



Regulatory Update February 11, 2019

In this update, we discuss the developments surrounding troubled crypto exchange QuadrigaCX and the latest statements from SEC Commissioners regarding the agency's direction in the blockchain space.

Troubled Crypto Exchange QuadrigaCX Gets Creditor Protection from Canadian Court

The media has been abuzz with news of Canada's largest crypto exchange, QuadrigaCX, announcing that it cannot access upwards of \$150 million of client funds due to the death of its CEO Gerald Cotten, reportedly the sole holder of the private keys to the exchange's cold wallets. Quadriga shared in January that the 30-year-old CEO had died in India in December due to complications related to Crohn's disease. Shortly thereafter, the company halted trading on the platform and filed for creditor protection, which was granted by a Canadian court.

Early Legal Troubles

The exchange appeared to be facing troubles far before Cotten's death. In January of last year, the Canadian Imperial Bank of Commerce (CIBC) froze accounts associated with the exchange after concerns arose over the proper owners of the close to \$22 million in account funds held by a third-party payment processor. Quadriga maintained its right to the frozen funds before the court in June, though the judge sided with the bank in its long-awaited [November opinion](#).

Court documents indicated that Cotten used pending lawsuits and the frozen accounts as reasons why clients were having trouble making withdrawals. In a later deleted post, the exchange attempted to reassure customers that all pending withdrawals would be fulfilled and their remaining funds were secure.

Quadriga Reports Cotten's Death and Goes Down for Maintenance

In early January, Quadriga reported Cotten's death through a [post](#) on its Facebook attributed to his wife Jennifer Robertson. The post stated that current Head of Operations Aaron Matthews would serve as interim CEO and provide an update on business activities. It assured

that Quadriga remained committed to “servicing its customers in an open, timely and transparent manner.” Quadriga continued to accept deposits at this time.

On January 26, another post indicated that the exchange was going down for maintenance, causing further panic as customers continued to experience difficulties accessing funds.

A few days later, Cotten’s wife submitted an [affidavit](#) recounting her “repeated and diligent” attempts to locate the private keys of her late “security conscious” husband. She described how she employed an expert to try to decrypt Cotten’s laptop to no avail.

Skeptics Emerge

Public figures in the crypto space, like Kraken’s CEO Jesse Powell, [spoke out](#) on the Quadriga developments, calling for a police investigation. Some [attempted to show](#) that funds from Quadriga’s wallet addresses were moving or [had moved out](#) prior to the exchange’s shutdown. Others [purported](#) that the wallets for some digital assets might have never existed.

Participants on social media voiced theories that Cotten was not actually dead and the circumstances were all a part of an elaborate exit scheme. A later death

certificate was produced in an attempt to quell these proposals.

Filing for Protection

Shortly after going down for maintenance, Quadriga made the [announcement](#) that it was filing for creditor protection under the Creditors Arrangement Act (CCAA) on February 1. It advocated that it had “worked extensively to address [its] liquidity issues” to no resolve. It expressed hopes to “maximize the funds available for the company’s stakeholders,” sharing that the accounting firm Ernst & Young will oversee the proceedings.

Quadriga appeared before the Nova Scotia Supreme Court on February 5 who granted the protection, effectively preventing litigation during the 30-day stay. After the stay, Quadriga’s protection may be extended. Representative counsel is scheduled to be appointed by the courts on February 14.

On Thursday, the British Columbia Securities Commission, Canada’s securities regulator, [told](#) Reuters that it had no oversight over the exchange because it was not dealing in securities or derivatives, though in the following day it [shared](#) that it was looking into the situation.

SEC Commissioners Discuss Blockchain Innovation, Timeline for a Bitcoin ETF

As federal regulators in the U.S. resume operations after the government shutdown, digital assets appear to be a top priority. On February 6, an [article](#) depicted SEC Commissioner Robert J. Jackson Jr.'s hopeful outlook regarding the agency's approval of a bitcoin ETF. Days later, SEC Commission Hester Peirce discussed blockchain innovation and securities laws in a [speech](#) before the University of Missouri School of Law. The SEC also tweeted its [ICO guide](#) on Sunday, restating its general views on token sales.

Commissioner Jackson Hopeful on "Eventual" Approval of a Bitcoin ETF

In his interview, Commissioner Jackson praised market participants for their efforts in addressing the "serious issues" facing the industry. These issues, including market manipulation and liquidity, made it easy for the agency to deny the Winklevoss Bitcoin Trust ETF proposal in July, according to Jackson, stating that the previous case "wasn't especially close." He said that he is happy that "market participants have begun to come in with ideas," though he is

still unprepared to say whether a proposal with the necessary investor protection will gain "the American stamp of approval."

Currently, three bitcoin ETF proposals are pending before the Commission—one re-filed by the CBOE last month, [another](#) submitted by NYSE Arca and Bitwise Asset Management, and [another](#) submitted Monday by Reality Shares, which seeks to include bitcoin as part of a larger currency portfolio.

Commissioner Peirce Calls for Careful Regulation in Support of Innovation

Commissioner Peirce, the [sole dissenter](#) in the 3-1 vote denying the Winklevoss proposal, conveyed a similarly hopeful perspective of the crypto space, though expressed reservations regarding regulators overreaching their mandates. She reiterated that every innovation "carries with it some risk," but that the SEC has the present opportunity to enable innovation without compromising the objectives of securities laws.

Mentioning Basis, the cryptocurrency project that shut down citing difficulty with regulatory compliance, she warned against SEC actions that cause "apparently legitimate projects" to cease operations. She demonstrated concern that the

application of the *Howey* test may be overly broad, but forwarded that ambiguity may allow blockchain projects the freedom to mature on their own.

Speaking on the topic of decentralization in the context of securities laws, she repeated the central tenant of SEC Director William Hinman's June [speech](#): "Tokens sold for use in a functioning network, rather than as investment contracts, fall outside the definition of securities"—it is the "nature of the transaction" that determines whether securities laws apply. While this is "useful guidance," she stated the agency is still working on "supplemental guidance" to provide the market with further clarity.

Peirce expressed a slightly different view than Jackson regarding the SEC's role in judging the safety of investment products by its "preference." She [tweeted](#) that she looked forward to working with Jackson "to open the doors to innovation," though emphasizing that the SEC is not a "merit regulator issuing seals of approval." She highlighted the need for the public to conduct their own independent investment research—a notion she highlighted in her November [speech](#) before the Crypto Valley Summit in Switzerland.

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Something to Watch

- Fintech Finance: [Paris Fintech Forum 2019: Hugo Renaudin, LGO Markets](#)

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