

SEC Charges Against Kraken Identify Specific Tokens as Securities

The complaint is another sign to 401(k) plan fiduciaries to take care with digital asset availability in plans, according to attorneys.

Reported by NATALIE LIN

The Securities and Exchange Commission identified 11 crypto tokens as securities [in a complaint](#) brought Monday against crypto trading platform Kraken.

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 comingled its assets with that of its customers and also comingled the functions of exchange, broker, dealer and clearing agency in its client services. Kraken comingled 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.

Plan Fiduciaries, Take Note

401(k) plan fiduciaries should take note of the complaint when it comes to offering cryptocurrency to plan participants, Wagner Law Group partner Kimberly Shaw Elliott wrote in emailed commentary.

“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. Because if the tokens in question are not securities, then the SEC cannot bring the other [allegations](#) against them.

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

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, Kraken, SEC, Securities and Exchange Commission,

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