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Digital Assets Alert

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SEC beefs up crypto unit

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SEC nearly doubles cryptocurrency enforcement staff.



What's the Impact

- / The announcement reiterates the agency's regulatory and enforcement priorities and demonstrates that it is willing to reallocate significant resources to further those efforts
- / The work of the Crypto Assets and Cyber Unit will undoubtedly focus on charging allegedly fraudulent conduct more commonly associated with traditional financial markets that the agency now believes is occurring with greater frequency
- / Without explicit authority from Congress, the SEC is likely to continue its "regulation by enforcement" approach

On May 3, 2022, the U.S. Securities and Exchange Commission announced that it had allocated 20 additional enforcement positions to the unit tasked with protecting investors in cryptocurrency markets and from cyber-related threats.¹ The SEC also renamed the now 50-person unit the "Crypto Assets and Cyber Unit," (previously the "Cyber Unit") reflecting the

¹ [SEC Nearly Doubles Size of Enforcement's Crypto Assets and Cyber Unit](#), U.S. SECURITIES AND EXCHANGE COMMISSION (May 3, 2022).

SEC's increasing focus on regulating the crypto space, and noted that the new positions will be filled by a mix of supervisors, investigative staff attorneys, trial attorneys, and fraud analysts.

In the announcement, SEC Chair Gary Gensler highlighted the unit's work to combat "those seeking to take advantage of investors in the crypto markets," and noted that by "nearly doubling the size of this key unit, the SEC will be better equipped to police wrongdoing in the crypto markets while continuing to identify disclosure and controls issues with respect to cybersecurity." The announcement also identified the specific areas of focus for the new unit: crypto asset offerings, crypto asset exchanges, crypto asset lending and staking products, decentralized finance (DeFi) platforms, non-fungible tokens (NFTs), and stablecoins.

Implications for companies operating in the crypto space

Last week's announcement reinforces the SEC's commitment to [cryptocurrency enforcement under Chair Gensler](#), in an attempt to reign in what he previously characterized as "more like the Wild West."² The newly branded unit undoubtedly will focus on charging allegedly fraudulent conduct more commonly associated with traditional financial markets that the agency now believes is occurring with greater frequency in this fast-moving and largely unregulated space. The SEC's work of charging individuals and companies that have defrauded investors in connection with traditional securities offerings, for example, has now expanded to enforcement actions involving pump-and-dump initial coin offerings (or ICOs).³ As the SEC's Director of Enforcement, Gurbir S. Grewal, noted in the announcement, "[c]rypto markets have exploded in recent years, with retail investors bearing the brunt of abuses in this space," and the new unit "will be at the forefront of protecting investors and ensuring fair and orderly markets in the face of these critical challenges."

However, of greater concern to companies attempting to operate lawfully in this emerging industry is the SEC's use of its enforcement authority to draw regulatory lines that are yet undefined. Although Chair Gensler has signaled that there is only so much the SEC can do to regulate the industry absent congressional action,⁴ that has not stopped the SEC from bringing enforcement actions involving financial products and exchanges that the agency believes clearly fall within its jurisdiction. Perhaps the two most prominent examples of the SEC's "regulation by enforcement" approach are the litigation it initiated in 2020 against Ripple Labs, Inc. and the charges it settled recently against BlockFi Lending LLC.

² [Remarks Before the Aspen Security Forum](#), Chair Gary Gensler, U.S. SECURITIES AND EXCHANGE COMMISSION (Aug. 3, 2021).

³ [Investor Alert: Public Companies Making ICO-Related Claims](#), U.S. SECURITIES AND EXCHANGE COMMISSION (Aug. 28, 2017).

⁴ See, e.g., [2021 FINRA Annual Conference: A Conversation With The Honorable Gary Gensler, Chair, U.S. Securities and Exchange Commission \(SEC\)](#), FINRA (May 20, 2021), (see approx. 18:00 mark).

In the litigation against Ripple, the SEC has alleged that Ripple sold unregistered digital asset securities worth over \$1 billion.⁵ According to the complaint, Ripple distributed the digital securities—called XRP—despite receiving legal advice that XRP could be considered a security under applicable laws. Throughout the litigation, Ripple has asserted that XRP is a virtual currency that is not subject to securities regulation, a conclusion also reached by other US-based and international regulators.⁶ Discovery in the case is ongoing with the parties' summary judgment motions due to be filed by September 2022.

The charges the SEC recently settled with BlockFi also stemmed from allegations that a crypto product constituted an unregistered securities offering.⁷ BlockFi's product—called BlockFi Interest Accounts (BIAs)—appeared to consumers to operate like an interest bearing savings account where customers could lend crypto assets to BlockFi in exchange for receiving a variable monthly interest rate. However, the SEC deemed BIAs to be unregistered securities because, in the agency's view, the accounts constituted both notes and investment contracts under the prevailing legal standards established by *Reves v. Ernst & Young*, 494 U.S. 56, 64–66 (1990) and *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946), respectively. BlockFi settled these charges in February for \$100 million, including \$50 million in fines to 32 states to settle similar charges.

In each of these cases, the SEC charged prominent and sophisticated crypto companies with securities violations for conduct that was not clearly prohibited under the existing regulatory regime. Given the newly allocated resources to the Crypto Assets and Cyber Unit, the SEC can be expected to continue to bring similar precedent-setting actions in an effort to establish its authority over the sectors of the crypto economy it believes it has jurisdiction. Companies operating in this space should remain vigilant of where the SEC and other regulators believe the lines are drawn and consult with legal counsel to ensure compliance with the shifting regulatory landscape. As the SEC and the other agencies that are tasked with regulating this space enjoy significant discretion in their enforcement authority, early engagement with the agency staff attorneys can be critical to avoiding—or favorably resolving—a potential enforcement action.

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⁵ Complaint, *SEC v. Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 46 (S.D.N.Y. Feb. 18, 2021).

⁶ Answer, *SEC v. Ripple Labs, Inc.*, No. 20-cv-10832, Dkt. No. 51 (S.D.N.Y. Mar. 4, 2021).

⁷ [Order, In re: BlockFi Lending LLC](#), U.S. SECURITIES AND EXCHANGE COMMISSION (Feb. 14, 2022).

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