

Harvard Law School Forum on Corporate Governance

The SEC and Virtual Currency Markets

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“For any normal person trying to respond, it would be hellish.” [1]

Major media sources reported last week that the US Securities and Exchange Commission (“SEC”) has intensified its ongoing probe of the virtual currency markets. [2] This probe builds on a recent disclosure by the head of the SEC’s Cyber Unit that more than a dozen issuers have voluntarily halted their initial coin offerings (“ICOs”) after receiving calls from the SEC and continues the months-old Cyber Unit’s focus on misconduct involving distributed ledger technology and ICOs. [3]

While the SEC has not commented on these latest reports of an industry sweep, the probe appears to consist of numerous non-public subpoenas and requests for information to virtual currency market participants, primarily focusing on issuers of ICOs but also including exchanges, lawyers and other advisers, and investors. Although the total number of subpoenas and requests is not known, sources have indicated that anywhere from 80 to perhaps hundreds have been sent out since the fall of 2017. [4]

In particular, it appears that the SEC is looking at ICOs that relied on “simple agreements for future tokens” or “SAFTs” to avoid complying with certain aspects of the federal securities laws. SAFTs have been used for fundraising in several major ICOs, and the question of whether they are a security has not been tested in the courts.

So what do you do if you are one of the unlucky recipients of an SEC subpoena or request for investigation? Or maybe you recently issued SAFTs in an ICO, and you’re nervous about answering the door? Without writing a treatise, [5] we offer these words to the wise:

- Take it seriously and prepare to comply;
- Don’t destroy evidence; and
- Don’t shoot yourself in the foot.

Take It Seriously and Prepare to Comply

SEC subpoenas, and even voluntary requests for information, must be taken very seriously. In our experience, they often are multiple pages in length and can instruct the recipient to provide the agency with almost anything related to its business, including “lists of investors, emails, marketing materials, organizational structures, amounts raised, the location of the funds and the people involved and their locations.” [6] They typically have short deadlines for compliance (often 14 days) and provide no indication of why the SEC issued them. Failure to comply with them may quickly lead to an action for

subpoena enforcement or charges in federal court and could even see a court temporarily (or permanently) enjoin the business of, and/or freeze the assets of, a noncompliant issuer until the matter is sorted out.

In certain cases, a request for information may be just that, and the SEC will not contact the subpoena recipient again after the SEC receives the requested information. In most cases, though, the SEC has a continuing interest in the recipient because the agency either is investigating them for a potential violation of law or needs their cooperation to pursue another potential violator. The SEC may not disclose that it believes a person has violated the law until immediately prior to bringing charges against them.

Even in cases where a subpoena recipient believes they have not committed a violation of law and/or that they are an innocent spectator, they should retain experienced counsel. Securities enforcement lawyers routinely deal with the SEC and can work with any subpoena recipient to ensure that only requested materials are produced in an appropriate manner. Such experts may even be able to work with agency staff to tailor or narrow requests to be less burdensome or to negotiate extensions to the typically short deadlines specified in initial requests.

Furthermore, if a subpoena recipient may have operated in a legally gray area, counsel can proactively begin negotiations with the SEC at an early stage in their investigation, potentially to the client's benefit later. In certain circumstances, typically in an industry-wide sweep, much like the case here, the first person to settle with the agency receives a lesser penalty for being first. In any situation, the SEC is more likely to be lenient with a defendant who is perceived as cooperative and not as a bad actor.

Don't Destroy Evidence

To avoid charges for destruction of evidence, also known as spoliation, subpoena recipients should immediately issue legal holds. A legal hold is an instruction to a company's employees and vendors to temporarily refrain from destroying records, including those no longer needed in the normal course of business, to ensure that such records are retained and may be used by the company, its lawyers and, in many cases, the SEC and private plaintiffs suing the company. This is an area fraught with traps for the inexperienced, as many documents are routinely deleted in the usual course of business. Again, counsel can assist subpoena recipients in drafting appropriate legal holds and securing records for the duration of the SEC's investigation.

Don't Shoot Yourself in the Foot

Some have indicated that the recent targets of the SEC's virtual currency probe can reduce their compliance burden by offering to meet with SEC staff as an alternative to producing documents, and that is, in fact, an option often provided by the SEC. [7] From our perspective, in the vast majority of cases, that is like offering to pet a lion instead of giving it a steak on a ten-foot pole.

SEC enforcement attorneys are highly trained interviewers with decades of experience deposing alleged bad actors. Even well-meaning interviewees can inadvertently expose themselves to avoidable legal risk by admitting to a violation that the SEC might not be aware of, "admitting" to a violation they haven't actually committed, lying about their actions (a crime commonly known as perjury) or creating a misimpression of dishonesty when they are only confused or ill-prepared. Only with experienced counsel at their side should a subpoena recipient agree to speak with SEC staff.

Endnotes

¹ Marc Hochstein and Bailey Reutzel, *SEC ICO Probe Underway, But Conflict on Size of Sweep*, CoinDesk (Mar. 1, 2018). [\(go back\)](#)

² Jean Eaglesham and Paul Vigna, *Cryptocurrency Firms Targeted in SEC Probe*, Wall Street Journal (Feb. 28, 2018); Marc Hochstein and Bailey Reutzel, *SEC ICO Probe Underway, But Conflict on Size of Sweep*, CoinDesk (Mar. 1, 2018). [\(go back\)](#)

³ Ted Knutson, *Investigations Pick Up As Cryptocurrency Worries Permeate SEC*, Forbes (Feb. 25, 2018).

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⁴ *Eaglesham*.

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⁵ Although we have written one: Steven Wolowitz, Richard Rosenfeld, and Lee Rubin, *Securities Investigations: Internal, Civil and Criminal* (Nov. 2017), available at <https://www.mayerbrown.com/Securities-Investigations-Internal-Civil-and-Criminal/>.

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⁶ *Eaglesham*.

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⁷ *Eaglesham*.

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