

Wenchi Hu PLLC

Regulatory Recap

January 16, 2024

Notable Developments:

- **SEC approved spot bitcoin ETP; is SEC rethinking crypto approach?**
- **SEC adopted mandatory clearing of eligible secondary transactions in Treasury securities.**
- **A global investment bank and former head of equity syndicate desk were charged by the SEC with fraud in block trading and the investment banking firm agreed to pay over \$249 million to settle charges.**
- **A global software company agreed to pay nearly \$100 million to settle SEC charges for violations of the Foreign Corruption Practices Act.**
- **SEC Commissioner Mark Uyeda sworn in for second term.**
- **SDNY Judge ruled that Terraform's crypto assets --- UST, LUNA, wLUNA, and MIR --- are securities**
- **Department of Labor issued final rule revising prior guidance on classifying workers as employee vs. independent contractor.**

Spot Bitcoin ETP approval on January 10, 2024 – Does it signal a change of SEC's approach to crypto?

On January 10, 2024, the SEC issued a highly anticipated [omnibus order](#) to approve eleven spot bitcoin exchange traded trust shares ("ETP") filings by NYSE Arca, Nasdaq and Cboe BZX exchanges, sponsored by BlackRock, ARK, Fidelity and Invesco, Grayscale, and others. Concurrent with the approval order, SEC Chairman Gensler issued a [statement](#) which explained the SEC's change in course, after disapproving more than 20 exchange rule filings for listing spot bitcoin ETPs for trading. Gensler felt that "the most sustainable path forward is to approve the listing and trading of these spot bitcoin ETP shares," in light of the DC Circuit's [decision](#) in August 2023 against the SEC.

While many consider the spot bitcoin ETP approval a big win for crypto advocates, it is not an indication that the SEC is changing its approach to crypto. In his statement, Gensler made it clear that the approval is limited to the ETP trusts "holding one non-security commodity, bitcoin. It should in no way signal the Commission's willingness to approve listing standards for crypto asset securities. Nor does the approval signal anything about the Commission's views as to the status of other crypto assets under the federal securities

laws or about the current state of non-compliance of certain crypto asset market participants with the federal securities laws.” As Gensler stated many times in the past, he views the vast majority of crypto assets as securities under the *Howie* test and therefore subject to the SEC’s jurisdiction.

In 2023, the SEC took enforcement actions against crypto trading platforms, including [Coinbase](#), [Binance](#), [Kraken](#), and [Bittrex](#) with various charges including operating an unregistered securities exchange, broker-dealer and clearing agency. Gensler’s statement indicates that the SEC is not likely to drop or settle charges against these crypto exchanges and will continue to litigate in court.

The two Democrat commissioners Caroline Crenshaw and Jaime Lizarraga [voted](#) against the spot bitcoin ETP listing. Commissioner Crenshaw issued a separate [dissent statement](#), in which she raised concerns of fraud, manipulation and concentration of ownership in the spot bitcoin markets, as well as lack of unified oversight over these markets. She doubted the effectiveness of reliance on correlation with other surveilled markets to protect investors. She also pointed out the volatility of bitcoin price, which might cause a trading pause while the spot market would continue to trade, and the possibility that the spot market price might move away from the exchange trading price of ETP.

It remains to be seen whether banks will participate in the spot bitcoin ETP. One result of the spot bitcoin ETP approval is the risk of bitcoin being taken on by clearing brokers and entering into the clearing house. As the bitcoin ETPs are cleared by NSCC, the same clearing agency that clears equity securities traded on national securities exchanges, NSCC as the central counterparty must manage the T+1 settlement risk by assessing margin charges on clearing members. These margin charges, in times of extreme market volatility, may cause liquidity stress on clearing members.

Looking forward, it is likely that the SEC’s Divisions of Examination and Enforcement will devote resources to monitor and review exchanges’ surveillance, broker-dealer’s compliance with Regulation Best Interest, and investment advisers’ fiduciary duty when they recommend spot bitcoin ETPs to their customers.

SEC adopted [final rule amendments to Rule 17ad-22\(e\)\(18\)](#) on December 13, 2023 to require U.S. Treasury securities clearing agencies (currently, the Fixed Income Clearing Corporation (“FICC”)) to propose clearing rule changes that will implement mandatory clearing of eligible secondary market Treasury securities transactions and provide appropriate means to facilitate access to clearing.

Eligible secondary transactions in Treasury securities are (i) Treasury repo and reverse repo transactions in which one of the counterparties is a clearing member, (ii) all purchases and

sales of Treasury securities by clearing members who act as interdealer brokers, and (iii) all purchases and sales of Treasury securities between a clearing member and a registered broker-dealer or a government securities broker or dealer. Eligible secondary transactions do not include transactions with sovereign entities, international financial institutions, natural persons, affiliates, state/local governments and other clearing organizations.

In connection with the above, the SEC also amended Rule 15c3-3a to permit margin posted at FICC for U.S. Treasury securities to be included by broker-dealers as a debit in the reserve formulas for customer accounts and proprietary accounts of broker-dealers, subject to certain conditions.

The implementation of the mandatory clearing of clearing members' secondary market trades will depend on FICC to propose new rules. Currently, FICC's sponsorship model enables G-SIB banks with at least \$5 billion capital and regional banks to bring both sides of repo trades into FICC for netting benefits. It remains to be seen how FICC will design its new rules to facilitate access to clearing and how non-bank clearing members will be able to bring their customer trades into FICC.

The SEC contemplates a staged implementation of the mandatory clearing of eligible secondary Treasury securities trades over the course of two and a half years. First, regarding separation of house and customer margin and access to clearing, FICC is required to file proposed rule changes and/or advance notices by March 18, 2024 and the proposed rule changes must be effective by March 31, 2025. Regarding the requirements to clear eligible secondary transactions in Treasury securities, FICC is required to file proposed rule changes to implement mandatory clearing of eligible secondary transactions within 150 days following January 16, 2024 and must have the proposed rules regarding mandatory clearing of eligible secondary cash transactions be effective by December 31, 2025 and have the rules regarding mandatory clearing of eligible secondary repo transactions be effective by June 30, 2026. Compliance by FICC clearing members with mandatory clearing of secondary cash and repo transactions would not be required until December 31, 2025 and June 30, 2026.

In Case You Missed It...

- On January 12, 2024, SEC [charged](#) a global investment bank and former head of equity syndicate desk with fraud in block trading and the firm settled the charges and agreed to pay over \$249 million.
- On January 10, 2024, SEC [announced charges](#) against a global software company for violations of the Foreign Corrupt Practices Act and the company agreed to pay nearly \$100 million to settle the charges.
- SEC Commissioner Mark Uyeda was sworn in for his second term on December 28, 2023, which will expire in 2028.

- Judge Jed S. Rakoff of the U.S. District Court of Southern District of New York rendered an [opinion and order](#) on December 28, 2023, in which he ruled that Terraform's UST, LUNA, wLUNA and MIR met the Howie test and were securities and that Terraform offered and sold unregistered securities in violation of Section 5 of the Securities Act. SEC's fraud claims against Terraform and its founder, Do Hyeong Kwon, will go to the jury trial scheduled to commence on January 29, 2024.
- On January 10, 2024, the Department of Labor issued a [final rule](#) revising guidance on how to analyze whether a person is an employee or independent contractor under the Fair Labor Standards Act. The final rule implements a non-exhaustive six-factor test to classify workers: (i) opportunity for profit or loss depending on managerial skill, (ii) investments by the worker and the potential employer, (iii) degree of permanence of the work relationship, (iv) nature and degree of control, (v) extent to which the work performed is an integral part of the potential employer's business, and (vi) skill and initiative. The rule will become effective on March 11, 2024.

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