

The SEC Expands its Enforcement Throughout the Digital Industry

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The Securities and Exchange Commission (“SEC” or “Commission”) is ramping up its enforcement efforts in the digital asset industry, expanding its focus to include digital asset brokers and investment companies. On September 11, the Commission issued an order against a digital asset hedge fund and announced a settlement with a self-described “ICO superstore” for violating federal securities laws. The Commission fined Crypto Asset Management LP and its principal for failing to register as an investment company, among other things. According to the SEC, Crypto Asset Management, which trades digital assets exclusively, is an investment company pursuant to the Investment Company Act because it “*invest[s], reinvest[s], own[s], hold[s] or trad[es] in securities.*”

This enforcement action was the Commission’s first against a digital asset hedge fund. On the same day, the SEC announced a settlement with TokenLot, a now defunct seller of various digital assets, including those sold in initial coin offerings (“ICOs”). TokenLot, according to the Commission, sold digital asset securities but failed to register as a broker-dealer. This settlement was the SEC’s first with an unregistered broker-dealer of digital assets. The Financial Industry Regulatory Authority (“FINRA”) is wading into the industry as well. It filed its first disciplinary action involving cryptocurrencies also on September 11. In its complaint, FINRA accused a former securities broker of committing securities fraud by selling investors “HempCoin” under the false pretenses that each HempCoin gave the purchaser equity ownership in Rocky Mountain Ayre, Inc.

These actions underscore the SEC's (apparent) current view that a digital asset sold through an ICO is a security; therefore, federal securities law applies to subsequent sales of such tokens, at least until their underlying network becomes sufficiently decentralized. FINRA's disciplinary action signals that it is following suit. It appears that digital asset issuers are now no longer the only entity that must be mindful of federal securities laws. Moving forward, investment companies and broker-dealers interested in digital assets will need to carefully follow the SEC's evolving view to ensure they comply with securities laws.

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