

Alert

The SEC Continues to Target Cryptocurrencies and Other Digital Assets

June 28, 2021

Digital asset adoption is at an all-time high. The two largest cryptocurrencies, Bitcoin (“BTC”) and Ethereum (“ETH”), hit record prices during the first quarter of 2021 and multiple Fortune 500 companies, including Microsoft,¹ AT&T² and PayPal,³ have either added Bitcoin to their balance sheets or expressed a willingness to accept it in lieu of fiat currencies. Large investment banks, asset managers and insurance companies also have entered the digital asset ecosystem. The recent enthusiasm surrounding digital assets enabled Coinbase, the largest U.S. cryptocurrency exchange, to go public with an initial \$86-billion valuation.⁴

Notwithstanding the popularity and acceptance of digital assets in the financial industry, U.S. legal and regulatory guidance regarding digital assets remains limited.⁵ This is expected to change, however, as Gary Gensler settles into his position as Chairman of the U.S. Securities and Exchange Commission. Chairman Gensler joined the SEC with considerable knowledge of both financial technology and digital assets, having previously been a professor at the Massachusetts Institute of Technology where his teaching and research focused on blockchain technology and digital currencies.⁶ It is anticipated that digital asset guidance may come in the form of new regulations, specifically, registration requirements for digital asset exchanges as well as a host of other measures aimed at preventing both fraud and manipulation.⁷ Indeed, in a June 9, 2021 interview with CNBC, Chairman Gensler cautioned investors about the risks of trading Bitcoin and other cryptocurrencies, stating that “investors don’t have the full protections that they have in the equity markets or in the commodity futures markets . . . Bitcoin and these other cryptocurrencies do not have those full protections.”⁸ He went on to comment on the SEC’s enforcement actions related to digital assets and indicated that the SEC will be keeping a close eye on the space, explaining that “[t]he SEC has brought, I think, six to seven dozen enforcement actions over the last few years, but of course there’s hundreds of other tokens. I think there’s 1,600 tokens that

¹ “Microsoft to Accept Payments Made In Bitcoins,” *BBC*, Dec. 11, 2014, available [here](#).

² “AT&T Now Accepts Crypto Payments for Phone Bills Via Bitpay,” *Yahoo! Finance*, May 29, 2019, available [here](#).

³ “More Companies, Including Paypal And Xbox, Are Accepting Bitcoin and Other Cryptocurrencies as Payment, Despite Volatility Warnings,” *Business Insider*, April 3, 2021, available [here](#).

⁴ “Coinbase soars in market debute, valued near \$86 billion,” *Associated Press News*, April 14, 2021, available [here](#).

⁵ See, e.g., FIN-2019-G001, “Application of FinCEN’s Regulations to Certain Business Models Involving Convertible Virtual Currencies,” May 9, 2019, available [here](#) (consolidating current FinCEN regulations, related administrative rulings and guidance issued since 2011, to common business models involving convertible virtual currency).

⁶ “Biden SEC pick Gary Gensler on fintech, regulation, and blockchain,” *MIT Management; Thinking Forward Newsletter*, Jan. 21, 2021, available at [here](#).

⁷ “Gary Gensler has a full agenda as he gets set to take over the SEC,” *CNBC*, Apr. 14, 2021, available [here](#).

⁸ “Gensler on cryptocurrencies: Investors do not have full protection,” *CNBC*, June 9, 2021, available [here](#).

purportedly have a market value of over a million and 70 or 80 over a billion. So we're going to keep trying to protect investors as best we can under the authorities."⁹

It was perhaps surprising, then, when, on June 11, 2021, the SEC released its Spring 2021 Unified Agenda of Regulatory and Deregulatory Actions ("Agenda")¹⁰ and digital assets were not the subject of any of the proposed and final SEC rulemaking areas. This did not go unnoticed by SEC Commissioners Hester M. Peirce and Elad L. Roisman, who issued a joint statement on June 14, 2021, noting that "the Agenda is missing some other important rulemakings, including rules to provide clarity for digital assets."¹¹ It remains to be seen what place digital assets will have in Chairman Gensler's regulatory agenda moving forward.

Despite the limited regulatory guidance regarding digital assets, the SEC continues to pursue enforcement actions in the space. The high-profile lawsuit the SEC filed against Ripple Labs Inc. ("Ripple")¹² and a similar lawsuit the SEC brought against LBRY, Inc. ("LBRY"),¹³ alleging that those companies' digital tokens are unregistered securities, illustrate the evolving theories under which the SEC is pursuing cryptocurrency companies.

For example, the SEC complaint against Ripple alleges that Ripple's digital token, XRP, is an "investment contract" under Section 2(a)(10) of the Securities Act, and is therefore a security and subject to regulation as such. Whether something is an investment contract is determined by the four-pronged "Howey test" announced by the U.S. Supreme Court in *SEC v. W.J. Howey Co.*¹⁴ Ripple is contesting the charges, claiming they never offered or sold XRP as an investment, that XRP holders have no control or ownership over Ripple, and that XRP holders are not entitled to share in any profits generated by Ripple.¹⁵ Defendants also offered facts about XRP to help differentiate it from traditional securities, stating that XRP is decentralized, functions as a cryptocurrency, and that its price rises and falls in correlation with other cryptocurrencies and is not dependent on the actions taken by Ripple.¹⁶ Those assertions, if proven true, would help Ripple negate all four prongs of the *Howey* test.

Notably, in the Ripple lawsuit, Ripple has asserted as an affirmative defense that the SEC failed to provide "fair notice" that its conduct violated U.S. securities laws, amounting to what Ripple contends is a violation of due process.¹⁷ Ripple asserts that there is a lack of clarity regarding the SEC's position on

⁹ *Id.*

¹⁰ SEC Press Release No. 2021-99, "SEC Announces Annual Regulatory Agenda," June 11, 2021, available [here](#).

¹¹ SEC Public Statement, "Moving Forward or Falling Back? Statement on Chair Gensler's Regulatory Agenda," June 14, 2021, available [here](#).

¹² SEC Press Release No. 2020-338, "SEC Charges Ripple and Two Executives with Conducting \$1.3 Billion Unregistered Securities Offering," Dec. 22, 2020, available [here](#).

¹³ SEC Litigation Release No. 25060, "SEC Charges New Hampshire Issuer of Digital Asset Securities with Registration Violations," Mar. 29, 2021, available [here](#).

¹⁴ *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). The *Howey* test asks whether the instrument in question is (1) an investment in (2) a common enterprise with (3) the expectation of profits (4) based on the efforts of a promotor or a third party. See *id.* at 297-300.

¹⁵ Answer of Def. Ripple Labs, Inc. to Pl.'s. First Am. Compl. ("Ripple Answer"), 5-8, *SEC v. Ripple Labs, Inc. et al.*, No. 20 Civ. 10832 (S.D.N.Y. Feb. 18, 2021).

¹⁶ *Id.* at 6.

¹⁷ *Id.* at 91.

digital assets due to the SEC's lack of formal guidance on the matter for the past several years.¹⁸ If successful, this fair notice defense could have wide-ranging implications for future SEC enforcement actions against other cryptocurrency companies, who could raise a similar defense.

Beyond the Ripple and LBRY lawsuits, the SEC also continues to pursue enforcement actions under more traditional theories, including a recent lawsuit in connection with a digital asset lending program (akin to a stock loan desk, except participants allegedly loaned digital tokens instead of stock), which are becoming increasingly common.¹⁹ In addition to alleging that certain defendants offered and sold unregistered securities in the lending program, the SEC also charged the same defendants with failing to register with the SEC as broker-dealers.²⁰ Specifically, on May 28, 2021, the SEC filed an action against five individuals, alleging that they "conduct[ed] an unregistered offering and sale of securities in the form of investments into" a digital asset lending program offered by defunct cryptocurrency company BitConnect, raising over \$2 billion.²¹

It is evident that the SEC's enforcement efforts remain focused on the digital asset space despite the lack of formal rulemaking. Accordingly, any market participants involved with digital assets should carefully evaluate the regulatory risks associated with their investments, including risks that the SEC and other regulators may take the position that they constitute unregistered securities. Furthermore, those involved with crypto lending programs specifically should be knowledgeable of the relevant laws and regulations which may require crypto lending programs to be registered as securities and also require those who offer and sell such securities to register with the SEC as broker-dealers.

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¹⁸ *Id.*

¹⁹ SEC Press Release 2021-90, "SEC Charges U.S. Promoters of \$2 Billion Global Crypto Lending Securities Offering," May 28, 2021, available [here](#).

²⁰ *Id.*

²¹ Complaint, *SEC v. Brown et al.*, Case No. 1:21-cv-04791, ¶¶ 1–2 (S.D.N.Y. May 28, 2021).