KIRKLAND **ALERT**

December 14, 2017

SEC Chairman Issues Statement on Cryptocurrencies and Initial Coin Offerings

On December 11, 2017, U.S. Securities and Exchange Commission Chairman Jay Clayton issued a statement expressing his general views on cryptocurrencies and initial coin offerings (ICOs) as they relate to market professionals, including broker-dealers, investment advisers, lawyers and accountants.

Clayton, reiterating the SEC's view that ICOs may involve the offering of securities, urged market professionals to review the SEC's June 25, 2017, Report of Investigation wherein the SEC applied traditional securities law principles to virtual currency activities and found that certain virtual tokens or coins offered in an ICO could be deemed securities.[1] Clayton noted that following the Report, certain market professionals highlighted the utility characteristics of their ICOs in an effort to claim that their tokens or coins are not securities. Clayton clarified that merely structuring a token to provide some utility — or simply calling something a "currency" — does not prevent an offering from being a security under traditional securities law principles. He cautioned against "promoting or touting" tokens before determining whether the securities laws apply, as doing so may result in operating as an unregistered broker-dealer, and he put the burden of demonstrating that a currency or product is not a security on the promoter of such product.

Clayton also reminded market professionals of the SEC's jurisdictional reach with respect to certain cryptocurrencies and provided a non-exhaustive list of entities that may be within the SEC's jurisdiction, including securities firms that allow for payments in cryptocurrencies, allow customers to purchase cryptocurrencies on margin, set up structures to invest in or hold cryptocurrencies, or extend credit to customers to purchase or hold cryptocurrencies. He further noted that brokers, dealers and other market participants must ensure that their cryptocurrency activities do not undermine anti-money laundering and know-your-customer obligations.

This statement follows on the heels of the first two enforcement actions[2] pursued by the SEC's new Cyber Unit. Clayton noted that he has asked the SEC's Division of Enforcement to continue to police this area and recommend additional enforcement actions against those that conduct ICOs in violation of the federal securities laws.

Investment advisers should examine their investment strategies and current disclosures to determine if an investment in a particular cryptocurrency or ICO is permissible and in the best interest of their clients. Advisers should also be mindful of how such investments are contemplated under their policies and procedures, including the code of ethics preclearance and reporting requirements for securities transactions and holdings.

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[1] Courts and the SEC apply the "Howey Test" to determine whether an investment-related instrument meets the definition of a "security." The Howey Test provides that an investment contract that meets the definition of a security will contain four elements: (i) an investment of money; (ii) in a common enterprise; (iii) with an expectation of profits; (iv) solely from the efforts of others (e.g., a promoter or third party). *See SEC v. Edwards*, 540 U.S. 389 (2004); *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

2 *See* Plexcoin order and Munchee Inc. order.

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