BLOG

SEC Settles With Kraken Over Its Failure to Register Its Staking-as-a-Service Program

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On February 9, 2023, the U.S. Securities and Exchange Commission (**SEC**) announced charges against Payward Ventures, Inc. and Payward Trading Ltd. (collectively, **Kraken**) for failing "to register the offer and sale of their crypto asset staking-as-a-service program." To settle the SEC's charges, Kraken agreed to immediately cease offering or selling securities through crypto asset staking services or staking programs and pay $30 million in disgorgement, prejudgment interest, and civil penalties. Kraken also consented to the entry of a final judgment, subject to court approval, that would permanently enjoin each of them from violating Section 5 of the Securities Act of 1933 (the **Act**) and permanently enjoin them and any entity they control from, directly or indirectly, offering or selling securities through crypto asset staking services or staking programs.

In its complaint against Kraken, the SEC alleged that through the staking-as-a-service program, Kraken offered and sold investment contracts without registering such offers or sales with the SEC in violation of the Act. Specifically, the complaint provides specific detail on how Kraken offered and sold its crypto asset "staking services" to the general public, whereby Kraken pooled certain crypto assets transferred by investors and staked them on behalf of those investors in exchange for advertised annual investment returns and other benefits (including, no staking minimums, their technical expertise in staking, and an easy-to-use platform). "Staking" concerns the "proof of stake" validation protocols utilized by certain blockchains. It is a process in which investors lock up—or "stake"—their crypto tokens with a blockchain validator with the goal of being rewarded with new tokens when their staked crypto tokens become part of the process for validating data for the blockchain.

According to the SEC, "when investors provide tokens to staking-as-a-service providers, they lose control of those tokens and take on risks associated with those platforms, with very little protection." "Whether it's through staking-as-a-service, lending, or other means, crypto intermediaries, when offering investment contracts in exchange for investors' tokens, need to provide the proper disclosures and safeguards required by our securities laws," said SEC Chair Gary Gensler. According to Gensler, the SEC's enforcement action "should make clear . . . that staking-as-a-service providers must register and provide full, fair, and truthful disclosure and investor protection."

In response to the SEC's settlement announcement, Kraken published a blog post informing its clients that it would immediately unstake all U.S. client assets enrolled in the on-chain staking program, and that such assets would no longer earn staking rewards. Although U.S. clients would not be able to stake any additional assets, staking services for non-U.S. clients will continue to be offered through a separate Kraken subsidiary.

The settlement marks a potential watershed moment for digital asset regulation and the SEC's broader efforts to bring the industry under its purview. Rebuking the SEC's decision, however, SEC Commissioner Hester Peirce issued a dissenting statement regarding the settlement with Kraken, arguing that regulation by enforcement "is not an efficient or fair way of regulating" an emerging industry.

The SEC's enforcement action against Kraken raises a host of complicated questions regarding the status of staking in the United States. Most significantly, "one fundamental question," as Commissioner Peirce noted, is "whether SEC registration would have been possible." Other important questions include whether such decision applies to all staking services in the United States, what the manner of registration will be and what type of disclosures will be necessary for such services, and whether the SEC will issue any guidance for digital asset companies seeking to offer such services. Although companies offering staking services might now, depending on the facts and circumstances, be required to register with the SEC, it remains to be seen how the SEC would handle registration for these services in the future.

Please contact your Winston relationship partner should you have any questions or to request further information. We will continue to monitor developments and provide friends of the firm with updates as they become available.

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