The Crypto Exchange Podcast: S02E02, Crypto Year in Review 2022 - CFPB and FTC Enforcement Trends
Hosts: Keith Barnett, Ethan Ostroff, and Carlin McCrory

Carlin McCrory:
Welcome to another episode of *The Crypto Exchange*, a Troutman Pepper podcast focusing on the world of digital assets and payments. As longtime leaders in the intersecting worlds of law, business and government regulations, our lawyers can go beyond the buzzwords and headlines to make sense of the emerging legal and regulatory frameworks for operating in the digital asset and payments industries.

I'm Carlin McCrory, one of the hosts of the podcast and an associate at Troutman Pepper. Before we jump into today's episode, let me remind you to visit and subscribe to our blog, consumerfinancialserviceslawmonitor.com. And don't forget to check out our other podcasts on troutman.com/podcasts.html. We have episodes that focus on trends that drive enforcement activity, consumer financial services, the Fair Credit Reporting Act, cybersecurity, hot button labor and employment law issues and more. Make sure to subscribe to hear the latest episodes.

Today I'm joined by my co-hosts Keith Barnett and Ethan Ostroff for what will be a four-part series that takes a look back at what we have seen from the world of crypto in 2022 and also what we can expect in 2023. There were many noteworthy events that took place over 2022 related to cryptocurrency, and we saw numerous regulatory agencies weighing in throughout the year.

This four-part series will focus on the actions and insights we have seen from the CFPB, FTC, OFAC, FinCEN, FDIC, OCC, the Federal Reserve, and various states.

Keith and Ethan, we have a lot to unpack in this series, so let's jump into today's focus on the CFPB and FTC for their crypto updates. In March, Rohit Chopra was interviewed on CNBC. He briefly addressed crypto. Ethan, what did he have to say?

Ethan Ostroff:
Carlin, it's great to be with you again. It's been a very interesting year in this space and we're starting to see the CFPB become a lot more active and have a lot more to say. So going back to this March timeframe, when Chopra was interviewed, he was primarily focused on things like hacks, in errors and fraud. Looking at this, I think from one perspective of somewhat traditional consumer protections that you would expect to find the CFPB, and for that matter, the FTC concerned about.

He talked about the idea of when consumers swipe a card there are protections and then distinguish that from payments in the crypto space, and in his view, articulated he did not see the same types of consumer protections surrounding cryptocurrencies and the transfers of cryptocurrencies, even in the context of crypto being used in a payments-use case. And he indicated that the CFPB is hard at work thinking about how crypto operates in this context and how regulators should be thinking about situations where consumers experience losses. He also informed the public that the CFPB is tracking how crypto is scaling and indicated a concern about if it ever rides the rails of a big tech company, this could have significantly more impacts and implications for consumers and protections like the CFPB provides to consumers.

Carlin McCrory:
So that was pretty early on, Ethan. And Chopra had some subsequent interviews, Keith. Do you want to talk about what he said after that March timeframe?

Keith Barnett:
He's actually said quite a bit after that March timeframe, but I'll start off in the summer of 2022, in July, actually on July 27th, Chopra was interviewed by *Law360* and *American Banker* and it was a pretty wide-ranging interview. But among other things, he said that the CFPB'S complaint database had a huge surge in crypto complaints. And he said that right now cryptocurrencies are really primarily in the speculative trading markets.

But he also noted concerns when digital assets hold a place in most everyone's wallet, it will become a consumer issue.

Instead, however, the CFPB'S primary focus has been on real-time payments, which do not use blockchain technology. It uses other, more traditional, technologies. But he said that crypto is a part of a wave of innovations that are making faster payments a reality for many consumers. But these innovations, which also include mobile payment apps and other technologies raise new consumer protection questions that Chopra said the CFPB is studying, like whether additional fraud-related guidance is needed amid a bevy of complaints from peer-to-peer payments users. And then later on, in September, Chopra said that Washington is too obsessed with cryptocurrencies and should place some focus on other areas of FinTech and payment methods such as buy now, pay later.

Carlin McCrory:
Since you mentioned complaints, there have been some stats on the surrounding crypto that the CFPB has received. Ethan, can we talk a little bit about that?

Ethan Ostroff:
Yeah, definitely. Just one other thing to note about those more recent September interviews with Chopra was that he did also mention Stablecoins in his view that it is a rapid growth area and that regulators like the CFPB need to monitor it for risks to the overall financial system. With respect to CFPB complaints, there was a report from the *Wall Street Journal* at the end of September relying upon an analysis done by a compliance data firm called Dynamic Securities Analytics, which indicated that the CFPB received a little over 2,700 confirmed consumer complaints against digital asset companies during the timeframe of January 1st, 2020 through August 26th, 2020.

So, a little bit antiquated in that sense. One can only assume that those have increased over the course of the last couple years. And also indicated that there were over 1800 of those types of consumer complaints in the first eight months of 2022. That analysis indicated that 28% of the consumer complaints tied to scams and types of fraud, and they involved a lot of different companies, both entities that we would consider to be traditional financial institutions, as well as centralized exchanges like Binance.

Carlin McCrory:
Speaking of fraud, Ethan, the CFPB took action against Loan Doctor and its founder for offering what it called fake high yield accounts amongst some other things in relation to crypto. Can you talk a little bit about what happened in that case?

Ethan Ostroff:
Yeah, that's right, Carlin. The CFPB took action against Loan Doctor and the founder of the company, basically alleging they broke the law by deceiving consumers into thinking that these consumers were depositing funds into a guaranteed return savings product within a commercial bank. And these bad actors were falsely representing that the deposited funds would be used to originate loans for healthcare professionals, would be held in insured accounts, or backed by cash alternatives and would yield interest rates in excess of 5%.

The CFPB alleges that they made several false misleading and accurate marketing representations in advertising what Loan Doctor described as a healthcare finance savings CD account. And the complaint alleges that Loan Doctor represented that when not being used to originate loans, deposited funds will be held in an FDIC-insured account or an account insured by Lloyd's of London, or backed by a cash equivalent or cash alternative.

Loan Doctor also stated that it maintained a cash reserve in an amount equivalent to the amount customers deposited. But the CFPB'S investigation found that the founder of this company instead placed these funds in a hedge fund that he controlled and in crypto assets, such as Celsius Network, and that deposited funds were also invested in actively traded securities or loaned through a third party to investors using individual stock portfolios as collateral. This was amongst other false statements that the company is alleged to have made, such as that Loan Doctor was a commercial bank and that the CD accounts have a history of paying high interest rates between 5% and 6.25%.

Carlin McCrory:
Thanks, Ethan. And Keith, in May, the CFPB announced a new enforcement policy to prevent potential deception regarding products that aren't backed by FDIC insurance. Can you talk a little bit about that?

Keith Barnett:
Thanks, Carlin. I personally believe that this guidance was directed right at crypto companies because there are some crypto exchanges, or at least there were some crypto exchanges that had represented to their customers that their investments were FDIC insured. As a result, the FDIC'S guidance emphasizes several things.

First, that misrepresenting the FDIC logo or name will typically be a material misrepresentation as far as the FDIC is concerned. And then second, misrepresentation or misuse of the FDIC name or logo harms customers and puts them at a significant risk of unexpected losses. And then the third thing that they emphasized was that misuse of the FDIC name or logo harms honest companies. The CFPB'S guidance was issued in connection with the FDIC'S adoption of a regulation implementing a statutory provision that prohibits any person or organization from engaging in false advertising or misusing the name or logo of the FDIC, and from making knowing misrepresentations about the extent or manner of FDIC deposit insurance.

So, while the FDIC'S rule applies to FinTech potentially misleading customers that they are FDIC insured rather than their partner banks, the rule applies equally to digital asset companies and specifically those that offer, provide, or host Stablecoins.

Carlin McCrory:
Thanks Keith. And Ethan, as of this month, the CFPB launched its first investigation into a crypto firm. What's the CFPB's interest in that matter?

Ethan Ostroff:
Yeah, Carlin, it's very interesting. So, this is the first known civil investigation of a digital assets firm, against Nexo Financial. And we learned about this when we learned that the CFPB had denied a petition to modify a CID and we just learned about that in December of 2022. But that CID was originally served back in December of 2021.

From what we understand, what's going on there right now is that Nexo and its affiliates were advertising a range of products, including interest accruing accounts and lines of credit. And when Nexo filed its petition to modify this CID, it argued that it should exclude Nexo's earned interest product, which is an interest-bearing crypto lending product. Because under Nexo's view, it fell under the SEC's purview and outside of the

CFPB's jurisdiction. Now, the CFPB denied the request that actually ordered a corporate representative to appear for oral testimony on December 19th, 2022.

Some of the interesting things that came out of this was that according to the CFPB, Nexo did not contend that the SEC had determined that the earned interest product is a security or that Nexo is required to register this product with SEC. And so, it's through its CID that the CFPB appears to be trying to answer three questions.

One, whether these subject entities were engaged in conduct that is subject to federal consumer financial law, specifically the Consumer Financial Protection Act of Regulation E. Two, whether these entities violated the CFPA in Regulation E. And three, whether the CFPB enforcement action would be in the public interest.

So again, this is the first known investigation to determine whether a crypto firm is abiding by consumer protection laws that's been undertaken by the CFPB. And it'll be interesting to see what we learn about this during the course of the upcoming year.

Carlin McCrory:
That's a good placeholder to say what are your predictions for the CFPB in 2023 and beyond now that we've seen the CFPB launch its first civil investigation?

Ethan Ostroff:
Looking ahead, Carlin, the CFPB has a broad mandate to exercise oversight over people offering or providing a consumer financial product or service. We've seen the CFPB collect information on other companies such as the order regarding big tech. It could easily do the same thing around other big crypto players in order to look for consumer harm.

One option always in the background with the CFPB is that it uses its broad UDAP authority to bring enforcement actions against wrongdoers. Thus far, we have not seen Regulation E used to regulate crypto because these are not bank products. And also because cryptocurrencies are not typically used for consumer payments. But if you have an extended use case of payments that get into consumers using them in a B2C context, and particularly as you see more traditional financial institutions become more involved in the crypto space, we can certainly see Regulation E protections extended to a bank-based cryptocurrency product that's stored in digital wallets, or even potentially other cryptocurrency stored in a bank-issued digital wallet.

And then one final thought would be if crypto is used in the context of lending, we could see ECOA and fair lending issues come into play or even potentially dealer related issues having do with disclosures at the time of a transaction.

Carlin McCrory:
Thanks for that. And the FTC has put out a lot of alerts as it relates to scams and frauds pertaining to cryptocurrency and digital assets on a variety of topics. You can tell they're really trying to alert customers and inform them to be aware of the various scams that are out there. Can you discuss some of that, Ethan?

Ethan Ostroff:
Starting in June, the FTC reported that consumers lost over $1 billion for fraud involving cryptocurrencies during the time period of January 2021 through March of 2022. And the fraud report suggests cryptocurrency is quickly becoming the payment choice for many scammers, with about $1 out of every $4 reported lost to fraud paid in cryptocurrency.

The latest consumer protection data spotlight that came out from the FTC indicated that most of the cryptocurrency losses consumers reported involved bogus cryptocurrency investment opportunities, totaling about $575 million in reported losses since January, of 2021. These scams often falsely promise potential investors that they can earn huge returns by investing in their cryptocurrency schemes, but people report losing all the money they, quote, unquote, invest.

So, you've got these investment schemes that are significantly on the radar of the FTC from a consumer protection perspective. Then you've got these other types of large losses reported by consumers that involve romance scams, often involving a love interest who tries to entice someone into investing in what turns out to be some type of crypto-related scam. You've got business and governing impersonation scams. Scammers are targeting consumers by claiming their money is at risk because of a fraud or a government investigation, and scamming consumers by telling them the only way to protect their cash is by converting it to a cryptocurrency.

You also have indications from the data that the FTC has collected so far that people in the age group 20 to 49 were more than three times as likely as older age groups to have reported losing money to a cryptocurrency scam. People in older age groups did however report losing more money when they actually did report a cryptocurrency related scam. The FTC has also discussed some scammers offering recovery services to people who have lost money to fraud. And the FTC also reported fraud as it relates to the war in Ukraine. The government of the Ukraine is receiving donations in crypto, and the FTC has indicated scammers are setting up accounts and saying that any donations they collect will help the people in Ukraine, but instead of using the official government of Ukraine's wallet address, these scammers are using their own and making off with consumers' money.

Carlin McCrory:
And in that vein, the FTC has also initiated several investigations, and similar to what we discussed regarding the CFPB, the FTC also recently denied a petition to squash a CID. Ethan, can we talk a little bit about that?

Ethan Ostroff:
In August of 2022, the FTC denied a petition to quash a CID involving a company called Bachi Tech Corporation. This is, from our perspective, the first time that the FTC is known to have been investigating an entity in the Web3 center. The investigation, from what we know so far, is focused on a December 2021 security breach. Hackers withdrew digital assets valued somewhere between $150 million to $200 million from two BitMart wallets on the BitMart Cryptocurrency exchange operated on Bachi Tech.

We understand the FTC is examining BitMart's representations concerning its advertised exchange services, allegations that consumers have been denied access to their accounts, and concerns about the security of consumer accounts in light of the December 2021 security breach. And just to put a pin in that for a second, this issue and concern around actors in the crypto space dealing with security breaches is one of the things that we expect to see significantly uptick over the next 12 to 24 months.

From what we understand right now, the FTC is seeking to determine whether Bachi Tech's marketing and operation of BitMart constituted an unfair deceptive online practice, constituted deceptive or unfair consumer privacy or data security practices in violation of section five of the FTC Act, or violated the Graham-Leach-Bliley Act. The CID sought a variety of information relating to this company's operation of the BitMart cryptocurrency exchange, and that's an exchange that's operated by Bachi Tech with Spread Technologies. The FTC issued virtually identical CIDs to Bachi Tech to Spread Technologies in May of 2022.

And finally, on that point, at the time of the hack, the FTC claims that BitMart's website described itself as, quote, the most trusted cryptocurrency platform that is 100% secure, unquote, and claimed to have a quote, advanced risk control system, unquote.

Carlin McCrory:
The FTC also took action against DK Automation. Do you want to tell the audience a little bit about what happened in that case?

Ethan Ostroff:
Sure. So, another case involving both a company and its owners, right? This one is about using unfounded claims of big returns to entice consumers into moneymaking schemes involving Amazon business packages, business coaching and cryptocurrency.

The complaint filed by the FTC alleges that the defendants promised consumers that they could generate passive income on an autopilot, when the truth was that few consumers ever made money from these schemes. These defendants pitched supposed cryptocurrency investment services that included their number one secret passive income trading bot, which in my mind is laughable, which they claim could generate profits for you even while you sleep. And the complaint alleges they charged consumers thousands of dollars for this service.

The FTC’s complaint alleges they deceived customers about potential earnings, suppressed negative reviews, and did not provide the required disclosures under the FTC’s Business Opportunity Rule when selling their programs. And this enforcement action involved a monetary judgment of $53 million, which was partially suspended due to an inability to pay.

Carlin McCrory:
And Ethan, bouncing off of that a little bit, I wanted to discuss that the FTC recently announced some investigations over deceptive advertising. The FTC hasn't listed the specific firms it's investigating, but it did state that it is several companies over deceptive or misleading crypto advertising.

Basically, the FTC has said when consumers see or hear an advertisement, whether it's on the internet, radio, TV, that the ad must be truthful and not misleading, and if you're making certain types of disclosures, it should be backed by scientific evidence. The FTC wants to see truth in advertising as well as rules that require certain individuals to disclose when they've been paid for endorsements or reviews of a product, which would also include any crypto advertising. Ethan, on that note, what do you think we'll see from the FTC in 2023 and moving forward?

Ethan Ostroff:
The focus of the FTC from our perspective is going to continue to be on this issue of misleading customers through false advertisements and false statements that are made in some way or another to potential customers and more broadly to the public, whether it be on the website or in disclosure materials, or however it may be. They will continue to be looking at this through this lens of their traditional role in the financial services space to make sure that companies and actors who are making statements and representations to consumers are being truthful and accurate, and are going to likely continue to have increased supervision and enforcement activity in this space if they see what they perceive to be people misleading and scamming consumers.

Carlin McCrory:
Thank you both. This has been a great discussion. And as a reminder to our listeners, this is part one of our four-part series. Next week we'll take a look back at crypto updates from OFAC and FinCEN.

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