



Regulatory Update January 22, 2019

In our first update of the new year, we look back at the crypto regulatory actions that shaped 2018, the ongoing efforts that will develop over the coming months, and what LGO has accomplished.

2018 in Review: The Rush to Regulate Digital Assets

Crypto markets faced heightened scrutiny this year after the seemingly endless all time highs and ICO frenzy that colored late 2017 and early 2018 turned into a cold bear market. Authorities worldwide grappled with the legal and regulatory challenges presented by novel digital assets. Some attempted to fit token products within existing frameworks while others sought to fill the gaps with new legislation.

Fitting ICOs under Federal Securities and Commodities Laws

With the industry still contemplating the ramifications of 2017's [DAO Report](#) and [Munchee settlement](#), America's securities watchdog, the SEC, accelerated its efforts in the space in 2018. Enforcement actions

targeted tokens being sold as unregistered securities, the platforms for their exchange, and ICO-related fraud:

- The SEC pursued [AriseBank](#) and [Centra Tech](#) for ICO-related fraud with their founders also facing criminal charges for their participation. The SEC also fined [DJ Khaled](#) and [Floyd Mayweather, Jr.](#) for their undisclosed compensation from endorsing Centra's CTR token.
- Trading in NASDAQ-listed [Longfin Corp.](#) was frozen after the SEC alleged that company executives used the acquisition of a purported cryptocurrency website to sell their restricted shares.
- The SEC demonstrated that foreign entities are not beyond its reach. They began [proceedings](#) against 1Broker for failing to register its bitcoin swaps sold to U.S. customers.
- [Blockvest](#) and [Crypto Asset Mgmt.](#) had to answer to the SEC for their false claims to investors. They claimed to be the premier "regulated" crypto funds, but failed to file any registration materials.
- The [Airfox](#) and [Paragon Coin](#) settlements were notable in marking the first instances of the SEC pursuing token issuers with only

allegations that they failed to register offerings absent fraud.

- Founder of EtherDelta, [Zachary Coburn](#), was the subject of the SEC's first action against a "decentralized" exchange. He was charged with operating "an unregistered national securities exchange."

The SEC elaborated on its view of crypto markets through a series of public statements:

- [Statement on Potentially Unlawful Online Platforms for Trading Digital Assets](#) (Mar. 7): *"If a platform offers trading of digital assets that are securities and operates as an "exchange" ... then the platform must register with the SEC as a national securities exchange or be exempt from registration."*
- [Statement on Digital Asset Securities Issuance and Trading](#) (Nov. 16): *"[T]here is a path to compliance with the federal securities laws going forward, even where issuers have conducted an illegal unregistered offering of digital asset securities."*

Commissioners reflected on the definitions of "utility" and "centralization" and their roles in the context of securities laws:

- [Chairman's Testimony on Virtual Currencies: The Roles of the SEC and CFTC](#) (Feb. 6): *"Merely calling a token a 'utility' token or structuring it to provide some utility does not prevent [it] from being a security."*
- [Digital Asset Transactions: When Howey Met Gary \(Plastic\)](#) (June 14): *"If the network on which the token or coin is to function is sufficiently decentralized...the assets may not represent an investment contract."*

The agency debated the feasibility of a bitcoin ETF. They ultimately denied all applications on the view that digital assets do not trade on a national securities exchange and lack sufficient surveillance.

The CFTC similarly pursued crypto-related misconduct falling within its purview. In two prominent fraud cases, district court judges in New York ([Patrick K. McDonnell](#)) and Massachusetts ([My Big Coin](#)) expressed harmony with the agency's view that virtual currencies are commodities under the Commodity Exchange Act.

The Learning Curve

Governmental agencies labored to educate themselves on the innovative asset class through public inquiries, investigations, and the formation of focused task forces:

- The NYAG's office [launched its review](#) of the practices of virtual currency exchanges in April, releasing its [findings](#) in September.
- The SEC formed [FinHub](#) in October to engage with the industry.
- The CFTC [requested public comment](#) on Ether and the Ethereum network in December.
- New York's governor [signed a bill](#) creating a digital currency task force.

Seeking Redress through Class Actions

In addition to federal and state prosecutions, market participants faced heat from actions filed by private plaintiffs seeking redress for securities laws violations, fraud, and hackings:

- Participants in the Tezos ICO, which raised upwards of \$232 million, filed class actions in [California](#) and [Florida](#) alleging that the sale was an unregistered offering of securities.

- Ripple Labs faced a similar [lawsuit](#).
- Coinbase defended [claims](#) of insider trading in connection with its launch of Bitcoin Cash.
- Coincheck faced [multiple lawsuits](#) after a hack resulting in the loss of over \$500 million worth of crypto.

Legislating to Fill Gaps

Congress hosted several hearings where industry leaders presented their views on the need for targeted legislation. In December, representatives introduced three cryptocurrency-specific bills that will be subject of much debate in 2019:

- [Virtual Currency Consumer Protection Act of 2018](#)
- [U.S. Virtual Currency Market and Regulatory Competitiveness Act of 2018](#)
- [Token Taxonomy Act](#)

State authorities proposed legislation focused on various aspects of blockchain technology, including the legality of smart contracts, the status of tokens under securities laws, whether state definitions of "money" include cryptos for money

transmitter licensing purposes, and tax issues surrounding virtual currencies.

International Landscape

International authorities similarly varied in their responses to the regulatory uncertainty posed by emerging crypto markets. Leaders at the G20 Summit [announced plans](#) to regulate cryptocurrencies in the coming months. Countries like Switzerland and Gibraltar sought to create regulatory safe havens to attract crypto companies whereas countries like China opted for a more stringent approach, imposing a strict ICO ban starting in 2017:

- Switzerland's FINMA [published ICO guidelines](#) in February 2018.
- Japan introduced a licensing regime and exchanges formed a self-regulatory body known as the [Japan Virtual Currency Exchange Association \(JVCEA\)](#) in April.
- France's AMF forwarded a [voluntary licensing program](#) after receiving public input.

Where We Are

LGO Markets began 2018 with the goal of providing a differentiated solution to the institutional marketplace for digital assets that prioritizes compliance. With this focus, we have:

- Strengthened our compliance efforts and closely monitored regulatory developments;
- Maintained communication with regulators and lawmakers;
- Registered for a BitLicense with the NYDFS in order to serve New York clients and as a broker-dealer with FINRA and the SEC; and
- Developed a [client onboarding process](#) that meets AML, ATF, and KYC requirements while protecting the security of customer data.

We hope to build on this progress in 2019 as a more mature and regulated cryptocurrency market emerges.

[Read more on our website](#)

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