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Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
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State Regulators Block Celsius from Offering Interest-Bearing Cryptocurrency Accounts

*Ghillaine A. Reid, Casselle Smith, Christopher Carlson,
and Namrata Kang**

State regulators in Alabama, Kentucky, New Jersey, and Texas variously allege that both BlockFi and Celsius have unlawfully offered unregistered securities in the form of high interest-bearing accounts used to fund their lending operations and proprietary trading. The authors of this article discuss the orders and the implications.

State regulatory agencies in Alabama, Kentucky, New Jersey, and Texas have increased their efforts to challenge digital asset-related products by issuing cease-and-desist or “show cause” orders against New Jersey-based cryptocurrency company, Celsius Network LLC (“Celsius”). In September, Celsius—which provides a blockchain-based cryptocurrency lending and trading platform—became the most recent target of these states’ regulatory enforcement efforts against cryptocurrency products. Two months earlier, in July 2021, each of these states filed actions against BlockFi—another New Jersey-based cryptocurrency company that offers credit cards, loans, and interest-generating accounts. These state regulators variously allege that both BlockFi and Celsius have unlawfully offered unregistered securities in the form of high interest-bearing accounts used to fund their lending operations and proprietary trading.

STATE REGULATORY EFFORTS AGAINST CELSIUS

Celsius—with the tagline “Unbank Yourself”—advertises its mission as placing “unparalleled economic freedom in the hands of the people.” Celsius users buy, borrow, and trade various cryptocurrencies. Through its “Earn Rewards” program, Celsius encourages retail customers to place eligible cryptocurrency into interest-bearing accounts, which Celsius then pools to fund its lending operations and proprietary trading.

* Ghillaine A. Reid is a partner at Troutman Pepper Hamilton Sanders LLP and co-leader of its securities investigations and enforcement practice, focusing her practice on government and securities regulatory investigations, financial services litigation, commercial litigation, and corporate compliance. Casselle Smith is an associate at the firm focusing her practice on investigations, regulatory enforcement actions, commercial litigation, and corporate compliance. Christopher Carlson is an associate at the firm and a member of its State Attorneys General practice and Enforcement Actions and Investigations team. Namrata Kang is a law clerk at the firm, not licensed to practice law in any jurisdiction; her bar application is pending in the District of Columbia. The authors may be reached at ghillaine.reid@troutman.com, casselle.smith@troutman.com, and chris.carlson@troutman.com, respectively.

Additionally, Celsius offers an application programming interface (“API”) that allows institutional customers of Celsius (“API partners”) to integrate with the Celsius platform, enabling API partners to offer Earn Rewards accounts to their own retail customers. Earn Rewards accounts have high interest rates (purportedly “up to 17.78 percent APY”) that are paid on a weekly basis in bitcoin and more than 40 other cryptocurrencies. As of August 2021, Earn Rewards accounts have generated revenue exceeding \$14 billion.

On September 17, Alabama, New Jersey, and Texas each announced a cease-and-desist action against Celsius concerning the company’s Earn Rewards accounts program, which each state has classified as an offering of unregistered securities. The Alabama Securities Commission announced that it had issued an order to show cause¹ (the “Alabama Order”), providing Celsius 28 days to show cause why it should not order Celsius to cease and desist from further offers or sales of securities in the state. The New Jersey Bureau of Securities issued a summary cease-and-desist order² (the “New Jersey Order”), requiring Celsius to cease offering Earn Rewards accounts as of November 1, 2021. The Texas State Securities Board issued a notice of hearing³ (the “Texas Notice”) on whether to issue a proposed cease-and-desist order to Celsius, with the hearing scheduled for February 14, 2022.

The Alabama and New Jersey Orders each state that “an Earn Rewards Investor relinquishes control over the deposit cryptocurrency to Celsius and that Celsius is free to use those assets as it sees fit,” including commingling the cryptocurrency from different investors, investing the assets in the market, and lending them to institutional and corporate borrowers. The Texas Notice contains a similar statement, and all three states’ orders specify that Earn Rewards accounts are not subject to the following regulatory oversight: (1) They are not registered with any state or federal regulator; (2) they are not protected by the Securities Investor Protection Corporation (“SIPC”); and (3) they are not insured by the Federal Deposit Insurance Corporation (“FDIC”) or the National Credit Union Administration (“NCUA”).

In a press release⁴ announcing the New Jersey Order, Acting New Jersey Attorney General Bruck stated that “[f]inancial companies operating in the

¹ <https://asc.alabama.gov/Orders/2021/SC-2021-0012.pdf>.

² <https://www.nj.gov/oag/newsreleases21/Celsius-Order-9.17.21.pdf>.

³ https://www.ssb.texas.gov/sites/default/files/2021-09/20210917_FINAL_Celsius_NOH_js_signed.pdf.

⁴ <https://www.njoag.gov/new-jersey-bureau-of-securities-orders-cryptocurrency-firm-celsius-to-halt-the-offer-and-sale-of-unregistered-interest-bearing-investments/>.

cryptocurrency marketplace are on notice. If you sell securities in New Jersey, you need to comply with New Jersey's investor-protection laws. Companies dealing in cryptocurrencies are not immune from oversight."

Only the Texas Notice provides that Celsius had been given advance warning of potential violations in connection with the Earn Rewards accounts. Specifically, the Texas Notice stated that "[o]n or about May 14, 2021, the Enforcement Division of the Texas State Securities Board" notified Celsius that Celsius "may have offered securities in Texas that do not comply with the [Texas] Securities Act."

At least one other state has followed the Alabama/New Jersey/Texas state trio of regulatory actions. Just one week after those states' orders were issued, on September 23, the Kentucky Department of Financial Institutions also issued Celsius an emergency order to cease and desist⁵ (the "Kentucky Order"). The Kentucky Order notes that the "lack of oversight coupled with the extremely volatile nature of the cryptocurrencies used to fund [Celsius' Earn Rewards accounts] has resulted in an unregulated market that represents an unprecedented risk to consumers." The Kentucky Order also states that Celsius' interest-bearing accounts "amount to an investment product because they are 'an investment of money in a common enterprise with profits to come solely from the efforts of others.'"⁶

Following these state actions against Celsius, its CEO Alex Mashinsky expressed disagreement with the states' arguments, but offered to make no amendments to the Earn Rewards program. In a series of tweets, Mashinsky stated, "We are disappointed these actions have been filed and wholeheartedly disagree with the allegations being made that Celsius has not complied with the law." Mashinsky mentioned that he has and will continue to work with the regulators to comply with securities laws but noted that "there are no changes" in the Celsius's cryptocurrency product offerings right now.

FEDERAL ENFORCEMENT ACTION AGAINST COINBASE

On September 7, Coinbase (a well-known cryptocurrency exchange) announced⁷ that after its month-long effort "to engage productively, the SEC gave us what's called a Wells [N]otice about our planned Coinbase Lend program." Coinbase had advertised "Lend" as "a high-yield alternative to traditional

⁵ <https://kfi.ky.gov/Documents/Celsius%20Network%20LLC%202021AH00024.pdf>.

⁶ Citing *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946).

⁷ <https://blog.coinbase.com/the-sec-has-told-us-it-wants-to-sue-us-over-lend-we-have-no-idea-why-a3a1b6507009>.

savings accounts” through which customers could lend cryptocurrency to Coinbase and “earn 8x the national average of high-yield savings accounts.” According to Coinbase’s Wells Notice, the SEC informed Coinbase that it would consider Lend as a security under the *Howey* and *Reves* standard.

Most companies do not publicly announce their receipt of an SEC Wells Notice. Nevertheless, similar actions by the SEC against BlockFi, Celsius, or other cryptocurrency firms already offering lending products have not been publicized. However, SEC Chair Gary Gensler and other SEC officials have publicly expressed their concerns regarding cryptocurrency products, which may signal that further enforcement efforts are on the horizon.

In fact, in a September 21 interview, Gensler warned companies to expect more enforcement in the future against cryptocurrency programs that sell unregistered securities. Ultimately, however, there remains no clear federal regulatory framework specific to digital assets. Amidst the dearth of comprehensive regulation from the federal government concerning digital assets, state regulators are actively pursuing enforcement against cryptocurrency companies—particularly concerning products involving interest-bearing accounts. News of the SEC’s recent Wells Notice to Coinbase may have emboldened state regulators to enhance their challenge efforts against these cryptocurrency products.

Coinbase CEO Brian Armstrong has publicly characterized the SEC’s actions as “sketchy.” Coinbase Chief Legal Officer Paul Grewal also expressed frustration⁸ over the SEC’s failure to explain why the Lend program constitutes a security. Nevertheless, on the same day that the Alabama/Texas/New Jersey issued state enforcement actions against Celsius, Coinbase announced⁹ that it is no longer launching its lending program.

IMPLICATIONS AND CONCLUSION

First with BlockFi and now Coinbase and Celsius, digital asset products—particularly those tied to interest-bearing accounts—continue to come under regulatory scrutiny. News of the SEC’s Wells Notice to Coinbase sent a clear message to other cryptocurrency companies to register their products as securities within the meaning of Section 5 of the Securities Act. It is very likely a matter of time before the SEC begins issuing Wells Notices, and filing enforcement actions, against other cryptocurrency companies for offering alleged unregistered securities.

⁸ *Id.*

⁹ <https://blog.coinbase.com/sign-up-to-earn-4-apy-on-usd-coin-with-coinbase-cdad79e5f5eb>.

In the meantime, state regulators are actively challenging interest-earning cryptocurrency lending programs. With both state and federal enforcement efforts, these programs will struggle to survive unless they become registered—even though the SEC has yet to set forth a clear regulatory protocol for cryptocurrency offerings and programs.