The State of Digital Assets

Q2 2020

POWERED BY TheTie

A Message from eToro USA

Guy Hirsch
Managing Director

While media coverage in Q2 continued to focus on Bitcoin, the real story emerging from the data is centered around stablecoins. Stablecoins saw 10x growth since January 2018, approaching $11B in total market cap. In 2020 total market cap went up more than 2x. Fiat inflows into stablecoins exceeded $5B in only six months. We might be on the cusp of a systemic change, in particular in developing countries, where the population needs a way to "exit" from fiat controlled by corrupt or ineffective governments. A business owner in Pakistan or Iran can now get yield on a USD-pegged stablecoin, pay vendors and perhaps employees, all the while not worrying about the out-of-control inflation in the local fiat currency. As importantly, she doesn't need to go through the traditional banking system, subject to all sorts of restrictions and limitations because of bad government actors. We hope to see this growth continue in Q3 and beyond, as a catalyst for a free and fair global economy that is censorship and corruption resistant.

About eToro USA

eToro is a global, multi-asset trading platform with over 10 million registered users. At eToro, you can share your real track record, portfolio, and trades with the community, allowing users to engage with each other on trading ideas that are executed using real dollars. For those new to crypto trading, the community and educational resources introduce users to this new asset class and the risk profiles involved in it.

A Message from The TIE

Joshua Frank
CEO

The emergence of coronavirus and the flash crash defined Q1. But there were no major macro events that could encapsulate Q2. The second quarter of 2020 featured a series of iterative improvements to infrastructure and institutional support. These help lay the ground work for the future of more mainstream digital asset adoption. I see the explosion of stablecoins in Q2 as the most critical development towards widespread utility that crypto has ever seen.

About The TIE

The TIE is the premier provider of alternative data for digital assets. The TIE offers trusted and transparent data solutions that power the leading cryptocurrency institutional investors and market participants. Among The TIE's offerings are the exclusive digital asset sentiment feed powered by the Twitter firehose and the first corporate actions feed for cryptocurrencies.

About the Data

Unless otherwise noted, all data is provided by The TIE. Throughout the report you will encounter a number of proprietary sentiment-driven metrics produced by The TIE. In the context of this report, sentiment is a measure between 0-100 of how positive or negative Twitter conversations are on a particular cryptocurrency over a given time interval. A score above 50 implies that conversations on an asset are positive and a score below 50 implies that they are negative.

Daily Sentiment Score is a normalized representation of investor emotion over a rolling 24 hours as compared to the previous 20 days.

Click here to learn more about The TIE's proprietary sentiment data.

Key Takeaways

We Finally Have a Mainstream Use Case

The substantial rise of stablecoins in Q2 is the most notable narrative for digital assets. They are the first non-speculative use case for cryptocurrencies that has garnered significant adoption and that solves mainstream challenges. In this paper, we breakdown how fully-collateralized stablecoins can solve the challenges of foreign remittances and present a massive fiat on-ramp into the cryptocurrency ecosystem.

Slow and Steady Wins the Race

There was not one major event that made Q2 a successful quarter, rather it was a combination of smaller developments. The digital asset market saw a significant uptick in institutional adoption, including Paul Tudor Jones' foray into the space and the announcement that 1/3rd of institutions hold crypto. While the market may not be experiencing the inbound frenzy many predicted when BTC futures were launched at the height of the 2017/2018 bull market, crypto is emerging stronger and more resilient than ever before.

Crypto isn't a One Trick Pony

While many predicted that by now Bitcoin would be the only cryptocurrency still performing, quarter-over-quarter we are seeing other digital assets beating the price movement of BTC. This quarter Cardano (+175%) and Ethereum (+70%) were the biggest winners, but it is clear that this race is far from over. Cryptocurrencies are surely maturing, but they remain in beta. Bitcoin has established itself as the dominant protocol with the greatest staying power in the industry, but it is clear that at least in the short-term there may greater opportunities for investors seeking to differentiate beyond one coin.

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Quarterly Contributors

The Quarterly Contributor Series covers unique cryptocurrency narratives from the past quarter, written by leading experts in the field of digital assets. This quarter's contributors are Jorge Pesok from the law firm Crowell & Moring and Philip Gradwell from blockchain analysis firm, Chainalysis. This quarter's Founders Series features Justin Sun of TRON.

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What Telegram's Settlement With The SEC Tells Us About Future Cryptocurrency Enforcement Actions and Litigation Strategies

By: Jorge Pesok

CHAINALYSIS

On-Chain Trends

By: Philip Gradwell

TRON

eToro Founders Series Featuring Justin Sun of TRON

Telegram's Settlement and Future Cryptocurrency Enforcement Actions and Litigation Strategies

By: Jorge Pesok

Jorge Pesok is a counsel in Crowell & Moring's White Collar & Regulatory Enforcement and Blockchain and Digital Assets practices in the New York office. Jorge's practice represents financial institutions, technology companies, digital asset trading platforms, and individuals in a variety of regulatory, compliance, and litigation matters. His work includes representing clients in enforcement and litigation matters before the SEC, DOJ, CFTC, and CME. Jorge also counsels blockchain and distributed ledger technology clients on the application of federal and state securities, commodities, and money transmission laws.

On June 25, 2020, Judge P. Kevin Castel of the U.S. District Court for the Southern District of New York issued the final judgment in the U.S. Securities Exchange Commission's (SEC) legal battle with Telegram Group Inc. and TON Issuer Inc. (collectively, "Telegram") marking the official end to one of the most important legal battles in the cryptocurrency space. The final judgment was an approval of the settlement agreement entered into between the parties in which Telegram agreed to, among other things, a $1.22 billion disgorgement, an $18.5 million civil penalty, and give the SEC 45 days' "notice before participating in an issuance of 'cryptocurrencies,' 'digital coins,' 'digital tokens,' or any similar digital asset issued or transferred using distributed ledger technology." As the first litigated case to test the theory underlying the Simple Agreement for Future Token (SAFT), some of the implications of this decision are already evident. The full impact of this decision, however, will likely take years to fully materialize.

One of the most significant parts of the court's decision is its holding that Telegram SAFT investors are statutory underwriters and therefore Telegram's SAFTs are not entitled to the exemption from registration in Rule 506(c) of Regulation D under the Securities Act of 1933 (the "Securities Act"). As more fully discussed in this article, the legal implications of that holding should not only give pause to issuers and participants in token offerings who executed SAFTs, but also to issuers who previously thought they were immune from civil litigation because the one year statute of limitations applicable to unregistered securities offerings has run.

Background

The SEC commenced its action against Telegram on October 11, 2019, alleging that Telegram's planned offering of Grams violates the registration requirements of Sections 5(a) and 5(c) of the Securities Act and requested a temporary restraining order (TRO) against Telegram.

At the center of the dispute is whether issuers of digital tokens can avoid registering their sale with the SEC by issuing them pursuant to SAFTs. SAFTs are instruments, typically issued to sophisticated investors prior to the development of the underlying functionality of the tokens that convert into digital tokens upon completion and launch of the functionality. While in many cases issuers treat SAFTs as securities and offer and sell them pursuant to the exemption from registration in Rule 506(c) of Regulation D under the Securities Act, they have typically taken the position that the digital tokens that are later distributed upon conversion of the SAFTs, when the development of the underlying functionality is complete, are not securities and not part of an integrated offering. The issuer's theory is typically that once use-cases exist for the tokens, they no longer constitute securities, but rather utility tokens that can be distributed as commodities or currency without being subject to regulation as securities by the SEC. Hence issuers claim that there should be no integration between the initial SAFT offering and any future token conversion or re-sale of tokens.

The status of the SAFT itself was not at issue in this case as Telegram conceded its SAFTs are securities. What was at issue, however, is whether Telegram's planned creation and distribution of Grams to the SAFT investors, after the use-cases have been developed (i.e., the "functional consumptive uses" of Grams), and the subsequent re-sale of Grams to the public by the purchasers of the SAFTs, constitute an integrated offering and sale of securities subject to regulation by the SEC.

Telegram argued that its SAFTs and the Grams were not part of an integrated offering but rather must be separately analyzed from the SAFTs under the federal securities laws. Telegram also noted that the SAFT investors warranted and represented to Telegram that they were purchasing Grams for their own account and "not with a view towards, or for resale in connection with, the sale or distribution."

The SEC took the position that the SAFTs and the issuance of the Grams were part of an integrated offering and that the time delay between the SAFTs and issuance of the tokens is immaterial. In particular, the SEC alleged that Telegram's SAFTs are not entitled to the benefit of an exemption from registration (e.g., Rule 506(c) of Regulation D) because Telegram did not intend the Grams to come to rest with the SAFT investors and upon delivery of the Grams to the SAFT investors, those investors, functioning as statutory underwriters, intended to resell the Grams in the secondary markets thereby completing Telegram's unregistered offering.

The Court's Decision

Judge Castel's 44 page opinion methodically dismissed Telegram's arguments and adopted those of the SEC. The court looked beyond the representations in the SAFTs, focusing almost exclusively on the economic realities of the Gram distribution "scheme."

In its most consequential holding the court adopted the SEC's argument and held that Telegram's sale of Grams to the SAFT investors were not entitled to the benefit of an exemption from the registration requirement under either Section 4(a) or Rule 506(c).

As a recap, Rule 506 of Regulation D states that "[o]ffers and sales of securities by an issuer that satisfy the conditions [of this Rule] shall be deemed to be transactions not involving any public offering within the meaning of section 4(a)(2) of the [Securities] Act." Crucially, Rule 506(c) requires, among other things, that the sales satisfy Rule 502(d). In pertinent part, Rule 502(d) requires that the issuer "exercise reasonable care to assure that the purchasers of the securities are not underwriters within the meaning of section 2(a)(11) of the [Securities] Act." Section 2(a)(11) defines an "underwriter" as "any person who has purchased from an issuer with a view to . . . the distribution of any security."

The court dismissed Telegram's claims that it complied with Rule 502(d) through the provision in its SAFT requiring the investors to represent and warrant that they were "purchasing the Tokens for [their] own account and not with a view towards, or for resale in connection with, the sale or distribution." The court reasoned that "in evaluating [the] economic reality of this scheme, legal disclaimers do not control" and that the "representation and warranty that the [SAFT investors] purchased without a view towards resale rings hollow in the face of the economic realities." The court further reasoned that "[t]he economic reality of Telegram's course of conduct is straightforward and rather easily understood." The court was unequivocal, "find[ing] as a fact that the economic reality is that the Gram Purchase Agreements and the anticipated distribution of Grams by the [SAFT investors] to the public . . . are part of a single scheme," and therefore, the SAFT investors which "acted as mere conduits to the general public, are underwriters."

SAFT Investors as Underwriters

The Court's opinion will undoubtedly reverberate through the cryptocurrency industry. In particular, Judge Castel's determination that the Telegram SAFT investors are underwriters may be the biggest game-changer as it could carry significant legal implications for SAFT issuers and investors· implications that likely were not contemplated when the investors entered into the Telegram SAFTs. The SEC has not brought charges against any of the Telegram SAFT investors in this matter and there is no indication that it intends to, but that does not mean it will not bring charges in the future or in another matter.

By deeming SAFT investors to be underwriters, Judge Castel and the SEC have converted the role of the SAFT investors from passive to active. That conversion may carry significant legal implications ranging from SEC enforcement actions to private plaintiff litigation. For example, the SEC, relying on this precedent, may name SAFT investors as defendants in future actions against SAFT or token issuers in which it alleges that the issuers and defendants offered and sold unregistered securities.

SAFT investors should also be aware that they may be named as defendants by private litigants claiming that they offered and sold unregistered securities under Section 12(a)(1) of the Securities Act.**[1]** Depending on the facts and circumstances, SAFT purchasers (as statutory underwriters) may also face disclosure liability under Sections 11 and 12(a)(2) of the Securities Act, as well as fraud liability under Rule 10b-5 of the Exchange.

Potential Extension of Applicable Statute of Limitations

The plaintiffs' bar has been very active this year in the crypto space. In April alone, 11 class actions were filed in the Southern District of New York against four crypto exchanges and seven digital token issuers. While the claims in each of the actions are different, the central claim is that the issuance of the relevant digital asset constitutes an unregistered securities offering in violation of Section 12(a)(1) and Section 5 of the Securities Act. As many legal commentators have rightfully pointed out, to survive dismissal of these claims, plaintiffs will have to overcome the one-year statute of limitations that governs such claims. The Court's ruling "that the Gram Purchase Agreements and the anticipated distribution of Grams by the [SAFT investors] to the public . . . are part of a single scheme," clears a path for plaintiffs to bring claims against issuers that distributed their tokens pursuant to SAFTs because, based on the particular facts and circumstances of their case, the applicable one-year statute of limitations may not have run until the SAFT investors distributed all of the digital assets they received pursuant to the SAFT.

Judge Castel's decision does not contemplate these potential implications. But given the plaintiffs bar's interest in the digital asset industry, it is advisable that all SAFT participants review their exposure.

Conclusion

Though this case has settled, its implications on the cryptocurrency industry have yet to fully materialize. The plaintiffs' bar is likely to cite this case in an attempt to defeat statute of limitations arguments, and to expand its list of potential defendants to include SAFT investors. Similarly, it is not yet clear how the SEC will adjust its crypto enforcement strategy as a result of this victory. For example, the SEC could use this decision to expand its enforcement targets in the crypto space from direct issuers to ancillary players that facilitate the distribution of alleged unregistered securities. Though the SEC has brought some actions against these ancillary players in the past, it has focused predominantly on the issuers themselves. Thus, it is reasonable to predict that we will hear about this case for years to come.

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[1] Section 12(a)(1) of the Securities Act provides that:

> Any person who … offers or sells a security in violation of [Section 5] … shall be liable … to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.