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State Attorneys General Are Paying Attention to Crypto!

WRITTEN BY

Christopher Carlson | Timothy A. Butler | Matthew White

While active in the space for several years, state attorneys general have taken increasingly aggressive action over the last year to regulate crypto-based products and services and prosecute those abusing this otherwise exciting innovation. In this article, we summarize the basics of crypto, as well as recent actions by state attorneys general involving crypto-based products and services.

Crypto in a Nutshell

As a digital currency, cryptocurrency does not exist in any physical form, cannot be placed in a leather wallet like cash, and is not held in a bank with four walls and a villain-proof vault. Built on blockchain technologies, the most popular cryptocurrencies employ cryptography to manage and record transactions on decentralized and distributed ledgers.

Because they employ decentralized and distributed ledgers, cryptocurrencies and cryptocurrency-based financial product are not tied to financial institutions nor *directly* controlled by many of the laws and regulations that govern financial institutions^[1] — and that's a sore spot for some regulators concerned that a lack of regulation has already facilitated all sorts of abuse.

Although not (yet) used for most financial transactions, the value of cryptocurrencies — and the related potential for abuse — has grown enormously. As of April 2021, the total market value of the various publicly available cryptocurrencies went as high as \$2 trillion,^[2] and just last month, the FTC noted that since October 2020, nearly 7,000 people have reported losses of more than \$80 million in cryptocurrency-related scams.^[3]

To address these growing concerns, a number of state and federal regulators have taken steps to regulate cryptocurrencies. But at least at present, that's resulted in a patchwork of state and federal laws, rather than a comprehensive and coherent regulatory regime. As Treasury Secretary Janet Yellen noted this May, "While there are several agencies that arguably have some ability to address [cryptocurrency] through regulation, I frankly don't think we have a framework in the United States that is quite up to the task."^[4]

That said, state attorneys general are doing what they can — and are certainly paying attention to consumer protection issues related to crypto-based products and services.

State Action

Some states have taken steps to encourage crypto-related innovation. As recently as May 2021, Nebraska Governor Pete Ricketts signed legislation that created a state bank charter for digital asset depository institutions and allows existing state-chartered banks in the state to open cryptocurrency banking divisions, which could spur growth in Nebraska for the crypto market.^[5] Yet, the more prominent trend is aggressive enforcement activity challenging crypto-related financial products and services.

For example, in September 2020, Massachusetts Attorney General Maura Healey sued Stripe, Inc. for inappropriately facilitating transactions by individuals engaged in an initial coin offering (ICO).^[6] Attorney General Healey alleged that these individuals fraudulently sold PlexCoin, resulting in the fraudulent and unregistered offer and sale of cryptocurrency.^[7] In addition to a \$120,000 payment, Stripe agreed to improve its risk monitoring procedures, including enhancing duplicate screening procedures for accounts with shared bank accounts, improving merchants' websites monitoring, revising its procedures for handling law enforcement requests, and conducting employee training for risk monitoring.^[8]

In February 2021, New York Attorney General Letitia James entered into a settlement agreement with Tether, a cryptocurrency trading platform that purported to offer a "stablecoin" backed by the U.S. dollar.^[9] Attorney General James alleged that Tether made false statements about its cryptocurrency, which was not fully backed by U.S. dollars.^[10] In the settlement agreement, Tether agreed to pay \$18.5 million in penalties, cease trading activity with New Yorkers, and provide more transparent disclosures about the backing of its stablecoin.^[11]

Also in February 2021, Attorney General James filed an action against Coinseed, Inc. and two of its top executives. Attorney General James alleged that the Coinseed defendants unlawfully traded cryptocurrencies without registering as broker-dealers, and that they failed to disclose certain fees connected with trading virtual currencies on their investors' behalf.^[12] More recently in May, Attorney General James filed a motion in the Coinseed lawsuit, asking the court for a temporary restraining order, a preliminary injunction, and the appointment of a receiver to immediately block the Coinseed defendants from making additional unauthorized trades.^[13]

What's Next?

We expect more regulatory scrutiny of crypto-based products and services. As their recent activity demonstrates, state attorneys general will stay at the forefront of this action.

We'll continue to monitor crypto-related innovations, as well as crypto-related regulatory developments. If you're offering a crypto-related product or service, or if you're just interested in how regulators respond to (and sometimes frustrate) innovation, stay tuned.

^[1] For a more detailed understanding of cryptocurrency, review the article, "What is Cryptocurrency?" by Kate Ashford and Josh Schmidt. <https://www.forbes.com/advisor/investing/what-is-cryptocurrency/>.

^[2] Noah Manskar, "Cryptocurrency Market Value Tops \$2 Trillion for First Time." *The New York Times* (Apr. 6, 2021), <https://nypost.com/2021/04/06/cryptocurrency-market-value-tops-2-trillion-for-first-time/>.

[3] "Cryptocurrency buzz drives record investment scam losses." Federal Trade Commission (May 17, 2021), <https://www.ftc.gov/news-events/blogs/data-spotlight/2021/05/cryptocurrency-buzz-drives-record-investment-scam-losses>.

[4] "Yellen Says U.S. Lacks Adequate Regulatory Framework for Crypto." *Bloomberg Tax* (May 4, 2021), <https://news.bloomberglaw.com/daily-tax-report/yellen-says-u-s-lacks-adequate-regulatory-framework-for-crypto?context=article-related>.

[5] Jared Austin, "Cryptocurrency to be Regulated in Nebraska." 1011 Now (May 26, 2021), <https://www.1011now.com/2021/05/27/cryptocurrency-to-be-regulated-in-nebraska/>.

[6] "Payment Processor to Pay \$120,000 in Connection with Cryptocurrency Scheme." Office of Mass. Att'y General (Sept. 18, 2020), <https://www.mass.gov/news/payment-processor-to-pay-120000-in-connection-with-cryptocurrency-scheme>.

[7] *Id.*

[8] *Id.*

[9] "Attorney General James Ends Virtual Currency Trading Platform Bitfinex's Illegal Activities in N.Y." Office of N.Y. Att'y General (Feb. 23, 2021), <https://ag.ny.gov/press-release/2021/attorney-general-james-ends-virtual-currency-trading-platform-bitfinexs-illegal>.

[10] *Id.*

[11] *Id.*

[12] "Attorney General James Sues to Shut Down Illegal Cryptocurrency Trading Platform and Virtual Currency, Seeks to Recoup Defrauded Funds for Thousands of Investors." Office of N.Y. Att'y General (Feb. 17, 2021), <https://ag.ny.gov/press-release/2021/attorney-general-james-sues-shut-down-illegal-cryptocurrency-trading-platform-and>.

[13] "Attorney General James Seeks Court Order Immediately Halting Continued Fraud by Illegal Virtual Currency Trading Platform." Office of N.Y. Att'y General (May 7, 2021), <https://ag.ny.gov/press-release/2021/attorney-general-james-seeks-court-order-immediately-halting-continued-fraud>.

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