Regulatory Update
November 26, 2018

SEC Chair Focuses on Custody, Market Manipulation in Keynote at Consensus Invest

SEC Chairman Jay Clayton delivered the keynote address at Consensus Invest in New York City on Tuesday where he spoke about recent enforcement actions and the issues he believes are preventing the agency from approving a bitcoin ETF. He highlighted the need for better custody solutions for digital assets and improved market surveillance that parallels the safeguards of traditional stock exchanges.

Clayton stated that there have been some digital asset thefts "that make you scratch your head." He discussed that he would not be "comfortable" with an ETF based on bitcoin or other virtual currency until custody is improved–where "the risk in the ETF is the risk in the underlying asset, not its security or theft."

Speaking on Airfox and Paragon, he stated that remedies in the future may be different, indicating that the agency may not be as lenient in future actions. He proposed that token issuers raising money to start a business begin with the assumption that they are engaging in a securities offering and register as such, providing the necessary disclosures to investors.

While he encouraged market participants to come talk to the SEC, alluding to providing no-action letters (agency statements that they will not recommend legal action for the described activity), some expressed doubt in the benefit to his open invitation for dialogue.[1] In a panel after Clayton's speech, Caitlin Long of the Wyoming Blockchain Coalition and Lewis Cohen, a lawyer in the space, stressed that it could take years to receive a no-action letter and none have been issued to crypto startups.

Meanwhile, SEC Commissioner Hester Peirce recently advocated for the approval of exchange-traded products based on digital assets in a speech before the Crypto

[1] https://www.sec.gov/fast-answers/answersnoactionhtm.html.

Valley Summit in Switzerland.[2] She criticized regulators for sending "mixed messages" to the market and creating an unwelcoming environment for innovators. She proposed an easier, more transparent approval process that permits investors to make their own independent decisions on what products they include in their portfolios.

The Flip Side of the Coin: Federal Judge Tells SEC It Failed to Show Blockvest Token Was a Security

In the first ruling of its kind from a federal court, a California judge told the SEC that it failed to establish that the Blockvest ICO constituted an unregistered securities offering under the *Howey* test.[3] The judge denied the SEC's bid for a preliminary injunction, which was previously granted to place a freeze on Blockvest's assets.

Blockvest's sale of its BLV token, an ERC-20 token, took place between July and August 2018 with the goal of establishing a "smart economy" for the management of digital assets. As described in its [whitepaper](), it aimed to grant access to a diverse cryptocurrency portfolio through a single centralized token tracking an index of the top 30 performing cryptos.

Judge Gonzalo Curiel repeated the standard for deciphering what constitutes a security and, more specifically, an "investment contract," holding that the BLV sale and its promotion lacked the fundamental indicia of a securities offering. The court sided with the defense who argued that the sale was meant to test the platform, involving only 32 individuals close to the company who contributed a total less than $10,000.

The evidence that the purchasers wrote "Blockvest" or "coins" on the checks was not conclusive proof that the funds were intended as genuine investments. The court paid little note to the fact that Blockvest used an SEC-like logo to promote the creation of the Blockchain Exchange Commission on its website and falsely claimed contributions totaling $2.5 million.

The ruling indicates that courts will not blindly ratify federal agencies' viewpoints regarding digital assets, but rather they will

[2]https://www.sec.gov/news/speech/peirce-lasting-impressions-crypto-valley-summit.
[3] *Order Denying Plaintiff's Motion for Preliminary Injunction*, SEC v. Blockvest, LLC, and Reginald Buddy Ringgold III, Case No. 18-CV-02287 (Nov. 27, 2018).

analyze each product on a case-by-case basis. While Blockvest's assets are unfrozen for the time being, the SEC will have the opportunity to present their case to a jury who will ultimately decide the issue.

[Read more on our website]

DJ Khaled and Floyd Mayweather Jr. Settle Charges With the SEC Over Undisclosed Fees from ICO Promotions

The SEC announced settlements Thursday with two celebrities charged with unlawfully promoting securities offered in several ICOs.[4] Floyd Mayweather Jr., a professional American boxer, and rapper DJ Khaled promoted ICO products on their social media accounts without disclosing the compensation paid for such endorsements in violation of Section 17(b) of the Securities Act of 1933. Mayweather received $300,000 from three ICOs, including $100,000 from Centra Tech–the subject of an ongoing SEC securities fraud action, class action lawsuit, as well as a criminal investigation in New York that led to the arrest of founders Sam Sharma and Robert Farkas in April 2018. Khaled received $50,000 from Centra.

Centra promised the "world's first Multi-Blockchain Debit Card and Smart and Insured Wallet," raising over $32 million through the unregistered sale of its CTR token from July to October 2017. The company fraudulently boasted of partnerships with Visa, Mastercard, and cryptocurrency exchanges like Kraken who would host its "utility token." It also created fictitious LinkedIn profiles for its fake CEO and CFO that were later deleted.

Referring to himself as "Floyd Crypto Mayweather," he promoted the ICOs on his Facebook, Instagram, and Twitter, reaching his combined 42.2 million followers. He posted a photo of himself shopping with his Centra card in Beverly Hills and with his championship belts announcing the sale:

[4] https://www.sec.gov/news/press-release/2018-268.

Khaled advertised token sales on his Instagram and Twitter, together followed by 16.3 million accounts. He called Centra a "game changer."

In total, the fines reached close to $800,000 with Mayweather paying about $615,000 in disgorgement, penalties, and prejudgment interest, while Khaled agreed to pay close to $153,000. The SEC banned Mayweather from promoting securities, "digital or otherwise," for three years and imposed a two year ban on Khaled. It emphasized that: "These cases highlight the importance of full disclosure to investors."

Khaled and Mayweather are among a group of celebrities that promoted tokens in 2017, including Paris Hilton and actor Jamie Foxx. This led the SEC to issue an alert and public statement in November 2017, advising that it is never a good idea to invest solely based on an endorsement without personal research.

Other News

- Law.com: The CFTC Releases Starter Guide to Smart Contracts
- The Washington Examiner: For the First Time, Treasury Targets Bitcoin Addresses in Sanctions
- CoinDesk: FBI Arrests AriseBank CEO Over $4 Million Crypto Fraud

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