

Is Crypto a Security? Insider Trading Case Leads to DOJ, SEC Scrutiny

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Just one month after bringing the first ever insider trading case involving NFTs, the U.S. Attorney's Office for the Southern District of New York has charged three men in an [alleged insider trading scheme involving cryptocurrency](#). This is the first case in which prosecutors have alleged insider trading of cryptocurrencies. At the same time as the DOJ's announcement of criminal charges, the [SEC filed a companion civil case](#) in Seattle federal court alleging that the three men engaged in insider trading and arguing that some of the assets involved were "securities" under federal securities law.

These two cases suggest a more aggressive stance by federal authorities towards fraud involving cryptocurrency and crypto assets trading platforms in the U.S.

In an indictment unsealed on July 21, 2022, a former Coinbase Global, Inc. product manager, Ishan Wahi, was charged with tipping off his brother and a close friend with confidential business information he learned regarding crypto assets that were listed or under consideration for listing on Coinbase. Specifically, federal prosecutors alleged that as a manager at Coinbase, Wahi had access to detailed and advanced knowledge of which crypto assets Coinbase was planning to list and the timing of public announcements about those listings.

This information was considered highly confidential within Coinbase since the market value of crypto assets would ordinarily increase after Coinbase announced that it would be listing a particular asset on its exchanges. Despite numerous internal policies designed to protect this information from dissemination, Wahi allegedly misappropriated and disclosed it to his brother and his friend so that they could make well-timed purchases of crypto assets in advance of Coinbase's listing announcements. According to the indictment, Wahi's brother and friend purchased at least 25 crypto assets in advance of at least 14 separate Coinbase crypto asset listing announcements, generating approximately \$1.5 million in returns.

The three defendants were ultimately charged with four counts of wire fraud resulting from their insider trading scheme.

In a parallel civil action, the SEC did file securities fraud charges against the three defendants involved in the Coinbase insider trading scheme. While the basic facts of the SEC's complaint mirrored the charges from the criminal indictment, the SEC alleged that at least nine of the Coinbase listing announcements involved "crypto asset securities . . . subject to the federal securities laws." The SEC maintained these crypto assets were "securities" since they were "investment contracts; they were offered and sold to investors who had made an investment of money in a common enterprise, with a reasonable expectation of profits to be derived from the efforts of others."

Unlike a typical insider trading case, however, federal prosecutors did not bring securities fraud charges against the defendants and made no substantive allegations that any of the defendants traded in securities as part of their scheme. The SEC's efforts to characterize these assets as securities will be critical in its attempt to successfully charge Wahi and his co-defendants with insider trading. Unlike the DOJ action, which relies upon a more traditional wire fraud claim of theft of confidential business information, the SEC must first establish that the crypto assets at issue are in fact securities before it can get to the next step of establishing the defendants engaged in securities fraud.

The classification of these crypto assets as securities is a controversial position, as many cryptocurrency exchanges have taken the position that the assets on their exchanges are not securities and cannot be regulated like stocks or bonds. Coinbase objected to the SEC's characterization of the assets as securities and insisted that "[n]o assets listed on our platform are securities." The SEC's classification also drew criticism from Caroline D. Pham, a commissioner with the Commodity Futures Trading Commission, who wrote on Twitter that the SEC's complaint "was a striking example of ?regulation by enforcement." She went on to note that the SEC's decision to pursue securities fraud charges in this case had broader implications for the crypto industry and the appropriate regulatory framework.

These insider trading cases demonstrate the [enforcement priority prosecutors and regulators](#) are putting on crypto assets and exchanges. Indeed, federal prosecutors have been clear that they will not be deterred from aggressively pursuing fraud charges involving digital assets. "Fraud is fraud is fraud, whether it occurs on the blockchain or on Wall Street," said Damian Williams, the U.S. Attorney for the Southern District of New York, in a DOJ press release.

It is reasonable to expect that these recent cases are just the beginning of an enforcement crackdown on illegal conduct in the crypto environment. Both the DOJ and SEC have been putting increased resources into understanding crypto markets and learning how to apply their enforcement tools to those markets. Accordingly, we should expect to see an increase in enforcement cases involving the NFT and cryptocurrency markets.

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