Cryptocurrency firms renew push to break free from SEC rules

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Many cryptocurrency startups and investors are unhappy with the Securities and Exchange Commission’s uncertain approach to the sector, saying the agency is killing innovation and driving companies from the US. Now the Canadian social media company Kik—backed by prominent voices in the crypto world—is stepping up its effort to use the courts to force the SEC’s hand.

On Tuesday, Kik announced a crowdfunding effort to help it fight the SEC over the company’s 2017 initial coin offering, in which it sold nearly $100 million worth of a token it called kin. The company says it sold a currency that could be used across a network of apps, whether to get paid for taking surveys or to buy new stickers and themes. The SEC disagrees, arguing in a proposed action last November that kin are securities—investments subject to strict rules about how they can be sold.

Kik’s fight has drawn interest from major investors and cryptocurrency exchanges such as Circle, that are hoping for changes in how tokens are regulated. By drawing the SEC into a legal battle, Kik and its backers are hoping the courts will

devise rules that would impact a wide array of crypto companies. The catch? The SEC hasn't taken any action yet, and it's unclear if it will.

Kik's ICO was one of thousands that occurred during and after the 2017 crypto boom—many of which turned out to be shady affairs with no intention of following through on their promises. The SEC has since gone after the obvious fraudsters, but the status of more legitimate coins, like kin, is less clear. SEC chairman Jay Clayton has indicated such coins are securities, but the agency has thus far taken a more tentative approach, meeting with companies for more than a year to tease out how coins are being used and what promises were made to buyers.

The result, says Kik CEO Ted Livingston, is a "divide-and-conquer" strategy on the part of the SEC, where companies are individually guided into settlements. "This is happening behind the scenes for every project that did an ICO," he says. He adds that Kik has already spent $5 million on SEC negotiations.

Kik took its fight public in January, posting a response to an SEC letter that indicated imminent action for sale of unregistered securities. That in itself was unusual. Typically, those kinds of notices are handled quietly. In its response, Kik said it had produced a working currency with 300,000 users spending kin on a monthly basis. It also argued that it made no promises to buyers of the coin about its value or guaranteed any ongoing relationship with the company. The SEC declined to comment.

The eventual goal, Livington says, is a new set of rules for what constitutes an investment contract when it comes to cryptocurrency. "Maybe it'll be called the kin test," he adds.

But that could take time, especially in an industry concerned about innovations moving ahead in parts of Europe and East Asia.

The crypto elite like Kik's case—at least as a way to send a message to the SEC. Venture capital firms invested in crypto companies have been pressing their case behind closed doors since at least 2016, says Fred Wilson, a partner at Union Square Ventures, which is a Kik investor. "It's not like we haven't put in literally hundreds of hours making these arguments, suggesting different regulatory frameworks," he says. "We have basically been met with a deaf ear." At this point, he says, Kik's only option was to go public in a way that pressures the SEC to act. He hoped other projects would follow Kik's lead. "The industry needs an 'I'm mad as hell and I'm not gonna take it anymore' moment," he adds.

Some crypto firms are airing their frustrations publicly. For exchanges, the uncertainty affects what kinds of coins can be bought and sold on their platforms and clouds the overall legitimacy of the space. When Circle shed 10 percent of its staff earlier this month, CEO Jeremy Allaire cited an "increasingly restrictive" regulatory environment that prevented it from offering some services to US-based customers. Kik's case has also piqued the interest of other venture firms invested in crypto startups. Last month, Katie Haun, a partner at Andreessen Horowitz, which is not a Kik investor, published a blog post noting the apparent strength of Kik's case based on its response to the SEC. (Andreessen Horowitz says it didn't contribute to the crowdfunding campaign.)

Kik's crowdfunding campaign comes before the SEC has decided whether to accuse the company of violating its rules. The decision is subject to a vote of the SEC's five commissioners, who appear to be divided on how cryptocurrencies should ultimately be regulated. The agency has been aggressive about pursuing obvious fraud, but it may be hesitant to step into a

regulatory gray area by fighting Kik. Win or lose, the SEC would potentially lose some of its flexibility to craft its own regulations. Still, if the SEC let the matter go, it would send its own signal. While nonbinding on others, any settlement or decision not to act would give some clarity to other firms still negotiating with the SEC.

That could be preferable for crypto companies looking for a quick answer. “W. J. Howey was long dead by the time the Supreme Court decided his case,” notes Peter Van Valkenburgh, director of research at Coin Center, a cryptocurrency think tank, referring to the 1946 case in which the court set out the criteria for an investment contract. “These things take a long time.”

The SEC does face other pressure points. This April, five members of the House of Representatives reintroduced the Token Taxonomy Act, which would circumvent the SEC to set up a regulatory regime for cryptocurrencies. But Livingston says that even a court case would likely move faster than Congress, which has shown little interest in moving forward on crypto-friendly legislation. “We’re coming up on two years since we started this process,” Livingston says. “Everyone in the industry is realizing that we’re just not getting anywhere.”

This story originally appeared on wired.com.

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