

SEC Case Highlights Why Fiduciaries Should Be Cautious About Crypto

Kraken filing should be "a clear warning" to retirement plans to consider if offering crypto investments is "prudent," Wagner Law attorney writes.

Reported by [PAUL MULHOLLAND](#)

401(k) plan fiduciaries should take note of the complaint the Securities and Exchange Commission filed Monday against crypto trading venue Kraken when considering offering cryptocurrency as a retirement plan investment, an ERISA law firm has cautioned.

Wagner Law Group partner Kimberly Shaw Elliott wrote Thursday in emailed commentary noted the litigation charging Payward Inc. and Payward Ventures, Inc. (together "Kraken", an online crypto platform) with a litany of securities registration failures and other wrongdoing which took place since 2018.

"The SEC's new enforcement activity should be a clear warning to not only unregistered crypto providers and the advisers who recommend crypto investments, but also to retirement plan fiduciaries who approve those investments," she wrote. "Is it prudent to place faith in the seller or holder of crypto who does not go through the rigors of registration? While some registered broker/dealers are now offering crypto to 401(k) plans through registered exchange-traded funds, a fiduciary must still weigh the risk of loss against the opportunity for gain from these highly volatile investments."

Shaw Elliott noted a 2022 Department of Labor bulletin warning about the risks of allowing participants to invest in cryptocurrency. The regulator successfully received the dismissal of a lawsuit filed by recordkeeper [ForUsAll Inc.](#), which had sought damages for the bulletin's chilling effect on providing cryptocurrency through the self-service brokerage window.

Philip Moustakis, a partner in Seward & Kissel and a former attorney with the SEC's enforcement division, says the "threshold question is whether we are dealing with securities" in this case. If the tokens in question are not securities, then the SEC cannot bring the other allegations against them.

At various points in the complaint, the SEC asserts that different tokens were "sold as investment contracts," a key component in determining that an asset is a security. The SEC also notes that the 11 tokens in question were all previously brought as examples of securities in enforcement actions taken against cryptocurrency exchanges Binance and Coinbase. The SEC stated that it needs "only [to] establish that Kraken has engaged in regulated activities relating to a single crypto asset security."

The 11 tokens trade under the symbols ADA, ALGO, ATOM, FIL, FLOW, ICP, MANA, MATIC, NEAR, OMG and SOL.

November 20 Complaint

The [lawsuit](#) brought by the SEC in U.S. District Court for the Northern District of California, San Francisco Division, alleges that Payward Inc. and Payward Ventures Inc., the registered companies behind Kraken, have been operating Kraken as an unregistered securities exchange since at least September 2018. The SEC refers to the tokens traded on Kraken as "crypto asset securities" in the corresponding [press release](#) relaying the charges.

The complaint alleges further that Kraken commingled its assets with that of its customers and also commingled the functions of exchange, broker, dealer and clearing agency in its client services. Kraken commingled a total of \$33 billion in cryptocurrency and \$5 billion in cash with its own assets, the SEC alleges.

The “comingling of functions” is a common criticism SEC Chairman Gary Gensler has made against actors in the crypto industry.

The Howey Test

The SEC alleges in the complaint that: “Based on the public statements of their respective issuers and promoters—at least some of which were rebroadcast by Kraken itself on the Kraken Trading Platform—a reasonable investor would have understood the offer and sale of each of the Kraken-Traded Securities as offers and sales of investment contracts.”

Moustakis says that a fair attorney “could write both sides of the brief” about the tokens’ status, and this case “brings no further clarity” on which tokens are securities.

Though “the Howey Test is fairly clear,” Moustakis says, referring to the legal test for determining if an asset is a security, it can be difficult to apply to crypto because of the nature of blockchain technology. With crypto, “a security one day can be a non-security the next.”

Whether or not the tokens satisfy the Howey Test is the key question, because if they do not, then the other allegations fall outside the SEC’s jurisdiction, the attorney says. Comingling assets is “a no-no in the securities world,” Moustakis says, while also questioning whether cryptocurrency is the securities world.

On the comingling of functions, Moustakis says “federal securities laws break out the functions” of broker, dealer, exchange and clearing agency “to create a series of checks and balances” to protect investors. However, if the tokens are found to not be securities, then this “is an unregulated space.”

Gensler has repeatedly stated that the securities laws and Howey Test are clear enough and that further regulation or other clarification is not needed to bring enforcement actions against the crypto industry.

Tags

[cryptocurrency](#), [ERISA fiduciary responsibilities](#), [Kraken](#), [SEC](#), [Securities and Exchange Commission](#)

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