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# Chair Gensler Reaffirms Focus on Crypto Enforcement; SEC Brings Actions Against a DeFi Lender and a Crypto Exchange for Offering Unregistered Securities

At the Aspen Security Forum on August 2, 2021, SEC Chair Gary Gensler reaffirmed the SEC's heightened focus on cryptocurrency. Following these comments, the SEC announced two enforcement resolutions that provide further guidance on the SEC's approach to crypto enforcement. First, on August 6, the SEC announced a \$13 million resolution against a lender and its two founders for offering unregistered securities using decentralized finance (DeFi)<sup>1</sup> technology.<sup>2</sup> And second, on August 9, the SEC announced a \$10 million settlement with an online digital asset exchange for offering unregistered securities.<sup>3</sup>

The key takeaways are as follows:

- **The SEC continues to emphasize that it will be an aggressive enforcer of the securities laws in the cryptocurrency space.** As Chair Gensler said at the Aspen Security Forum, the SEC “will continue to take [its] authorities as far as [it can] go” to address the lack of investor protection in the cryptocurrency space—which he described as “the Wild West.”<sup>4</sup> He called on SEC staff to “continue to protect investors in the case of unregistered sales of securities” based on what he called “well-settled” and “clear” rules, while requesting that Congress pass legislation to close regulatory gaps and provide additional resources to the SEC, particularly as it relates to “crypto trading, lending, and DeFi platforms.”<sup>5</sup>
- **Current SEC leadership reiterated that the securities laws clearly apply to a variety of actors in the digital asset space.** Chair Gensler said that he agreed with former SEC Chair Jay Clayton that “every ICO [they have] ever seen is [a] security” to which “federal securities laws apply,”<sup>6</sup> referring to 2018 testimony by Chair Clayton.<sup>7</sup> As to crypto trading platforms, Chair Gensler said that “the probability is quite remote” that the average platform has zero securities trading on it. Chair Gensler also briefly addressed stablecoins, saying that these tokens, which are pegged to fiat currency, “may be securities and investment companies” in addition to potentially implicating anti-money laundering, tax, and sanctions concerns.<sup>8</sup>
- **Still, the SEC has not affirmatively offered guidance on multiple tokens.** During the question and answer period at the Aspen Security Forum, Chair Gensler would not confirm whether Ether was a security despite being asked repeatedly, saying “[g]ood try. You’ve tried a third and fourth time, but I’m not going to go into any one token.”<sup>9</sup>

- **DeFi is within the SEC’s sights.** Chair Gensler highlighted the SEC’s focus on DeFi platforms—including crypto trading and lending platforms—stating that DeFi platforms offering “securities” must be registered with the SEC.<sup>10</sup> A few days later, the SEC announced its first charges involving the sale of cryptocurrency using DeFi technology<sup>11</sup> against Blockchain Credit Partners d/b/a DeFi Money Market (“DMM”) and its two founders for the unregistered sale of more than \$30 million of what the SEC viewed as securities.<sup>12</sup> The order alleges DMM used smart contracts and DeFi technology to sell two types of digital tokens: (1) mTokens that could be purchased using specified digital assets and paid over 6% interest, and (2) governance tokens that purportedly gave holders certain voting rights, a share of excess profits, and the ability to profit from the resale of the token in the secondary market.<sup>13</sup> The SEC alleged that the mTokens were notes (which, the SEC said, were presumed to be securities unless certain exceptions applied), and that both the mTokens and governance tokens were investment contracts under the *Howey* test, which were offered in violation of federal securities laws.<sup>14</sup> The SEC also alleged that the respondents made materially false and misleading statements concerning the operations and profitability of DMM. DMM and the founders agreed to the order,<sup>15</sup> which includes a \$12.85 million disgorgement and penalties of \$125,000 for each of the founders.<sup>16</sup>
- **SEC brings second action against digital asset exchange.** Finally, one week after Chair Gensler’s speech, the SEC announced a \$10 million resolution with Poloniex LLC<sup>17</sup> for operating an unregistered digital asset exchange that facilitated the buying and selling of securities from July 2017 through November 2019.<sup>18</sup> Although the exchange began operations in 2014, the SEC measured the penalty from July 2017, the date the SEC issued its *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO*, which is known as the DAO Report.<sup>19</sup> The DAO Report was the first time that the SEC applied the *Howey* test to cryptocurrency to determine whether it qualifies as a security under federal law. It will be interesting to see whether this marks the beginning of an SEC practice to measure liability in such cases from the date of the DAO Report rather than an earlier date. In its order, the SEC found that Poloniex had made available for trading digital assets that it believed were at “medium risk” of being determined securities under the *Howey* test. The SEC stated that Poloniex “chose increased profits over compliance with the federal securities laws.”<sup>20</sup>
- **Commissioner Pierce continues to raise her concerns over regulatory uncertainty.** Commissioner Hester M. Pierce, who has long been an advocate for cryptocurrency, issued a statement noting “that market participants may understandably be surprised to see [the SEC] to come onto the scene now with [its] enforcement guns blazing and argue that Poloniex was not registered or operating under an exemption as it should have been.”<sup>21</sup> Commissioner Pierce stated that the “minor problem” with the charges is that the SEC was “moving very cautiously with respect to regulated entities’ engagement with crypto assets” from 2017 through 2019, adding that Poloniex LLC would have tried to register with the SEC but “likely would have waited...and waited...and waited some more.”<sup>22</sup> She concluded her statement by identifying a number of questions that the SEC needs to address prior to the registration of cryptocurrency trading platform, which include whether the platform can custody the assets, whether the platform can trade securities and non-securities, and how a platform can determine whether a digital asset is a security.<sup>23</sup>

Both Chair Gensler’s recent statements, and the charges against DeFi Money Market and Poloniex LLC, demonstrate the SEC’s continued focus on shaping the cryptocurrency space through enforcement, while Commissioner Pierce’s statement highlights the regulatory uncertainties that still exist in the space. We will continue to monitor these developments.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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- <sup>1</sup> DeFi is a form of finance that uses smart contracts on the blockchain instead of relying on central financial intermediaries to offer traditional financial instruments.
- <sup>2</sup> Press Release, *SEC Charges Decentralized Finance Lender and Top Executives for Raising \$30 Million Through Fraudulent Offerings* (Aug. 6, 2021), [https://www.sec.gov/news/press-release/2021-145?utm\\_medium=email&utm\\_source=govdelivery](https://www.sec.gov/news/press-release/2021-145?utm_medium=email&utm_source=govdelivery).
- <sup>3</sup> Press Release, *SEC Charges Poloniex for Operating Unregistered Digital Asset Exchange* (Aug. 9, 2021), [https://www.sec.gov/news/press-release/2021-147?utm\\_medium=email&utm\\_source=govdelivery](https://www.sec.gov/news/press-release/2021-147?utm_medium=email&utm_source=govdelivery).
- <sup>4</sup> Remarks of SEC Chair Gary Gensler Before the Aspen Security Forum (Aug. 3, 2021), <https://static.politico.com/c4/d6/5c46bb1543c792aaa5789d82af80/0803gensler.pdf>.
- <sup>5</sup> *Id.*
- <sup>6</sup> *Id.*
- <sup>7</sup> See Jay Clayton, Testimony United States Senate Committee on Banking, Housing, and Urban Affairs, “Virtual Currencies: The Oversight Role of the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission” (Feb. 6, 2018), available at <https://www.banking.senate.gov/hearings/virtual-currencies-the-oversight-role-of-the-us-securities-and-exchange-commission-and-the-us-commodity-futures-trading-commission> (see approx. 32:00 mark).
- <sup>8</sup> *Id.*
- <sup>9</sup> Aspen Security Forum, *The View from the SEC: Cryptocurrencies and National Security with Speaker: Gary Gensler, Chairman, Securities and Exchange Commission*, transcript available at <https://www.aspensecurityforum.org/asf-transcript-library>.
- <sup>10</sup> Remarks of SEC Chair Gary Gensler, *supra* note 4.
- <sup>11</sup> Press Release, *SEC Charges Decentralized Finance Lender and Top Executives for Raising \$30 Million Through Fraudulent Offerings* (Aug. 6, 2021), [https://www.sec.gov/news/press-release/2021-145?utm\\_medium=email&utm\\_source=govdelivery](https://www.sec.gov/news/press-release/2021-145?utm_medium=email&utm_source=govdelivery).
- <sup>12</sup> In the Matter of Blockchain Credit Partners d/b/a DeFi Money Market, Gregory Keough, and Derek Acree, *Order Instituting Cease-and-Desist Proceedings* (Aug. 6, 2021), <https://www.sec.gov/litigation/admin/2021/33-10961.pdf>.
- <sup>13</sup> *Id.*
- <sup>14</sup> *Id.*
- <sup>15</sup> DeFi Money Market and its founders did not admit or deny liability.
- <sup>16</sup> *Id.*
- <sup>17</sup> Poloniex LLC did not admit or deny liability.

<sup>18</sup> Press Release, *supra* note 3.

<sup>19</sup> In the Matter of Poloniex LLC, *Order Instituting Cease-and-Desist Proceedings* (Aug. 9, 2021), <https://www.sec.gov/litigation/admin/2021/34-92607.pdf>.

<sup>20</sup> Press Release, *SEC Charges Poloniex for Operating Unregistered Digital Asset Exchange* (Aug. 9, 2021), [https://www.sec.gov/news/press-release/2021-147?utm\\_medium=email&utm\\_source=govdelivery](https://www.sec.gov/news/press-release/2021-147?utm_medium=email&utm_source=govdelivery).

<sup>21</sup> Public Statement by Commissioner Hester M. Peirce, *In the Matter of Poloniex, LLC* (Aug. 9, 2021), <https://www.sec.gov/news/public-statement/pierce-statement-poloniex-080921>.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*