Q2 2024

WILSON SONSINI

Focus on Fintech

Welcome to Wilson Sonsini's *Focus on Fintech* newsletter. This quarterly newsletter provides ongoing analysis and commentary on regulatory developments impacting the fintech industry.

In this issue, our attorneys discuss updates and developments from federal regulators, including those related to cryptocurrencies, cybersecurity in financial markets, and the intersection of fintech and artificial intelligence. We also discuss rulemakings and proposals from the SEC, the CFTC, and FinCEN, and examine a federal appellate court's recent decision to vacate SEC rules governing private fund advisers. Finally, we wrap up this edition with a survey of consumer protection developments, which discusses recent policy initiatives from the CFPB, and a novel payments law passed by the Illinois legislature.

Enforcement Update

CFTC Charges Digital Asset Derivatives Intermediary for Failure to Register as FCM

Digital asset prime broker Falcon Labs, Ltd. (Falcon) agreed to a May 13, 2024, order settling Commodity Futures Trading Commission (CFTC) charges that it had operated as an unregistered futures commission merchant (FCM). The charges alleged that Falcon had unlawfully served as a trading intermediary for its U.S.-based customers by soliciting and accepting orders for digital asset derivatives and subsequently executing those orders on various digital asset trading platforms. Through Falcon's services, its customers were able to access the platforms without registering or disclosing any identifying information—even to Falcon. To manage each of its customers' holdings, Falcon created networks of accounts and sub-accounts on the exchanges it used for its intermediary trading. These and other activities caused Falcon Labs to meet the definition of an FCM and to be in violation of the requirements imposed on FCMs. According to the order, Falcon received approximately $1,179,008 in fees directly related to its unregistered FCM activities.

As a condition of its settlement, Falcon must cease and desist acting as an FCM and pay a combined $1,768,512 in disgorgement and penalties. The enforcement against Falcon marks the first time that the CFTC has charged an entity with acting as an unregistered FCM based on digital asset trading activities.

In This Issue

Enforcement Update .... Pages 1-3

Financial Markets Policy Update .... Pages 4-5

Consumer Protection Update .... Pages 5-6

Select Publications .... Page 7

Speaking Engagements .... Page 7

Continued on page 2...

Enforcement Update *(Continued from page 1)*

Genesis Global Capital Agrees to $21 Million Settlement in U.S. Securities and Exchange Commission (SEC) Enforcement

On March 19, 2024, the SEC announced that Genesis Global Capital, LLC (Genesis) had agreed to a final judgment to settle SEC charges that it had engaged in the unregistered offer and sale of securities. The charges arose from Genesis' involvement in the Gemini Earn program with Gemini Trust Company, LLC (Gemini). According to the SEC, through the Gemini Earn program, launched in February 2021, Gemini customers could lend their digital assets holdings to Genesis in exchange for interest payments. The program authorized Genesis to use the digital assets in its discretion to generate revenue. In November 2022, Gemini suspended its customers' ability to remove their assets from the program after volatility in digital asset markets left Genesis without the liquid assets to accommodate withdrawal requests. The withdrawal suspension affected approximately 340,000 Gemini Earn investors and $900 million in digital assets.

Although the Gemini Earn program formally ended in March 2024, Gemini Earn investors remain unable to access or withdraw digital assets loaned under the program. Under the terms of the final judgment, Genesis must pay a $21 million penalty, which will be used to satisfy claims brought by Gemini Earn investors before any allocation is made to the SEC.

SEC Charges 17 Individuals for Involvement in Cryptoasset Ponzi Scheme

The SEC has charged 17 individuals for their involvement in a Ponzi scheme centering on CryptoFX, LLC (CryptoFX), a Texas entity

that purported to offer cryptoasset investment management services.

The complaint, filed in the U.S. District Court for the Southern District of Texas, alleges multiple violations of federal securities laws, including interference with whistleblower protections. According to the charges, CryptoFX personnel, including the 17 charged individuals, solicited customers across 10 different states and two foreign countries, promising returns of 15 percent to 100 percent on investments with CryptoFX.

The complaint alleges that CryptoFX focused its investment solicitation efforts on Latino communities, conducting paid seminars on cryptoasset trading that were ultimately designed to coerce attendees into investing with CryptoFX. The complaint further alleges that to perpetuate the Ponzi scheme, CryptoFX allegedly allocated portions of new investments to earlier investors, presenting the funds as returns.

According to the charges, CryptoFX raised approximately $300 million from 40,000 investors from May 2020 to September 2022, at which time its assets were frozen following a successful SEC emergency action. Some defendants continued soliciting investments even after the scheme was enjoined in federal court, pressuring existing investors to retract complaints and assuring new investors that the SEC emergency action was fake. Two of the defendants, Luis Serrano and Julio Taffinder, have consented to final judgments that, pending court approval, will permanently restrain and enjoin them from violating the securities-registration and broker-registration provisions of the federal securities laws and require them to pay over $68,000 in penalties and restitution.

SEC Charges R.R. Donnelley & Sons Co. with Cybersecurity-Related Controls Violations

Business logistics firm R.R. Donnelley & Sons Co. (RR) has agreed to pay $2.125 million to settle SEC charges that its inadequate cybersecurity incident disclosure procedures and access controls for sensitive client and business data led to its failure to respond to ransomware attacks. Attackers were able to encrypt RR's computers, exfiltrate data, and otherwise disrupt business services. In announcing the June 2024 settlement, the SEC noted that RR's civil penalty was tempered by its significant and meaningful cooperation throughout the investigation, including reporting the cybersecurity incident to staff prior to filing a disclosure and voluntarily adopting new cybersecurity technology and controls.

Continued on page 3...

Enforcement Update *(Continued from page 2)*

SEC Charges Consensys Software for Unregistered Offers and Sales of Securities Through Its MetaMask Staking Service

Consensys Software Inc. (Consensys) faces SEC charges alleging that it engages in the unregistered offer and sale of securities and operates as an unregistered broker. Filed on June 28, 2024, the charges arise from Consensys' MetaMask Staking and MetaMask Swaps services, which offer Consensys customers access to liquidity for staked digital assets, mitigating a significant drawback to asset staking.

"Staking" is a transaction verification method that many blockchains rely on for validating new trading data. Blockchain users have the option to stake, or contractually commit, their own assets as a means of vouching for new transaction data pending addition to the blockchain. Users who stake legitimate transactions earn more of the staked asset as a reward, while those who validate fraudulent transactions are penalized through the loss of some or all of the stake. Typically, staking contracts provide for locking, meaning that staked assets are restricted from trading until their assigned validation process is complete. MetaMask Staking reduces the loss of liquidity that accompanies locking by allowing Consensys customers to mint liquid staking tokens (LSTs) as claims against their stakes. Unlike the staked assets they represent, LSTs are freely tradeable on decentralized exchanges. Further, through MetaMask Swaps, Consensys customers can exchange LSTs for other digital assets, including the type of asset originally staked.

The SEC charges allege that Consensys' ongoing distribution of LSTs constitutes the unregistered offer and sale of securities, and that Consensys acted as an unregistered broker in soliciting digital asset trades from customers, providing investment information to its customers, handling customer trades and assets, and receiving transaction-based compensation. The SEC enforcement, which seeks injunctive relief and monetary penalties, follows an action filed by Consensys against the SEC in April 2024, in which Consensys sought, among other forms of relief, declaratory judgment that digital tokens are not securities.

Federal Reserve Issues Cease-and-Desist Order to Evolve Bank

In June 2024, the Federal Reserve Board issued an enforcement action against Evolve Bancorp, Inc., and Evolve Bank & Trust (collectively referred to as Evolve) for deficiencies associated with Evolve's risk management and compliance with applicable laws, such as anti-money laundering, economic sanctions, and consumer protection laws. In particular, supervisory exams found that Evolve engaged in unsafe and unsound banking practices by failing to have in place an effective risk management framework for its partnerships with various financial technology companies that, in turn, provide access to banking products and services to their end customers. The Board's action was taken in conjunction with the Arkansas State Bank Department, the state supervisor of Evolve.

The cease-and-desist order requires that Evolve take remedial actions to address these issues. These include strengthening board oversight, enhancing risk management, improving capital and liquidity risk management, amending lending and credit risk management policies, and ensuring compliance with BSA/AML and OFAC regulations. The cease-and-desist order prohibits Evolve from establishing any new financial technology partnerships without approval from the Federal Reserve and the Arkansas State Bank Department.

Abra Settles with 25 States for Operating Without Necessary State Money Transmission Licensure

On June 26, 2024, the Conference of State Bank Supervisors confirmed a settlement between financial regulators from 25 U.S. states and Plutus Financial, Inc., Abra Trading, LLC, Plutus Financial Holdings, Inc., Plutus Lending, LLC (collectively referred to as Abra), and Abra's CEO and largest equity owner, William Barhydt. The regulatory action was prompted by Abra and Mr. Barhydt's alleged operation of a digital asset company without having secured the various money transmission licenses required by the states. Abra's operations, which were carried out through a mobile application, were alleged to involve various digital asset transactions allowing customers to buy, sell, trade, and invest in digital assets, all of which required a money transmission license. Financial authorities became aware of Abra's money transmission activities during a separate investigation into allegations that the firm had engaged in the unregistered offer and sale of securities. The settlement agreement requires Abra to reimburse customers up to $82 million and prohibits Mr. Barhydt from participating in any money transmission businesses for a five-year period.

Financial Markets Policy Update

CFTC Committee Releases Report on Responsible AI in Financial Markets

The CFTC's Technology Advisory Committee (TAC) has released a report detailing its findings on the use of advanced AI technologies in financial markets, including the risks posed by current uses of AI and recommendations to the CFTC on leveraging its regulatory authority to promote responsible AI practices in commodities trading. The report proposes that the CFTC adopt a regulatory approach to "responsible AI" based on five defining characteristics—fairness, robustness, transparency, explainability, and privacy. The report also analyzes the risks that may arise from the increased reliance on AI in the absence of regulatory safeguards enforcing its responsible use, including market instabilities caused by biased or flawed AI models, a lack of transparency in automated trading processes, and enhanced threats to cybersecurity.

TAC emphasizes that harm to financial markets can result not only from the malicious use of AI, but also its reckless use in carrying out conventional trading activity. For example, if multiple firms deploy similar AI models that make similar high-volume trading decisions in response to the same market data, the resulting procyclicality could destabilize the market. TAC has urged the CFTC to adopt robust data governance and cybersecurity protocols to protect market trust and stability and encouraged the CFTC to adopt its own AI-based technologies for cybersecurity and fraud detection and develop protocols governing their use.

The report ends with five recommendations to the CFTC on strategies it could adopt to improve AI regulation. TAC advises that the SEC should: 1) host a public roundtable discussion and engage with CFTC-registered entities to better understand how AI technology is currently used; 2) adopt a risk management framework for assessing the efficiency of AI models and potential consumer harms; 3) catalog the existing regulations related to AI and develop a gap analysis to determine where risks are most likely to emerge; 4) establish a process to align AI policies and practices with other federal agencies; and 5) invest in developing internal competency among its staff with respect to AI regulation.

FinCEN Finalizes CIP Rule for RIAs and ERAs

The Financial Crimes Enforcement Network (FinCEN) has proposed and finalized a new rule that subjects registered investment advisers (RIAs) and exempt reporting advisers (ERAs) to affirmative regulatory obligations meant to serve as safeguards against money launderers, terrorist financers, and other actors who seek access to the U.S. financial system for illicit purposes and threaten U.S. national security. The final rule extends anti-money laundering obligations and "countering the financing of terrorism" provisions of the Bank Secrecy Act to RIAs and ERAs. RIAs and ERAs must also adhere to customer information program (CIP) obligations similar to those currently applicable to other financial institutions. This is a significant change in regulation of ERAs in particular, which generally have light regulatory requirements as exempt entities under the Investment Advisers Act of 1940.

To comply with the CIP obligations, which were jointly proposed by the FinCEN and the SEC, RIAs and ERAs must create policies and procedures for verifying the identities of their customers. The final rule will become effective on January 1, 2026.

SEC Adopts Rule Amendments to Regulation S-P to Enhance Protection of Customer Information

In May 2024, the SEC announced that it had adopted final amendments to

Continued on page 5...

Financial Markets Policy Update *(Continued from page 4)*

its Regulation S-P (Amended Rule), which governs how "covered financial institutions" (CIs) treat consumers' nonpublic personal information. Under the Amended Rule, brokers, dealers, investment companies, investment advisers, crowdfunding portals, and transfer agents registered with the SEC or another appropriate regulatory agency are all considered CIs. The Amended Rule requires that CIs notify affected individuals in the event that their sensitive information was, or is reasonably likely to have been, accessed or used without authorization. Notably, the Amended Rule does not require notification if CIs determine that the information accessed without authorization has *not* been, or is *not* reasonably likely to be, used in a manner that would result in substantial harm or inconvenience to the affected individual. See our client alert and the Amended Rule's fact sheet for further information.

Fifth Circuit Vacates SEC's Attempt to Tighten Regulatory Oversight of Private Fund Advisers

The U.S. Court of Appeals for the Fifth Circuit (the Fifth Circuit) has sided with private investment advisers against the SEC, deciding on June 5, 2024, to fully vacate SEC rules that would have imposed heightened regulatory obligations on private funds (the Private Fund Rules). Private funds are pooled investment vehicles that are exempt from the regulations typically applicable to investment companies. The Private Fund Rules, which the SEC adopted in August 2023, would have, among other things, imposed restrictions on fund managers' ability to provide certain investors with preferential treatment and to charge certain fees and expenses to customer accounts. In September 2023, the National Association of Private Fund Managers filed a petition challenging the Private Fund Rules, claiming that their adoption exceeded the SEC's authority under the Investment Advisers Act of 1940 (the Advisers Act). The Fifth Circuit agreed with the petitioners, finding that Section 211(h) of the Advisers Act, which authorizes the SEC to "promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes" for investment advisers, applies only to funds that serve retail customers—who generally cannot invest in private funds. The Fifth Circuit further concluded that the SEC lacked the authority to adopt the Private Fund Rules under Section 206(4) of the Advisers Act, which permits it to regulate against business practices that are "fraudulent, deceptive, or manipulative," finding no rational relationship between the Private Fund Rules and the conduct that Section 206(4) seeks to proscribe. In publishing the final Private Fund Rules, the SEC had estimated that their implementation would cost "$5.4 billion" and "millions of hours of employee time." The SEC did not appeal the Fifth Circuit's decision before the required deadline.

Consumer Protection Update

CFPB Takes Aim at Unlawful and Unenforceable Fine Print Terms

The Consumer Financial Protection Bureau (CFPB) recently issued a Circular warning against the use of contract terms that purport to limit consumer rights and protections in contravention of state laws and federal consumer financial protection laws. Using fine print tactics may deceive consumers into believing certain contractual terms are enforceable, even where they may be legally unenforceable or prohibited by federal or state law. The inclusion of these terms in contracts for consumer financial products and services could violate the prohibition on deceptive acts or practices in the Consumer Financial Protection Act and lead to an enforcement action by the CFPB. Please see our previous alert, "Avoiding Pitfalls in Consumer Financial Services Contracts: CFPB Warns Against Unlawful and Unenforceable Fine Print Terms," for more information.

CFPB Launches Process to Recognize Open Banking Standards

In June 2024, the CFPB finalized its Industry Standard-Setting Rule, which outlines qualifications for becoming a CFPB-recognized industry standard-setting body for the spurposes of setting standards that companies can use to comply with the CFPB's upcoming Personal Financial Data Rights Rule. The Personal Finance Data Rights Rule, which is slated to be finalized in the coming months, would provide consumers certain rights to their data in an effort

Continued on page 6...

Consumer Protection Update *(Continued from page 5)*

to allow smaller financial institutions and start-ups more opportunity to offer consumer products and services. The rule provides details about the application process and identifies key attributes that applicants must possess to be recognized by the CFPB, such as: openness to all; transparent procedures; balanced decision-making that considers firms of various sizes and public interest groups; fair and impartial consensus-based decisions; due process; and an appeals process. In outlining the recognition process, the CFPB process aims to protect competition by preventing dominant firms from setting unfair industry standards and promote the growth of open banking across the financial sector.

CFPB's Interpretive Rule Takes Aim at Buy-Now-Pay-Later Providers

The CFPB recently issued an interpretive rule stating that certain providers of Buy Now, Pay Later (BNPL) payment plans are to be considered lenders, and thereby subject to some of the same regulatory requirements as credit card issuers under consumer financial protection laws. For example, this interpretive rule requires certain BNPL providers to investigate customer disputes, issue credits under certain conditions, credit refunds for returned goods or cancelled services, and provide regular billing statements. Note, however, that not all regulations that apply to credit card issuers apply to BNPL providers. Please see our previous alert, "CFPB's New Interpretive Rule Takes Aim at BNPL Payment Plans: Practical Takeaways," for more information.

Illinois Passes Novel Payments Law

The Illinois state legislature took aim at credit card issuers and networks (card companies) on June 7, 2024, when it passed a new revenue bill prohibiting banks, processors, and card networks from imposing interchange fees on credit and debit card payments for gratuities and excise taxes, in instances where the merchant informs the acquirer bank of the tax or gratuity amount as part of the authorization or settlement process for the transaction. The new law defines "interchange fee" as a fee established, charged, or received by a payment card network for the purpose of compensating the issuer for its involvement in an electronic payment transaction. Proponents of the new law hope that it will correct the perceived unfairness of card companies assessing swipe fees on merchants for payments benefiting other parties—specifically, their workers or the government. When the new law becomes effective on July 1, 2025, banks, processors, and card companies that charge prohibited fees will be subject to civil penalties of $1,000 per transaction. The law will also bar banks, processors, and card companies from altering their rates or fee structures to circumvent the effect of the new law.

Select Publications

Fintech in Brief
Recent SEC Enforcement Activity on the Custody Rule: Clues for the Focus of Anticipated Rules on Safekeeping Client Assets?
September 11, 2024

Wilson Sonsini Alert
The Critical Reporting Requirement U.S. Companies Can't Afford to Ignore: Upcoming Deadlines for Beneficial Ownership Information Compliance
August 14, 2024

Wilson Sonsini Alert
Five Issues for Wealthtech Companies to Consider Under the U.S. Securities Laws
July 24, 2024

Wilson Sonsini Alert
Avoiding Pitfalls in Consumer Financial Services Contracts: CFPB Warns Against Unlawful and Unenforceable Fine Print Terms
June 20, 2024

Wilson Sonsini Alert
CFPB's New Interpretive Rule Takes Aim at BNPL Payment Plans: Practical Takeaways
June 4, 2024

Wilson Sonsini Alert
SEC Expands Security and Breach Notification Requirements for Investment Firms
May 30, 2024

Newsletter
Focus on Fintech – Q1 2024
May 29, 2024

***Law360* Article**
Fintech Compliance Amid Regulatory Focus on Sensitive Data
J. Cheng, L. Weingarten, and M. Alioto
May 29, 2024

Fintech (Law and Regulation, 3rd Edition)
Bank-Fintech partnerships: a practitioner's guide to the evolving policy landscape and key regulatory considerations
J. Cheng, E. Daum, and M. Alioto, 2024

Payments Playbook Series
AI in Payments
May 2, 2024

Speaking Engagements

Wilson Sonsini Partner Jess Cheng Speaks at Consensus 2024 Conference

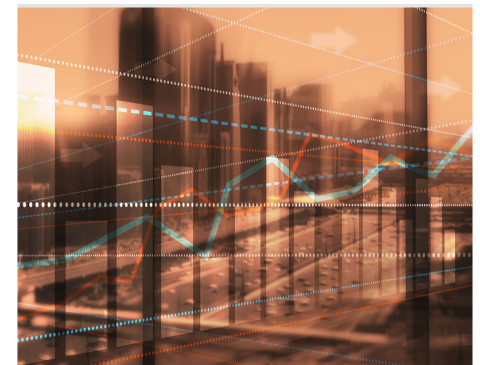
Fintech and financial services partner Jess Cheng recently spoke on a panel titled, "Town Hall: To CBDC or Not to CBDC: Digital Fiat Without Big Brother," at CoinDesk's Consensus 2024 conference. The panel focused on strategies for implementing central bank digital currencies while preserving individual privacy.

Wilson Sonsini Hosts AI in Fintech Event

Wilson Sonsini's fintech industry working group hosted an exclusive gathering for fintech and AI leaders on September 10, 2024, in New York. Attendees enjoyed an evening of dialogue and networking that was capped by a fireside chat with CUBE3 AI president Jonathan Anastasia.

Wilson Sonsini Partner Jess Cheng Moderates Emerging Technologies Panel at Federal Reserve Fraud and Privacy Symposium

Fintech and financial services partner Jess Cheng recently moderated a panel titled, "Emerging Technologies for Fighting Fraud While Protecting Privacy: Legal Practitioner's View," at the Fraud & Privacy Symposium, hosted by Federal Reserve Financial Services on September 12, 2024. The panelists, Chinue Richardson (Stripe), Derek Schwede (Modern Treasury), and Lia Sheena (Mastercard), discussed legal issues and considerations arising from the adoption of anti-fraud technologies, with a focus on privacy ethics and regulatory compliance.



The following attorneys have editorial oversight of Wilson Sonsini's *Focus on Fintech*.
They would like to take this opportunity to thank Varun Lella,
Rebecca Weitzel Garcia, and Boniface Echols, who contributed to this edition.

Amy Caiazza
(202) 973-8887
acaiazza@wsgr.com

Jess Cheng
(212) 453-2853
jcheng@wsgr.com

Josh Kaplan
44-20-39634069
jkaplan@wsgr.com

Stephen Heifetz
(202) 973-8802
sheifetz@wsgr.com

Maneesha Mithal
(202) 973-8834
mmithal@wsgr.com

Drew Minick
(415) 947-2075
dminick@wsgr.com

Troy Jenkins
(202) 920-8732
tjenkins@wsgr.com

Clinton Oxford
(202) 920-8750
coxford@wsgr.com

WILSON
SONSINI

650 Page Mill Road, Palo Alto, California 94304-1050 | Phone 650-493-9300 | Fax 650-493-6811 | www.wsgr.com

Wilson Sonsini has 19 offices in technology and business hubs worldwide. For more information, visit wsgr.com/offices.

This communication is provided as a service to our clients and friends for general informational purposes. It should not be construed or relied on as legal advice or a legal opinion, and does not create an attorney-client relationship. This communication may be considered attorney advertising in some jurisdictions. Prior results do not guarantee a similar outcome.

© 2024 Wilson Sonsini Goodrich & Rosati, Professional Corporation. All rights reserved.