

FTX Founder Samuel Bankman-Fried Arrested and Facing Lawsuit From the SEC

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News of the collapse of FTX, which was one of the world's top digital currency exchange platforms, has flooded the airwaves and social media feeds alike in recent weeks—and the Justice Department and Securities Exchange Commission have been paying attention.

On December 12th, FTX founder Samuel Bankman-Fried was arrested at his home in the Bahamas by Bahamian authorities at the request of the U.S. government, just over a month after he resigned as CEO of FTX. FTX was founded in May 2019 by Bankman-Fried and after a meteoric rise, became one of the world's top exchanges where investors could buy and sell bitcoin, dogecoin, and other cryptocurrencies, including FTX's own token called FTT.

Despite a belief that it was one of the most stable cryptocurrency firms, FTX's stunning collapse began in early November after reports spread that FTX had diverted incoming funds from investors to support its partner firm, Alameda Research, allegedly at Bankman-Fried's direction. FTX's collapse was intensified as it was reported that most of Alameda's balance sheet was made up of FTT tokens, sending the markets into a tizzy and causing notable investors to withdraw their money and also causing the tanking of the price of FTTs. It was at this point that Bankman-Fried resigned and FTX filed for bankruptcy.

Following the arrest of Bankman-Fried, on December 13th, prosecutors unsealed a criminal indictment filed in the U.S. District Court for the Southern District of New York which charged Bankman-Fried with eight counts, including wire fraud on customers, wire fraud on lenders, as well as conspiracy, including conspiracy to commit securities fraud, commodities fraud, and to defraud the United States and to violate campaign finance laws.

On the same day, the Securities and Exchange Commission filed civil charges against Bankman-Fried, alleging that he misled investors who committed around \$1.8 billion to FTX while also defrauding customers of the exchange. The SEC alleges that Bankman-Fried hid from investors that customer funds were being diverted to support his Alameda Research hedge fund and to make venture investments, real estate purchases, and political donations. The SEC's lawsuit seeks civil fines, disgorgement of any illegally earned profits, and a bar from serving as an officer and director of a public company.

According to the SEC, it brought its action against Samuel Bankman-Fried pursuant to the authority conferred upon it by Section 20(b) of the Securities Act (15 U.S.C. § 77t(b)) and Section 21(d)(1) of the Exchange Act (15 U.S.C. §§ 78u(d)(1)). These acts allow the SEC, upon the belief that a person is engaged or is about to engage in violations of these acts, to bring an action in federal court to enjoin such individual's practices that it believes are violations.

However, the question of whether cryptocurrencies are securities as defined under the Securities Act and the Exchange Act is a disputed one. Although, SEC Chair Gary Gensler has made clear that he believes that most cryptocurrencies are in fact securities. In an appearance on CNBC, Mr. Gensler stated that "The law is clear. I believe that based on the facts and circumstances most of these tokens are securities." [1] Accordingly, Mr. Gensler has indicated that these cryptocurrencies need to be properly registered and regulated as securities. "I've asked the SEC staff to work directly with entrepreneurs to get their tokens registered and regulated, where appropriate, as securities." [2]

Mr. Gensler has also issued a statement regarding the SEC's lawsuit against Mr. Bankman-Fried: "We allege that Sam Bankman-Fried built a house of cards on a foundation of deception while telling investors that it was one of the safest buildings in crypto. The alleged fraud committed by Mr. Bankman-Fried is a clarion call to crypto platforms that they need to come into compliance with our laws." [3]

As suggested by Mr. Gensler's comments, FTX's collapse could spark further oversight from regulators over the cryptocurrency industry. If you have questions on regulatory issues surrounding the emergence of cryptocurrencies in the financial markets, please contact a member of Reminger's Financial Services Liability Practice Group.

[1] See, <https://www.forbes.com/advisor/investing/sec-crypto-regulation/>.

[2] See, <https://www.sec.gov/news/speech/gensler-sec-speaks-090822>.

[3] See, <https://www.sec.gov/news/press-release/2022-219>.