

New York Doubles Down on Regulatory Scrutiny of Crypto Lending Firms

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On October 18, New York Attorney General Letitia James issued cease-and-desist letters directing two virtual currency lending platforms to cease “unregistered and unlawful” lending activities in New York State within 10 days, while also ordering three additional digital currency platforms to provide information about their activities and products within the state by November 1. James’ office issued a press release on the same day, announcing the actions and attaching copies of the letters with recipient names redacted.

The orders from the New York attorney general’s office (OAG) are just the latest in a series of actions by several state regulatory bodies against virtual currency lending firms, including those dealing specifically in cryptocurrency (a subset of virtual currency that uses cryptography to validate and secure transactions). As discussed in [our October 7 alert](#), several other states recently issued orders against the New Jersey-based cryptocurrency company Celsius Network LLC (Celsius). Specifically, Alabama, Kentucky, New Jersey, and Texas alleged that Celsius unlawfully offered unregistered securities in the form of high interest-bearing accounts used to fund its lending operations and proprietary trading. These same states also filed actions against BlockFi, another New Jersey-based cryptocurrency firm, earlier this year.

New York Alleges Violations of the Martin Act

In the two cease-and-desist letters, New York alleges that under the state’s General Business Law Article 23-A (the “Martin Act”), certain interest-bearing products offered by the unnamed virtual currency firms are considered to be securities because they promise a rate of return to investors and deliver that return through the company trading with, or lending, the virtual assets. New York further alleges that the currency lending companies are serving as brokers, dealers, or salespeople because their interest-bearing products are openly offered to, and utilized by, New York purchasers. Finally, New York alleges that these companies have not registered with the office of the attorney general and/or other applicable governmental authorities as required under the Martin Act. The Martin Act, initially passed in 1921, grants the attorney general broad authority to investigate and prosecute cases of securities fraud.

At the same time that the cease-and-desist letters were sent, the attorney general’s office also issued written requests for information to three unnamed companies regarding their product offerings. Without alleging any wrongdoing, New York asked these companies to produce information sufficient to demonstrate compliance with the following New York laws: (1) the Martin Act’s registration requirement, (2) the prohibition of fraudulent activity in connection with the purchase or sale of securities and commodities, (3) and the prohibition of repeated or persistent fraudulent or illegal activity in the conduct of business. Specifically, New York requested descriptions

of all virtual currencies available for the companies' lending products; detailed information about any virtual currency deposited with the platform; information about "unverified accounts" or accounts from which a user can deposit virtual currency onto the platform using solely an email address or virtual wallet; and whether the platforms or lending products accept "tethers," a so-called "stablecoin" issued by the virtual currency firm Tether Limited (Tether). Along with Bitfinex, another virtual currency trading platform, Tether was the subject of an investigation by the New York attorney general's office earlier this year.

In the press release announcing the issuance of the letters, James made clear to other companies dealing in virtual currencies that her office is prepared to actively enforce New York's investor protection laws.

"Cryptocurrency platforms must follow the law, just like everyone else, which is why we are now directing two crypto companies to shut down and forcing three more to answer questions immediately," said Attorney General James. "My office is responsible for ensuring industry players do not take advantage of unsuspecting investors. We've already taken action against a number of crypto platforms and coins that engaged in fraud or that illegally operated in New York. Today's actions build on that work and send a message that we will not hesitate to take whatever actions are necessary against any company that thinks they are above the law." Although New York redacted the names of the companies in the copies of the letters provided publicly, cryptocurrency lending firm Nexo Financial LLC since has confirmed that it received one of the OAG cease-and-desist letters, while Celsius confirmed that it received a request for information.

Prior Enforcement Actions

New York has aggressively pursued virtual currency businesses through several enforcement actions brought by its Investor Protection Bureau in recent years. The October 18 letters follow closely on the office's September 13 judgment against virtual currency trading platform Coinseed, which put an end to Coinseed's operations and appointed a permanent receiver to manage investor funds. In February 2021, James' office reached an agreement with Bitfinex, Tether, and related entities that required the companies to cease trading activities in New York and to pay \$18.5 million in penalties, as well as take several actions designed to increase transparency of the companies' operations.

In addition to enforcement actions and settlements, the OAG has made very clear its intent to pursue enforcement against virtual currency businesses that the office perceives as potentially noncompliant. In March 2021, James' office issued an industry alert that highlighted "significant noncompliance" with registration requirements and provided notice that the OAG would act on its authority under the Martin Act to enjoin fraudulent practices in service of investor and consumer protection. As the alert notes, New York courts have previously recognized some virtual currencies as commodities under the Martin Act,^[1] providing the attorney general with sufficient legal backing to conduct investigations and bring actions against companies trading virtual currencies in the state.

Federal and State Regulatory Landscape

State attorneys general are hardly the only regulators looking to assert their authority in the virtual currency arena. As we also discussed in our [October 7 alert](#), the well-known cryptocurrency exchange Coinbase announced in late September that it had received a Wells Notice from the Securities and Exchange Commission (SEC). In addition, various SEC officials have publicly expressed significant concerns regarding cryptocurrency products. As we concluded then, these prominent developments suggest that all digital asset products — particularly those tied to

interest-bearing accounts — will be subject to increased regulatory scrutiny and enforcement at the federal and the state level.

In the meantime, state regulators are taking advantage of the lack of a comprehensive federal regulatory framework to issue challenges against virtual currency lending products. New York's recent actions further emphasize increased regulatory scrutiny by the states on the virtual currency industry, and serve as a warning to all virtual currency businesses that they should be prepared for information requests and other enforcement actions on the horizon.

[1] *James v. iFinex*, 185 A.D.3d 22, 28 (1st Dep't 2020).

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