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Crypto Bank Silvergate Hit With Investor Suit Over FTX Ties

By **Hailey Konnath**

Law360 (December 2, 2022, 7:30 PM EST) -- Investors have lodged a proposed class action against Silvergate Bank, which they say was "complicit in and responsible for" some of the losses stemming from the downfall of FTX Trading Ltd. because the cryptocurrency bank allowed FTX to direct customer deposits to a hedge fund owned by its former CEO, Sam Bankman-Fried.

The FTX investors say Silvergate and its top brass violated know-your-customer and anti-money laundering regulatory obligations when they either knowingly or negligently permitted FTX to direct customer deposits to Alameda Research, the hedge fund owned by Bankman-Fried, according to the suit filed Thursday in California federal court.

How that allegedly worked: Customers must have deposited funds before they could trade on FTX. And at least some customers who wanted to make deposits via bank wire were directed by FTX to deposit those funds to accounts held at Silvergate, the investors said.

"As Mr. Bankman-Fried admitted, however, the account(s) that at least some customers were directed to deposit funds to was not held by FTX, but rather Alameda Research, a wholly separate entity," they said.

A number of customers have also posted online about being directed to deposit funds in an Alameda Research account, the investors claimed.

Under federal law, financial institutions such as Silvergate must perform due diligence, at the very least, or enhanced due diligence, in certain situations, with regard to correspondent accounts established or maintained for financial institutions such as FTX, according to the suit. Silvergate is aware of these obligations, but failed to fulfill them, the investors said.

"Ordinary due diligence would have revealed suspicious activity and required reporting," they said. "For example, it would be extremely unusual and suspicious for a hedge fund to receive the high volume of transfers or deposits, in relatively small amounts, from a high number of distinct persons, that was occurring with Alameda Research."

Named plaintiffs José Tomás Sepúlveda Zuleta, Michael Lehrer and Tristan Newman are looking to represent a class of all persons who, as of Nov. 11, had legal title to any fiat or cryptocurrency unable to be withdrawn from FTX.

FTX filed for bankruptcy after it saw \$32 billion in value evaporate over the course of a few days last month as its proprietary digital token foundered and users rushed to withdraw their holdings from the platform. After Bankman-Fried stepped aside, his replacement, restructuring expert John J. Ray III, painted a damning picture of FTX's previous leadership, saying Bankman-Fried ran the operation without any internal controls or appropriate accounting practices.

The investors said in Thursday's suit that Silvergate is a major player in the digital asset industry — it is the leading provider of financial infrastructure solutions and services for the cryptocurrency agency. Notably, Silvergate operates a real-time payments platform, the Silvergate Exchange Network, which allows customers to send money between Silvergate accounts at any time.

Silvergate and FTX had a close relationship, with FTX representing nearly 10% of the bank's deposits,

the investors said. It even included an endorsement from Bankman-Fried on its website as a marketing tool, they said. And in that endorsement, it identified Bankman-Fried as the founder and CEO of both FTX and Alameda Research, they added.

The investors noted that all the accounts held by Bankman-Fried's companies were held in Silvergate, giving the bank a full view of those financials. Had the bank and its executives complied with their due diligence obligations, they would have known that numerous transactions sent to the Alameda Research account weren't intended to go to the hedge fund, but were instead intended for deposit to FTX, they said.

And had the bank conducted "even a cursory review of FTX's audits," it would've been aware of the "serious issues" plaguing its corporate control, the investors said.

"Silvergate either reviewed FTX and Alameda audits and ignored their red flags, or it simply chose not to request audits," they said.

The investors are seeking unspecified damages, restitution and disgorgement of all money, revenues and profits obtained by Silvergate's alleged conduct.

Also on Thursday, **a bankruptcy watchdog** for the U.S. Department of Justice urged the Delaware bankruptcy judge overseeing FTX's Chapter 11 case to appoint a special examiner, saying an independent probe is needed to determine what led to its "free fall" into bankruptcy.

"Debtors' approximately one million worldwide creditors, outside investors and regulators are demanding answers to what happened and how," U.S. Trustee Andrew R. Vara said in a filing.

And earlier this week, Senate Banking Committee chair Sherrod Brown pressed U.S. Treasury Secretary Janet Yellen to **help develop legislation** allowing financial regulators to supervise crypto asset entities, saying the implosion of FTX highlights the "troubling risks" in cryptoasset markets.

Bankman-Fried **has continued to make public statements** on FTX's collapse, admitting that he's ignoring the advice of his attorneys to stop doing so. At a recent New York Times event, he said he "didn't ever try to commit fraud" and isn't thinking about potential criminal charges he might face, even as regulators in the U.S. and abroad **continue to investigate**.

Silvergate and counsel for investors didn't immediately respond to requests for comment late Friday.

The investors are represented by Jack Fitzgerald and Paul K. Joseph of Fitzgerald Joseph LLP and Timothy G. Blood and Thomas J. O'Reardon II of Blood Hurst & O'Reardon LLP.

Counsel information for the defendants wasn't immediately available Friday.

The case is José Tomás Sepúlveda Zuleta et al. v. Silvergate Capital Corp. et al., case number 3:22-cv-01901, in the U.S. District Court for the Southern District of California.

--Additional reporting by Jessica Corso, Sarah Jarvis and Lauren Berg. Editing by Jay Jackson Jr.