

2022 Year in Review: SEC Cryptocurrency Enforcement Actions

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Agenda

- Background to Cryptocurrency and the Securities and Exchange Commission (SEC)
- Conduct of New SEC Unit
- Impact on DeFi and Non-Crypto Companies
- Key Takeaways

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Background to Cryptocurrency and the Securities and Exchange Commission (SEC)

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The State of Cryptocurrency

- Cryptocurrencies generally have a history of turbulent price swings.
- In June 2022, Bitcoin and other more stable currencies, such as TerraUSD and Luna, crashed.
- Bitcoin experienced its worst quarterly loss in Q2 2022, loosing 58% of its value.
- The cryptocurrency market lost over $600 billion in value in the first week of May 2022.
- The unpredictable movement in cryptos led many experts to believe stricter regulations are unavoidable.

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Expansion of Crypto Assets Units

- The US Securities and Exchange Commission (SEC) announced the expansion of its Crypto Assets and Cyber Unit.
- The expansion included 20 new positions:
  - supervisors.,
  - investigative staff attorneys,
  - trial counsel, and
  - fraud analysts.
- The group was created within the SEC's Division of Enforcement to address cyber-related misconduct impacting retail investors.

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Why was the Unit Expanded?

- SEC Chair, Gary Gensler, believes investors are not receiving enough disclosures for the sale of cryptos.
- He believes disclosures occur at a much lesser rate than those with securities because of the lack of rules regulating them.
- Crypto platforms do not separate market making, buying and selling of assets, and safekeeping services. This leaves companies often trading against their customer's interests.

**SEC Press Release 2022-78*

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Significance of the Expansion

- The expansion shows that the SEC is serious about regulating crypto-related conduct.
- They are willing to dedicate more resources to investigating cryptocurrency businesses and their violations.
- Specifically, the SEC will be targeting consumer-focused crypto trading services, including DeFi and NFTs & crypto insider trading. Companies providing such services must begin to consider adjusting their operations to ensure security compliance.

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Conduct of New SEC Unit

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Focus of New Unit

- Security violations the Unit will be investigating:
  - Crypto-asset offerings,
  - Crypto-asset exchanges,
  - Crypto-asset lending and staking products,
  - DeFi platforms,
  - NFTs, and
  - Stablecoins.
- Since 2017, the Unit has already brought more than 80 enforcement actions raking in more than $2 billion in relief.

**SEC Press Release 2022-78*

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Recent SEC Action

- Jan. 2022 – charges against an Australian citizen's two companies.
  - Crowd Machine Inc & Metavine Inc. were charged for making misleading statements that raised more than $33 million from investors.
- Feb. 2022 – BlockFi Inc. cease-and-desist.
  - BlockFi allegedly failed to register its interest accounts as securities.
  - Settled for a $50 million penalty.
- March 2022 – two siblings defrauded investors for $124 million.

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Recent SEC Action

- July 2022:
  - The SEC charged a former cryptocurrency exchange platform manager and others in an insider trading action. The action involved cryptocurrency assets.
- September 2022:
  - The SEC also charged a financial technology company, its former CEO, and its current CEO for perpetrating an alleged scheme. The scheme was said to manipulate the trading volume and price of crypto asset securities.

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Recent SEC Action

- October 2022:
  - The SEC charged influencer Kim Kardashian for touting a crypto asset security offered and sold by EthereumMax on social media without disclosing that she had been paid $250,000 to do so. Kardashian agreed to settle the charges and pay $1.26 million.
- November 2022:
  - The SEC charged the founder and three promoters of the trading service Trade Join Club with running a Ponzi scheme.
- December 2022:
  - Following the highly publicized downfall of FTX Trading Ldt. in November 2022, the SEC charged its CEO and co-founder with orchestrating a scheme to defraud equity investors in FTX.

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SEC v. Sam Bankman-Fried

- **Facts:** In November of 2022, one of the largest cryptocurrency exchanges and hedge funds, FTX Trading Ltd. (FTX), saw a rapid downfall in less than two weeks due to a lack of liquidity and mismanaged assets. The company, valued at $32 billion before its collapse, has since filed for Chapter 11 bankruptcy.
- Among a number of criminal and civil charges against FTX and its CEO and co-founder, Sam Bankman-Fried (SBF), the SEC has charged Sam Bankman-Fried with orchestrating a scheme to defraud equity investors in FTX.
- He is charged with the violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act.

**Securities and Exchange Commission*

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SEC v. Block Bits Capital, LLC, et al.

- The SEC is pursuing criminal charges against the co-founders, Dillman and Mata, of Block Bits Capital, a cryptocurrency trading firm.
- The SEC alleges that the co-founders lied to investors about the company's automated trading functions and the use of investor funds.
- Dillman obtained $960,000 from investors by misrepresenting the functionality of their company's technology.
- Investors lost about $508,000 as a result of the scheme.

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SEC v. Block Bits Capital, LLC, et al.

- The Scheme:
  - Dillman and Mata allegedly told investors that 40% of their funds would be put in a "cold storage" plan to generate significant returns.
  - In reality, none of the funds were found in the storage.
  - It is alleged that the co-founders used the funds for risky investments of unsecured loans and one of the company's coins.
  - None of this was ever disclosed to investors.
  - Block Bits had also claimed they developed an auto-trading bot that never existed.

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SEC v. Block Bits Capital, LLC, et al

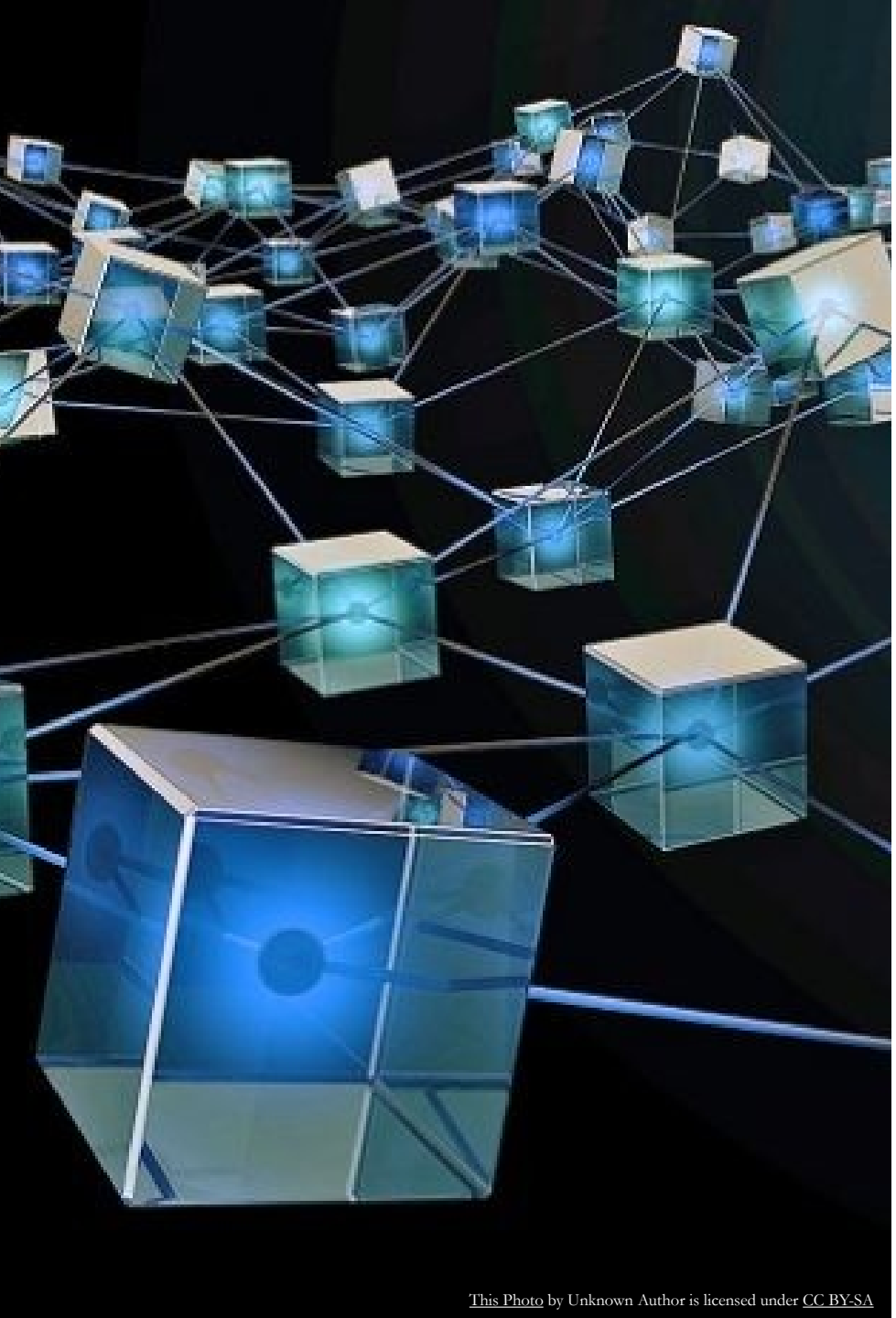
- SEC Requests:
  - The SEC has asked the court to block the co-founders from issuing, purchasing, or offering securities.
  - The SEC has asked for civil penalties, disgorgement, and prejudgment interest.

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Impact on DeFi and Non-Crypto Companies

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What does this mean for DeFi Companies?

- Centralized companies providing DeFi services must ensure compliance by restructuring their operations and policies within legal bounds.
- However, it is still unclear how the SEC will deal with decentralized platforms.

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Further Strengthening of the SEC

- The SEC requested an additional 125 staff members to join its Division of Enforcement for the 2023 budget.
- Of the 125 members, 33 are for the unit, 34 for litigation, and 44 for addressing misconduct and moving forward enforcement actions.

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Non-Crypto Related Companies

- The SEC has also made it clear that they will be targeting non-crypto currency-related companies in their enforcement actions.
- If non-traditional cryptocurrency companies find themselves involved in the industry, they must also comply with its regulations.
- Otherwise, with the increased SEC personnel, enforcement activities will be sure to follow.

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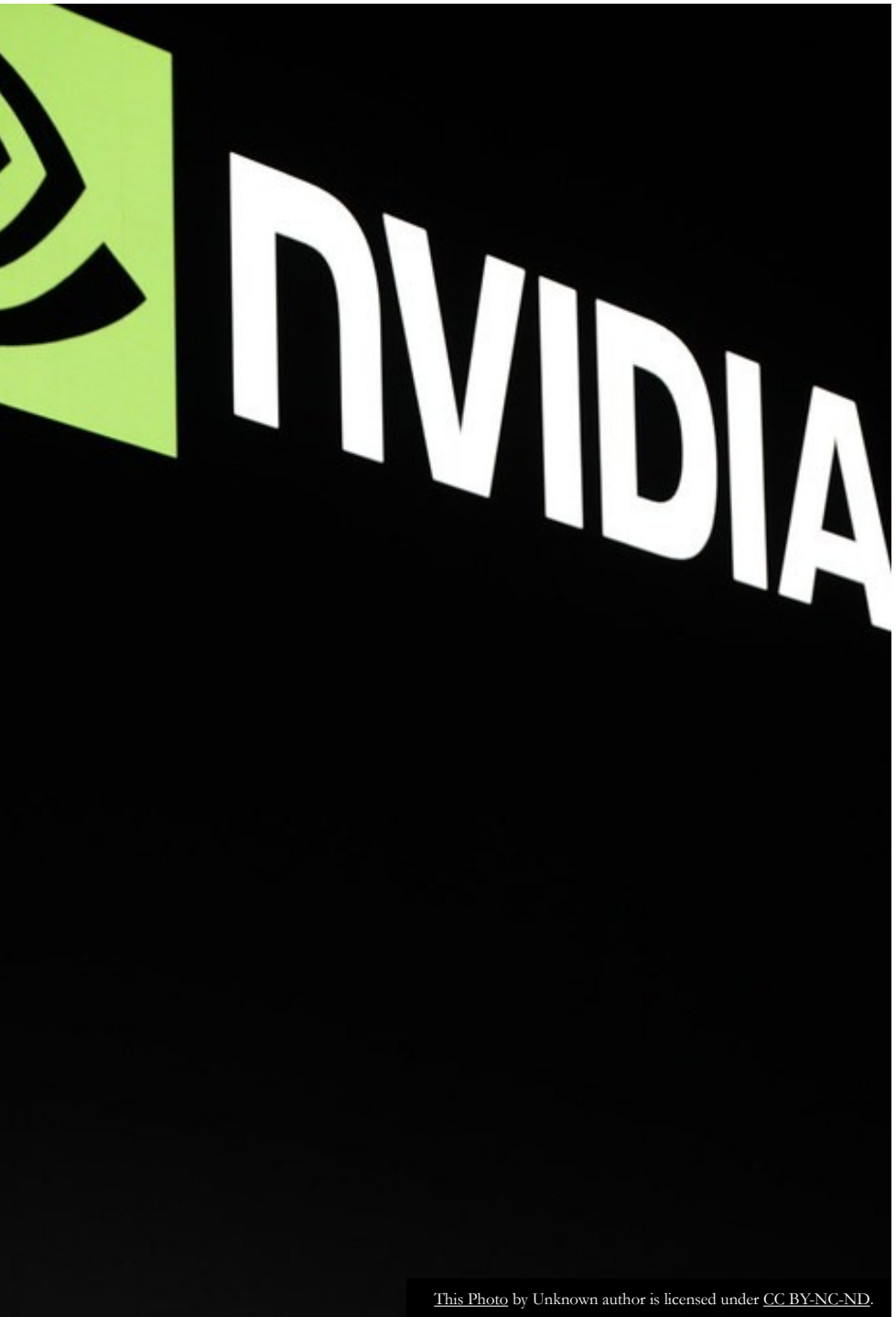


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NVIDIA Corp.

- NVIDIA, a technology company that markets computing technologies for PC gaming, was subject to enforcement action and penalties from the SEC.
- The SEC alleged that NVIDIA customers began using gaming GPUs for Ether crypto mining.
- NVIDIA was allegedly aware of the increase in GPU sales as a result of crypto mining but failed to disclose it.
- Failure to disclose misled investors about the growth of the gaming business.

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NVIDIA Corp. (cont.)

- The allegations violate Section 17(a)(2) and (3) of the Securities Act of 1933 and the disclosure provisions of the Securities Exchange Act of 1934.
- The SEC reached a $5.5 million settlement for its alleged failure to disclose crypto mining on its Form 10-Q for the fiscal year 2018.

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Key Takeaways

- The SEC's tighter enforcement of crypto violations will mean that existing cases will gain speed.
- Following the pattern, the SEC will certainly take on new investigations.
- Digital asset companies must initiate thorough reviews of their policies and activities to stay safe from the SEC's aggressive enforcement actions.

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Daniel Garrie, Esq. is the Co-Founder of Law & Forensics LLC, where he heads the Computer Forensics and digital discovery Cybersecurity teams. Daniel has been a dominant voice in the computer forensic and cybersecurity space for the past 20 years, as an attorney and technologist. He is an adjunct professor at Harvard for Computer Forensics and prior to Law & Forensics, he successfully built and sold several technology start-up companies.

Since co-founding Law & Forensics LLC in 2008, Daniel has built it into one of the leading boutique cybersecurity forensic engineering firms in the industry. He is a mediator, arbitrator, and e-discovery special master for JAMS and is a partner and head of the Cybersecurity at Zeichner, Ellman & Krause LLP. Daniel has both a Bachelor's and a Master's degree in computer science from Brandeis University, as well as a J.D. from Rutgers Law School.

Daniel has led cyber and forensic teams in some of the most visible and sensitive cyber incidents in the United States. He and his team have worked for two of the top five banks in the globe, and dozens of the largest private and public companies in the world. In addition, Daniel has been awarded several patents for advanced cybersecurity and forensic platform he built with his team that is currently used in the industry, TableTop.AI, CustodyTrack.IO, and Forensic Scan.

Daniel is also well-published in the cybersecurity space and has authored more than 200 articles and books. His work is cited by Black's Law Dictionary 10th Ed. In defining the terms "software", "internet", and "algorithm." Lastly, he has been recognized by several United States Supreme Court Justices for his legal scholarship and is a trusted source and thought leader for cybersecurity articles and opinions, being cited over 500 times to date.

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Mr. Cass recently joined Law and Forensics as a Senior Partner. He leads the Crypto & Digital Banking Practice and is a key member of the Cybersecurity & Privacy practice. Prior to joining, David served as a regulator. He was the Vice President for Cyber & IT Risk for the Federal Reserve Bank of New York. David specialized in large institution supervision, Fin-Tech, AI/ML, and cryptocurrencies. Prior to this role, David served as the Chief Information Security Officer for IBM. He had global responsibility for all aspects of security practices, processes, and policies across the IBM Cloud SaaS business unit.

Previously David served as the SVP & Chief Information Security Officer for Elsevier, where he led an organization of experienced legal, risk and security professionals that provided data protection, privacy, security, and risk management guidance on a global basis for Elsevier.

David has extensive experience in IT security, risk assessment, risk management, business continuity and disaster recovery, developing security policies and procedures. He has played a key role in leading and building corporate risk & governance and information security organizations in the financial sector. As the Senior Director of Information Security Risk and Governance for Freddie Mac, David rebuilt the risk and governance function and developed a team to provide risk assessments, methodologies, tools, services, and training to improve the organization's capabilities and maturity. Prior to that he was Vice President of Risk Management for JPMorgan Chase and was responsible for providing an accurate assessment of the current risk management state, contributing to the future direction of risk management, continuity and disaster recovery capabilities for the organization.

David has a MSE from the University of Pennsylvania, and a MBA from MIT. He is adjunct faculty for Rutgers Law School and Harvard. He is also a frequent speaker at high profile industry conferences and served on several boards.

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Distressed Real Estate
Mr. Nagi represents lenders and borrowers in every aspect of distressed real estate, from the pre-default stage through bankruptcy exit. Mr. Nagi is well versed in the issues presented by securitized loans, special servicers, banks, and private lenders in distressed commercial loans, sales via the Uniform Commercial Code, fraudulent transfer actions, and through every stage of insolvency proceedings. In addition to his experience in Single Asset Real Estate bankruptcy cases, Mr. Nagi has represented agent banks and majority lenders for syndicated loans, in out-of-court workouts, and both contested and consensual court-supervised restructurings. Mr. Nagi has represented large international corporations, insurance companies, financial institutions, and individual businesses in federal and state courts in New York and New Jersey.

FinTech
Mr. Nagi uses his creditor-focused, finance experience to counsel early-stage and mature FinTech companies as well as traditional and non-traditional lenders in both business ventures and litigation. He regularly counsels' companies in applying blockchain technology to their respective industries, fundraising efforts, and regulatory issues. Mr. Nagi advises clients on SEC, CFTC, FinCEN, and state-level MSB matters, including the issuance of securitized digital assets. He has authored numerous articles on FinTech issues and is a frequent speaker at conferences.

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John D'Agostino is the CEO of Dagger Consulting LLC as well as the Coinbase Institutional Lead for Advisory and Strategic Partnerships. Prior, John was the US Managing Director for Waystone Governance, the world's largest fund governance firm. There, John served on the global governance committee and served on the Board of Directors for several of the world's largest asset managers, including several of the largest digital asset funds in the United States.

Previously, John was a Managing Director at KPMG Consulting, where he was part of the firm's global leadership for the Finance and Hedge Fund consulting groups. While at KPMG, he provided operational and strategic advisory services across a variety of industries, including advising on the acquisition of the London Metals Exchange by the Hong Kong Stock Exchange.

John served as Vice President and Head of Strategy for the New York Mercantile Exchange, where he helped transition the floor to electronic trading and was part of the leadership team building out the core systems to accommodate co-location, quant and HFT volumes. He also led the effort to develop the first Middle East energy derivatives exchange in partnership with the Dubai Government. This work and John's role was chronicled as the subject of two NY Times best selling books, Rigged by Ben Mezrich and The Start Up Of You by Reid Hoffman.

A cum laude graduate of Williams College, John received a Master's degree in Business Administration from Harvard Business School. He also studied Politics, Philosophy and Economics at Oxford University. John has adjunct lecturer positions at Instead, MIT and Columbia Universities, where he teaches courses in Fintech and Governance. In 2019, John was named Chair of the UK Consulate's Financial Services Working Group.

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