis" of whether damages are susceptible to class-wide measurement. The appellate court also clarified that plaintiffs must propose different damages models for Securities Act and Exchange Act claims, and that courts must assess the adequacy of such damages models separately.

Strategic Considerations for Defendants: Issuers and their officers facing securities fraud class actions should carefully assess whether the alleged misconduct is truly omission-based or, as is often the case, primarily involves misrepresentations or half-truths. Defendants should also scrutinize plaintiffs' damages models at the class certification stage and be prepared to challenge any failure to meet the rigorous standards set forth in *Comcast*.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/insights/client-memos/sixth-circuit-raises-the-bar-for-class-certification-in-federal-securities-fraud-cases

For the Sixth Circuit's opinion in *FirstEnergy*, please see:

- https://www.opn.ca6.uscourts.gov/opinions.pdf/25a0225p-06.pdf

Second Circuit Limits Insider Trading Liability for Prime Brokers

On September 16, 2025, the U.S. Court of Appeals for the Second Circuit affirmed the dismissal of insider trading claims against Morgan Stanley and Goldman Sachs (the "Banks") following the March 2021 collapse of Archegos Capital Management. Plaintiffs—investors in seven public companies (the "Issuers") in which Archegos held highly leveraged positions through brokerage services provided by the Banks—alleged that the Banks received advance warning of Archegos's imminent collapse and sold off their positions in the Issuers, leaving retail investors holding the bag. The Second Circuit held that plaintiffs did not plead an insider trading claim under the "classical theory" because Archegos did not owe a fiduciary duty to the Issuers, nor did plaintiffs satisfy the "misappropriation theory" because the Banks did not owe a fiduciary duty to Archegos. Plaintiffs also failed to plead particular facts that the Banks tipped material nonpublic information ("MNPI") to certain preferred customers. The decision confirms the limits on insider trading risk for prime brokers and banks providing brokerage services to arm's-length counterparties, even when facing complex, rapid unwind events.

Background

Archegos built up large, highly leveraged positions in the Issuers using total return swaps and margin lending services provided by prime brokers, including the Banks. Under these arrangements, the Banks purchased the underlying stock and paid Archegos appreciation in the stock price and dividends in exchange for fees, allowing Archegos to receive the benefit of stock ownership without actually purchasing the stock. Archegos beneficially owned between 30% to 70% of each Issuer's stock. The arrangements further provided that, if the Issuers' stock value decreased, the Banks could issue a margin call to Archegos to

cover the decline. To offset their market exposure, the Banks also purchased, on their own and for themselves, the same volume of Issuers' shares.

In March 2021, as the prices of the Issuers' stocks declined, the Banks issued margin calls that Archegos was unable to meet. Plaintiffs alleged that, after Archegos informed the Banks that it could not cover its obligations and requested a standstill, the Banks refused and quickly sold off their Archegos-related positions—both the shares held in connection with the swaps and their own proprietary shares—before the broader market became aware of Archegos's financial distress.

Plaintiffs filed putative class actions in the Southern District of New York, alleging that the Banks engaged in insider trading in violation of Section 10(b) of the Exchange Act and SEC Rule 10b-5, as well as Sections 20A and 20(a) of the Exchange Act, by selling their positions based on MNPI about Archegos's impending collapse. Plaintiffs alleged that the Banks avoided billions of dollars in losses at the expense of ordinary investors who were unaware of Archegos's financial distress. The district court dismissed the claims, finding that plaintiffs had not adequately alleged the existence of a fiduciary duty or sufficient facts to support claims of insider trading. Plaintiffs appealed.

The Second Circuit's Decision

A three-judge panel of the Second Circuit affirmed the dismissal in a unanimous opinion written by Judge Maria Araújo Kahn. The Second Circuit held that the plaintiffs failed to plausibly allege insider trading under the classical theory because "Archegos did not owe a fiduciary or fiduciary-like duty to the Issuers and, thus, [the Banks] are not liable as Archegos' tippees." The court rejected plaintiffs' argument that Archegos's large swap exposures made it a controlling shareholder and constructive insider of the Issuers, explaining that "an entity does not become a corporate insider based solely on its beneficial ownership of stock" because it lacks power to "vote its shares, influence corporate decisions, or access internal corporate documents."

The court also held that plaintiffs failed to adequately plead the misappropriation theory of insider trading because the Banks never "agreed to serve as Archegos' fiduciaries." Rather, the Banks simply "offered Archegos various brokerage services" through contracts negotiated at arm's length that entitled the Banks "to sell their Archegos-related positions upon Archegos' default." The court stressed that "a fiduciary duty cannot be imposed unilaterally by entrusting a person with confidential information." The court also rejected plaintiffs' argument that the Banks tipped MNPI to certain "preferred clients" because the complaint lacked particularized facts about the "content and circumstances of such tips."

Implications

The Second Circuit's decision offers welcome clarity for prime brokers, banks and other market participants navigating complex unwind scenarios. The ruling confirms that large swap exposures alone do not confer insider status or create a fiduciary duty for purposes of insider trading liability. The ruling also underscores that prime brokers exercising arm's-length negotiated rights to protect their own interests do not assume fiduciary obligations to their counterparties, limiting insider trading risk. To further mitigate risk, firms should consider whether to expressly disclaim fiduciary duties in brokerage agreements, carefully document any confidentiality commitments and maintain robust controls around information-sharing during block trades and unwind events. Finally, the ruling reinforces that tipping claims must be supported by specific, particularized facts, not mere inferences from trading patterns or market events. At bottom, the decision provides a strong foundation for defending against civil insider trading claims where no fiduciary duty exists and factual allegations are lacking.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/insights/client-memos/second-circuit-limits-insider-trading-liability-for-prime-brokers

For the Second Circuit's decision in *In Re: Archegos 20A Litigation*, please see:

- https://ww3.ca2.uscourts.gov/decisions/isysquery/de6536bc-9f9b-4d1b-b710-735d5883a6ec/1/doc/24-1162_opn.pdf https://www.opn.ca6.uscourts.gov/opinions.pdf/25a0225p-06.pdf

GENIUS Act Ushers in Comprehensive Federal Regulation of Payment Stablecoins

On July 18, 2025, President Trump signed the Guiding and Establishing National Innovation for U.S. Stablecoins Act (the "GENIUS Act") into law, marking a significant shift from the prior patchwork of state money transmitter laws. The GENIUS Act establishes a federal regulatory framework for payment stablecoins in the United States, introducing licensing

requirements for issuers, imposing reserve standards, and mandating compliance with Bank Secrecy Act/Anti-Money Laundering ("BSA/AML") and sanctions obligations. It also incorporates consumer protection measures, including disclosure requirements and redemption rights, sets detailed governance and reporting requirements for issuers, and regulates when a foreign issuer may offer or sell payment stablecoins in the United States using a digital asset service provider.

The GENIUS Act will go into effect on the earlier of (i) the date that is 18 months after the date of enactment (January 18, 2027) or (ii) the date that is 120 days after the "primary Federal payment stablecoin regulators" (defined below) issue final regulations. The primary federal payment stablecoin regulators are required to undertake notice-and-comment rulemaking and issue final rules within one year of enactment. Further, absent a safe harbor, three years after enactment (July 18, 2028), digital asset service providers will be prohibited from offering or selling payment stablecoins to a person in the United States unless they are issued by a "permitted payment stablecoin issuer" (defined below) or by a "foreign payment stablecoin issuer" (defined below) that meets certain requirements.

Payment stablecoins are digital assets designed to maintain a stable value relative to a reference asset, such as the U.S. dollar, and are typically used as a means of payment rather than an investment or speculative instrument. Stablecoins circulate on blockchain networks that allow for near-instant transfers outside of conventional payment systems. The market for stablecoins has grown rapidly in recent years—as of June 2025, stablecoins in circulation have a market capitalization of over $250 billion, approximately 99% of which are pegged to the U.S. dollar.

Until now, stablecoin oversight in the United States has been fragmented and largely state-driven. Most payment stablecoin issuers have operated under state money transmitter laws. Under the GENIUS Act, a new federal licensing regime will apply to payment stablecoin issuers, and federal law will generally preempt conflicting state requirements. As explained in more detail below, however, the GENIUS Act preserves a role for states that adopt frameworks "substantially similar" to the federal standards, allowing for continued state oversight.

Key Provisions of the GENIUS Act

- **Limitation on Issuers: Who May Issue Payment Stablecoins?**

  The GENIUS Act begins with a sweeping prohibition: "It shall be unlawful for any person to issue a payment stablecoin in the United States unless such person is a permitted payment stablecoin issuer." The GENIUS Act defines a "permitted payment stablecoin issuer" as a U.S. entity that is one of the following: (i) an approved subsidiary of an insured depository institution; (ii) a federal qualified payment stablecoin issuer; or (iii) a "State qualified payment stablecoin issuer."

  - ***Subsidiaries of insured depository institutions***. An insured depository institution may issue payment stablecoins through a subsidiary, provided the subsidiary is found to meet the requirements in Section 5 of the GENIUS Act, which are described below. A subsidiary's application will be considered by the parent insured depository institution's primary federal stablecoin regulator—the Board of Governors of the Federal Reserve System ("Federal Reserve Board"), the Office of the Comptroller of the Currency ("OCC"), the National Credit Union Administration ("NCUA"), or the Federal Deposit Insurance Corporation ("FDIC").

    Once an entity's application becomes "substantially complete" (which is when sufficient information for the primary Federal payment stablecoin regulator to render a decision on whether the applicant satisfies certain required evaluative factors prescribed in the GENIUS Act), a regulator has 120 days to decide whether to approve or deny the application. In line with the GENIUS Act's "safety and soundness" touchstone, regulators may only deny an application if the regulator determines the applicant's activities would be "unsafe or unsound." This determination must be informed by certain enumerated factors: (i) an applicant's ability to meet the requirements of the GENIUS Act "based on financial condition and resources;" (ii) whether an applicant's officers or directors include individuals convicted of certain financial felonies; (iii) the competence, experience, and integrity of the officers, directors, and principal shareholders of the applicant; (iv) whether the applicant's redemption policy meets the GENIUS Act's requirements; and (v) any other factors necessary to ensure "safety and soundness."

  If the regulator denies the application, it must provide a "written notice explaining the denial with specificity." This notice must include "identified material shortcomings" and "actionable recommendations on how the applicant could

address the identified material shortcomings." As recourse following a denial, the applicant has a right to a written or oral hearing and a right to reapply.

- ***Federal qualified payment stablecoin issuers***. Federal qualified payment stablecoin issuers include (i) nonbanks (other than state-qualified payment stablecoin issuers), (ii) uninsured national banks, and (iii) federal branches (i.e., OCC-licensed branches of foreign banks). These entities must be approved by the OCC according to the criteria and procedures described above. Notwithstanding any state law relating to licensing and supervision, federal qualified issuers are "licensed, regulated, examined, and supervised" exclusively by the OCC.

- ***State qualified payment stablecoin issuers***. The GENIUS Act provides an opportunity for states to regulate certain permitted issuers—those with less than $10 billion of outstanding issuance who are approved by a state regulator operating under a regime "substantially similar" to the federal regulatory framework.

  The GENIUS Act does not set out what constitutes a "substantially similar" regulatory framework; instead, it calls on the Secretary of the Treasury, "through notice and comment rulemaking," to "establish broad-based principles for determining whether a State-level regulatory regime is substantially similar to the Federal regulatory framework under this Act." Once those principles are established, "State payment stablecoin regulators shall review State-level regulatory regimes" alongside those principles and, within one year after the effective date of the GENIUS Act, submit to the Stablecoin Certification Review Committee ("SCRC")—a new three-person committee comprised of the Treasury Secretary (who serves as chair), the Federal Reserve Board Chair, and the FDIC Chair—a certification "that the State-level regulatory regime meets the criteria for substantial similarity," as established by the Secretary of the Treasury through notice-and-comment rulemaking. The SCRC must unanimously approve or deny such certifications within 30 days. The GENIUS Act requires annual recertification to the SCRC.

The GENIUS Act includes provisions prohibiting a public company that is not predominantly engaged in financial activities (and its wholly or majority-owned subsidiaries) from issuing payment stablecoins, unless the company receives a unanimous vote by the SCRC. The SCRC is required to make certain findings, including that the issuer will not pose a material risk to the safety and soundness of the U.S. banking system or the financial stability of the United States, and that the company will comply with data use limitations (including on advertising) regarding data received from stablecoin transactions.

This framework represents a fundamental shift from the pre-GENIUS Act environment, where nonbank issuers could operate under state money transmitter licenses. Now, all issuers must secure federal approval or state approval under a federally validated regulatory framework. This model is designed to preserve flexibility for smaller issuers while forcing larger issuers into a unified federal framework.

- **Reserve Requirements: Standards for Asset Backing and Transparency**

  Central to the GENIUS Act's risk-mitigation strategy is its full-reserve mandate. The GENIUS Act imposes mandatory 1:1 reserve backing for all outstanding stablecoins issued by payment stablecoin issuers. Permitted reserves are limited to the most liquid, low-risk financial instruments, including U.S. coins and currency, balances at Federal Reserve Banks, insured demand deposits, and short-term U.S. Treasury bills with a remaining maturity of 93 days or less. Limited use of repurchase agreements and securities issued by an investment company or other registered government money market fund is also allowed, provided they meet stringent criteria for over-collateralization and clearing.

  Section 4(a)(2) of the GENIUS Act prohibits rehypothecation of reserve assets for most purposes. This prohibition seeks to reduce or eliminate certain leveraged practices within cryptocurrency markets.

  In addition, issuers must provide monthly reserve disclosures, subject to review by a registered public accounting firm and accompanied by CEO and CFO certifications under risk of criminal penalty.

- **Redemption Policies and Consumer Protection**

  The GENIUS Act requires payment stablecoin issuers to honor redemption requests in a "timely" manner. The issuer's

redemption policies must be publicly disclosed and "establish clear and conspicuous procedures for timely redemption." If the issuer charges fees on purchasing or redeeming stablecoins, those fees must also be disclosed "publicly, clearly, and conspicuously" in "plain language." Any modification to fees must be disclosed to consumers at least seven days in advance.

There are a number of other consumer protection-focused provisions in the GENIUS Act, including prohibitions on tying, the use of deceptive names in marketing, and representing that payment stablecoins are backed by the full faith and credit of the United States, as well as priority for payment stablecoin holders in the event a payment stablecoin issuer becomes insolvent. The Act also includes a "prohibition on interest"—permitted payment stablecoin issuers and foreign payment stablecoin issuers may not "pay the holder of any payment stablecoin any form of interest or yield (whether in cash, tokens, or other consideration) solely in connection with the holding, use, or retention of such payment stablecoin." This prohibition prevents payment stablecoins from functioning like deposit accounts or traditional investment products.

- **Anti-Money Laundering and Sanctions Requirements**

  - ***BSA/AML and sanctions requirements***. The GENIUS Act contains AML and sanctions compliance requirements, reflecting congressional concern over the potential use of stablecoins in illicit finance and terrorist activity. "[A] permitted payment stablecoin issuer shall be treated as a financial institution for purposes of the Bank Secrecy Act" and therefore "subject to all Federal laws applicable to a financial institution located in the United States relating to economic sanctions, prevention of money laundering, customer identification, and due diligence." This includes (i) maintenance of an effective AML program; (ii) retention of appropriate records; (iii) suspicious activity monitoring and reporting; (iv) technical blocking, freezing, and rejecting capabilities; (v) effective customer identification programs, including "identification and verification of account holders with the permitted payment stablecoin issuer, high-value transactions, and appropriate enhanced due diligence"; and (vi) maintenance of an effective economic sanctions compliance program. The Treasury Secretary is required to adopt regulations "tailored to the size and complexity" of the issuer, to implement these requirements.

  - ***Foreign payment stablecoin issuers***. The GENIUS Act also includes AML requirements focused on payment stablecoins issued by a foreign payment stablecoin issuer. In general, a "payment stablecoin that is issued by a foreign payment stablecoin issuer may not be publicly offered, sold, or otherwise made available for trading in the United States," unless, among other things, the issuer has the "technological capability to comply and complies with the terms of any lawful order." If the Secretary of Treasury deems the foreign payment stablecoin issuer noncompliant, the Secretary is required to publish that determination in the *Federal Register* and issue a notification prohibiting digital asset service providers from facilitating secondary trading of payment stablecoins issued by the foreign payment stablecoin issuer. The prohibition becomes effective 30 days after the date of notification.

    Notably, if a foreign payment stablecoin issuer is deemed noncompliant, the Secretary of the Treasury may grant a "specific license to any United States person engaging in secondary trading" of payment stablecoins issued by a foreign payment stablecoin issuer upon a determination that (i) prohibiting secondary trading would adversely affect the United States financial system, or (ii) the issuer has taken "tangible steps" to remedy "the failure to comply with the lawful order that resulted in the noncompliance determination." In consultation with the Director of National Intelligence and Secretary of State, the Secretary of the Treasury may also waive the application of secondary trading restrictions upon a determination that doing so is in the national security interest of the United States.

  - ***"AML innovation" provisions***. The GENIUS Act requires the Secretary of the Treasury to conduct research and seek public comment to identify "innovative or novel methods, techniques, or strategies that regulated financial institutions use, or have the potential to use, to detect illicit activity such as money laundering."

- **Custodial or Safekeeping Services**

  To provide "custodial or safekeeping services for the payment stablecoin reserve, the payment stablecoins used as collateral, or the private keys used to issue permitted payment stablecoins," custodians must be subject to supervision

or regulation by a primary federal payment stablecoin regulator, the SEC, the Commodities Futures Trading Commission, or certain state federal regulatory agencies. Such persons are required to treat "payment stablecoins, private keys, cash, and other property" as belonging to the issuer or customer.

- **Supervisory and Enforcement Authority**

  - ***Supervision***. Approved subsidiaries of insured depository institutions and federal qualified payment stablecoin issuers are subject to supervision and examination by their primary federal payment stablecoin regulator, as described above. Issuers must, upon request, submit reports to their primary federal payment stablecoin regulator including information on the issuer's financial condition, risk monitoring systems, compliance with the GENIUS Act, and compliance with BSA/AML and sanctions requirements. Similarly, under the GENIUS Act, each regulator shall examine the issuer to assess the issuer's financial conditions, risks, and systems to monitor risks.

    With respect to state-qualified payment stablecoin issuers, the applicable state payment stablecoin regulator shall have supervisory, examination, and enforcement authority over all such issuers, and they may issue orders and rules applicable to State qualified payment stablecoin issuers "to the same extent as the primary Federal payment stablecoin regulators issue orders and rules."

  - ***Enforcement***. If a primary federal payment stablecoin regulator determines that an approved subsidiary of an insured depository institution or a federal qualified payment stablecoin issuer (or an institution-affiliated party) is "willfully or recklessly" violating (or has willfully or recklessly violated) the GENIUS Act, its regulations, or any condition imposed by a regulator, the regulator may prohibit the issuer from issuing payment stablecoins. The regulator may also take other actions based on violations or attempted violations of the GENIUS Act, its regulations, and conditions imposed by a regulator, including temporary and permanent cease-and-desist proceedings, removal and prohibition proceedings, injunctive relief, and the imposition of civil penalties. The GENIUS Act sets out maximum penalty amounts for different tiers of violations.

- **Foreign Issuers**

  While the federal and state pathways discussed above apply to domestic issuers, foreign issuers may also become a permitted issuer if they meet certain requirements. To become a permitted issuer, (i) the foreign entity must be subject to regulation and supervision by a foreign regulator and (ii) the foreign regulatory and supervisory regime must be "comparable" to the regulatory and supervisory regime established under the GENIUS Act. The comparability of the foreign regime with the requirements established under the GENIUS Act is determined by the Secretary of the Treasury upon recommendation of the SCRC. Prior to such determination taking effect, the Secretary of the Treasury is required to publish a justification for the determination in the Federal Register. The Secretary of the Treasury must also keep and make publicly available a current list of foreign countries for which it has made such a determination.

  The GENIUS Act also requires the foreign payment stablecoin issuer to, among other things, be registered with the OCC and hold sufficient reserves in a U.S. financial institution to meet U.S. customers' liquidity demands.

  Foreign payment stablecoin issuers are also subject to ongoing monitoring, including reporting, supervision, and examination requirements as determined by the OCC, and must consent to U.S. jurisdiction relating to the enforcement of the GENIUS Act. Either the OCC or the Secretary of the Treasury may rescind the approval of or revoke a foreign payment stablecoin issuer's registration, provided they first consult with the other.

Next Steps

As noted above, the GENIUS Act will go into effect on the earlier of (i) the date that is 18 months after the date of enactment (January 18, 2027) or (ii) the date that is 120 days after the primary federal payment stablecoin regulators issue final regulations (November 15, 2026).

In the meantime, each primary federal payment stablecoin regulator and the Secretary of the Treasury is required to promulgate regulations to implement the GENIUS Act through notice-and-comment rulemaking. For states, the GENIUS Act contemplates that state regulators may establish a "qualified" regulatory regime for payment stablecoins. If a state chooses to do so, its regulator would need to adopt implementing rules under its own state law processes.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/insights/client-memos/genius-act-ushers-in-comprehensive-federal-regulation-of-payment-stablecoins https://www.paulweiss.com/insights/client-memos/second-circuit-limits-insider-trading-liability-for-prime-brokers

For the full text of the GENIUS Act, please see:

- https://www.govinfo.gov/content/pkg/PLAW-119publ27/pdf/PLAW-119publ27.pdf https://www.opn.ca6.uscourts.gov/opinions.pdf/25a0225p-06.pdf

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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