

SEC says third-largest cryptocurrency was sold all wrong



Ripple, its former CEO and founder Christian Larsen, and its current CEO Bradley Garlinghouse are being sued by the US Securities and Exchange Commission. The SEC says that they raised more than \$1.3 billion through an unregistered securities offering.

The suit claims that Ripple violated securities laws by selling XRP, which *The Wall Street Journal* calls “the third-largest cryptocurrency by market value,” over a seven-year period starting in 2013. According to the complaint, the “illegal securities offering” created an information asymmetry that let Larsen and Garlinghouse sell XRP to investors who only knew what Larsen and Garlinghouse chose to tell them.

At the heart of the suit is a basic question about XRP: is it a security or a currency? According to the SEC’s suit, it’s a security, and so Ripple didn’t provide its investors with the proper information they needed to assess any potential risk.

According to Garlinghouse, it's a virtual currency, which means the SEC has nothing to do with it. The SEC has previously ruled that bitcoin and Ethereum are currencies. Also, the Justice Department treated XRP as a currency in 2015, when Ripple settled a suit over its business.

But XRP differs from bitcoin and Ethereum in an important way. For those two cryptocurrencies, new coins are created through a "mining" process, which is ongoing. Ripple started XRP by creating 100 billion units all at once. Ripple owns about 6.4 billion XRP, and Garlinghouse and Larsen also own a good chunk of it. Another 48 billion XRP are held in reserve, for periodic sales. This difference may be why the SEC is claiming XRP is a security, not a currency.

I appreciate you saying what this could mean for the larger U.S. crypto industry. The SEC is doing the opposite of "fostering innovation" here in the US. It's not just XRP they're attacking here. <https://t.co/fGzrVmhu8b>

– Brad Garlinghouse (@bgarlinghouse) December 22, 2020

The SEC has won similar suits against Block.one and Kik in the past, saying that the initial coin offerings these startups offered were actually securities. But those cases were different; Kik and Block.one did their ICOs *after* an SEC directive in 2017. XRP came into existence years before that directive.

The lawsuit didn't come as a surprise; Garlinghouse announced yesterday that the company expected the suit, and Ripple has already published its Wells response, a document that explains to the SEC that its actions were legal.

An important part of settling whether XRP is a currency or a security may involve something called the Howey test, which was created by a 1946 Supreme Court case. That ruling defined a security as an investment of money in a shared enterprise

with an expectation of profits from others' work. According to Ripple, XRP doesn't satisfy the Howey test for a variety of reasons, but especially because no one bought XRP with the expectation of getting Ripple's profits.

The SEC's complaint challenges that. In 2016, Ripple admitted to the New York State Department of Financial Services that buyers were "purchasing XRP for speculative purposes." It also cites a hedge fund investor who owned XRP saying in 2015 that "the increase in XRP value is heavily dependent on the success of Ripple."

<https://www.theverge.com/2020/12/22/22196064/ripple-sec-crypto-currency-security-currency-xrp>