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Neither a Borrower nor a Lender Be: Analyzing the SEC's Reaction to Crypto Lending

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ABSTRACT

In June 2021, the largest U.S.-based crypto exchange, Coinbase, announced plans to allow its customers to earn 4% interest on deposits of certain cryptoassets through a new "Coinbase Lend" program. Despite a positive reaction from its customers, on September 7, 2021, Coinbase announced it had received a notice from the Securities and Exchange Commission (SEC) to the effect that the Commission had preliminarily concluded that the proposed Lend program was a security and that Coinbase would be in violation of the federal securities laws if it proceeded. The threat of enforcement caused Coinbase to terminate the program. Shortly thereafter, in the wake of several state enforcement actions, the SEC also announced a settlement with BlockFi that terminated its crypto lending program in the U.S. Neither of these actions conclusively explained the test that the SEC was using to determine when a crypto lending program involves the issuance of a security. This article considers the appropriate test for evaluating crypto lending programs and concludes that in many cases, the appropriate test should look at whether there are "notes" that fit within the definition of security. This article suggests that the SEC is applying the federal securities laws too broadly without offering sufficient explanation for its interpretations and that the Coinbase Lend program in particular should not have been shuttered. The article concludes that continuing regulatory uncertainty as to the scope of the federal securities laws is depriving U.S. citizens of potentially valuable opportunities.

AUTHOR'S NOTE

Carol R. Goforth is a University Professor and the Clayton N. Little Professor of Law at the University of Arkansas, in Fayetteville. She has decades of experience with corporate, securities and business law issues in the U.S., and has recently published numerous articles and blog posts dealing with the regulation of cryptotransactions. She is also the co-author of REGULATION OF CRYPTOASSETS (W. Acad., 2d. Ed., 2022)

* This line comes from Polonius' soliloquy in Act 1, Scene 3 of William Shakespeare's *Hamlet.* WILLIAM SHAKESPEARE, HAMLET act 1, sc. 3, l. 561.

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INTRODUCTION

Blockchain and crypto started with a pseudonymously posted whitepaper in late 2008.[1] This led to the initial genesis transaction involving Bitcoin, the first blockchain-hosted cryptoasset, in early 2009.[2] Just over a dozen years later, in September 2022, CoinMarketCap reported that there were more than 21,000 different privately issued cryptoassets with a total market capitalization of nearly $1 trillion (in U.S. dollars).[3] We have also seen initial proposals for creating global stablecoins, such as Facebook's proposed Libra

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1 Whoever used the pseudonym "Satoshi Nakamoto" wrote about the potential to create blockchains for digital assets using new consensus protocols in late 2008. Satoshi Nakamoto, *Bitcoin: A Peer-to-peer Electronic Cash System*, BITCOIN.ORG, https://bitcoin.org/bitcoin.pdf [https://perma.cc/72VL-S2AA] (last visited Oct. 11, 2022). This whitepaper originally appeared in an online discussion of cryptography. The Bitcoin genesis block (the initial mining transactions in which the first Bitcoins were issued) was validated in early 2009. *See* Kirsty Moreland, *A Brief History of Bitcoin & Cryptocurrencies*, LEDGER ACADEMY, https://www.ledger.com/academy/crypto/a-brief-history-on-bitcoin-cryptocurrencies [https://perma.cc/U9CS-6W9Z] (last updated Sept. 15, 2022). *See also* Cryptopedia Staff, *Who is Satoshi Nakamoto?*, CRYPTOPEDIA, https://www.gemini.com/cryptopedia/is-satoshi-nakamoto-alive-cypherpunk-satoshi-nakamoto-quotes [https://perma.cc/X65F-EJJZ] (last updated June 28, 2022) (describing search for Satoshi Nakamoto's true identity).

2 On January 3, 2009, the Bitcoin network went live with the first transactions. Brian Nibley, *Bitcoin Price History: 2009-2022*, SOFI (Sept. 15, 2022), https://www.sofi.com/learn/content/bitcoin-price-history/ [https://perma.cc/R2YC-6FPL].

3 *See Today's Cryptocurrency Prices by Market Cap*, COINMARKETCAP, https://coinmarketcap.com/ [https://perma.cc/DR5B-EFJW] (last visited Nov. 26, 2022). This total market value was amid a so-call "crypto winter," reflecting a dramatic downturn in crypto prices. Some sources reported that the total market capitalization of crypto reached $3 trillion at one point. *See Crypto World Hits $3 Trillion Market Cap as Ether, Bitcoin Gain in Trade*, BUS. STANDARD, https://www.business-standard.com/article/international/crypto-world-hits-3-trillion-market-cap-as-ether-bitcoin-gain-in-trade-121110900065_1.html [perma.cc/78K2-DM52] (last updated Nov. 9, 2021). The rapid growth of crypto markets is of international concern, as noted in a report on crypto prepared for the European Parliament. Robby Houben & Alexander Snyers, *Crypto-assets; Key Developments, Regulator Concerns and Responses*, EUR. PARL. DOC. PE 648.779 (2020) [hereinafter *Cryptoassets; Key Developments*]https://www.europarl.europa.eu/RegData/etudes/STUD/2020/648779/IPOL_STU (2020)648779_EN.pdf **[**https://perma.cc/49FE-CZDZ]. Note that all references to dollars in this Article will be to U.S. dollars.

tokens—as originally contemplated before being limited and eventually abandoned[4]—and a multitude of potential central bank digital currencies ("CBDCs").[5] Increasing numbers of crypto and blockchain entrepreneurs have also sought to mimic conventional financial services and products with business models that are sometimes difficult to place into the traditional regulatory framework.[6]

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[4] The Libra project was formally announced in June 2019. Josh Constine, *Facebook Announces Libra Cryptocurrency: All you Need to Know*, TECHCRUNCH (June 18, 2019, 5:01 AM), https://techcrunch.com/2019/06/18/facebook-libra/ [https://perma.cc/XTA4-SMSJ]. Thereafter, the Libra project was renamed Diem and substantially scaled back. Olga Kharif, *Facebook-backed Libra Association Changes its Name to Diem*, FORTUNE (Dec. 1, 2020, 1:11 PM), https://fortune.com/2020/12/01/facebook-libra-association-name-diem/ [https://perma.cc/5CSV-TQ6B]. Finally, in late January 2022, Meta announced that it was abandoning the project completely. *Meta Abandons Diem? The Indiscretion*, BITCOINETHEREUMNEWS (Jan. 27, 2022), https://bitcoinethereumnews.com/technology/meta-abandons-diem-the-indiscretion/ [https://perma.cc/J5W5-NGTD].

[5] Evidence suggests that research focused on central bank digital currencies, often abbreviated as CBDCs, began in 2017, with initial reports appearing in 2018. *See, e.g.*, Comm. on Payment & Mkt. Infrastructures & Mkts. Comm., *Central Bank Digital Currencies*, BANK FOR INT'L SETTLEMENTS (March 2018) https://www.bis.org/cpmi/publ/d174.pdf [https://perma.cc/DW2W-2727]. *See also* Christian Barontini & Henry Holden, *Proceeding with Caution – A Survey on Central Bank Digital Currency*, BANK FOR INT'L SETTLEMENTS, Paper NO. 101 (2019), https://www.bis.org/publ/bppdf/bispap101.pdf [https://perma.cc/2MDK-26VE].The E.U. has also actively been considering the potential role of CBDCs. *Crypto-assets; Key Developments*, *supra* note 3. China has conducted multiple successful regional beta tests or trials of its CBDC. *See* Patrick Thompson, *China's Latest CBDC Airdrop*, COINGEEK (Feb. 4, 2021), https://coingeek.com/chinas-latest-cbdc-airdrop/ [https://perma.cc/E6GL-SXNW].

[6] As noted by one law firm with a financial markets practice, "[i]ssues barely on the radar screen 18 months ago have come front and center in today's headlines. Areas with relatively small market capitalizations a year ago have ballooned many multiples during the past year." *Are Crypto Lending, DeFi and Stablecoins the New "Lions and Tigers and Bears, Oh My!"? A Review of Recent Crypto Legal and Regulatory Developments*, KATTEN (Sept. 14, 2021), https://katten.com/are-crypto-lending-defi-and-stablecoins-the-new-lions-and-tigers-and-bears-oh-my-a-review-of-recent-crypto-legal-and-regulatory-developments [https://perma.cc/2PC3-JZT5] (focusing particularly on decentralized exchanges, synthetic asset protocols, insurance protocols, prediction markets, as well as crypto lending programs). *See also* Veronica Reynolds, *Crypto Investment and Payment Products Launch*, THE BLOCKCHAIN MONITOR (June 4, 2021), https://www.theblockchainmonitor.com/2021/06/crypto-investment-and-payment-products-launch-bita-platform-announced-sec-and-ofac-take-crypto-enforcement-actions-fca-extends-aml-

The growth in financial innovation is a part of what has been called the blockchain era,[7] a rapidly developing technological and economic revolution with far-reaching implications. Crypto enthusiasts have suggested that blockchain and crypto could be as economically significant as the Internet and the worldwide web.[8] The technology and its applications have certainly been expanding at an at an exponential rate. A 2021 Reuters article suggested that the decision to have "Dogecoin whisperer" Elon Musk host Saturday Night Live was clear evidence that crypto had "arrived" for the masses.[9]

Crypto lending is part of this developing financial ecosystem. Crypto lending is an ambiguous phrase, sometimes covering both borrowing—where the customer pledges cryptoassets as collateral and pays interest—and lending—where the customer deposits crypto and

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exemption/ [https://perma.cc/W6QT-BV96] (discussing investment management and decentralized finance projects and credit cards that allow payments in crypto and mobile crypto payments systems).

7 *See, e.g.*, Yoav Vilner, *The Basics of Security Needs in the Blockchain Era*, FORBES (June 22, 2018, 2:13 AM), https://www.forbes.com/sites/yoavvilner/2018/06/22/the-basics-of-security-needs-in-the-blockchain-era/?sh=40cf90de4ac2 [https://perma.cc/PJF7-BJ43] (referring to the influx of financial innovation regarding cryptocurrency as the "blockchain era"). *See generally*, Sukmawati Sukamulja & Cornelia Olivia Sikora, *The New Era of Financial Innovation: The Determinants of Bitcoin's Price*, 33 J. OF INDON. ECON. & BUS. 46, 47 (2018).

8 Daniel Lanyon, *Blockchain Will be "as Transformative as the Internet*," ALTFI (Apr. 23, 2018), https://www.altfi.com/article/4334_blockchain-will-be-as-transformative-as-the-internet [https://perma.cc/3WVW-LN4R] ("Almost 9 in 10 technology professionals believe blockchain technology will be as transformative for business as the internet has been for business over the past few decades . . . .").

9 Donna Parisi, *Who's in Charge? An overview of U.S. Digital Asset Regulation*, REUTERS (June 14, 2021, 3:25 PM), https://www.reuters.com/legal/transactional/whos-charge-an-overview-us-digital-asset-regulation-2021-06-14/ [https://perma.cc/MY55-YYWE]. Dogecoin is a cryptoasset that originally started as a joke, but it has now grown far beyond its original cult following. Caitlin Ostroff & Caitlin McCabe, *The Cryptocurrency Dogecoin Began as a Joke, and now it's Worth More Than Ford*, WALL ST. J. MKT. WATCH (Apr. 20, 2021, 8:58 AM), https://www.marketwatch.com/story/the-cryptocurrency-dogecoin-began-as-a-joke-and-now-its-worth-more-than-ford-11618923488 [https://perma.cc/365Z-D7X9]. Of course, Elon Musk is (in)famous for numerous other reasons too. *See* Elizabeth Dwoskin, *Twitter Workers Face a Reality They've Long Feared: Elon Musk as Owner*, THE WASH. POST, https://www.washingtonpost.com/technology/2022/04/25/twitter-employees-musk/ [https://perma.cc/CKH2-W6US] (last updated Apr. 26, 2022, 7:47 PM).

receives interest payments while the assets are on deposit.[10] The particular programs upon which this Article focuses involved centralized crypto platforms that offered to pay their customers interest on cryptoassets deposited with them.[11] While this Article focuses primarily on Coinbase Lend and BlockFi BIAs, additional crypto lending options are also described, albeit in less detail, in order to evaluate crypto lending in general.

Coinbase and BlockFi serve the role that legacy financial institutions have played for years in the case of interest-bearing accounts

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[10] Jacob Wade, *Crypto Lending*, INVESTOPEDIA, https://www.investopedia.com/crypto-lending5443191#:~:text=Crypto%20lending%20is%20the%20process,return%20for%20regular%20interest%20payments [https://perma.cc/J4Z7-TGJ8] (last updated Aug. 31, 2022). Consider this explanation:

> [H]ow can you get your digital currency to grow? This is where crypto lending comes in. Not only can it enable savers to receive interest on their stash of Bitcoin, but it enables borrowers to unlock the value of their digital assets by using it as collateral for a loan.

What is Crypto Lending and How Does it Work?, COINCU NEWS (July 7, 2022), https://news.coincu.com/105736-what-is-crypto-lending-and-how-does-it-work/ [https://perma.cc/YS7X-A4XS]. Crypto lending is similar to conventional loans as there is both a borrower and a lender. The borrower requests a crypto loan and stakes the crypto collateral as soon as the platform accepts the loan request, while the lenders automatically fund the loan. The borrower will be able to get back the crypto collateral when they manage to pay off the loan. *Id. See also* Ben Luthi, *What is Crypto Lending*, U.S. NEWS & WORLD RPT. (June 8, 2021), https://loans.usnews.com/articles/what-is-crypto-lending [https://perma.cc/T3GP-53SN] (describing how crypto investors can cash out their crypto holdings and explaining the process of crypto lending).

[11] This Article focuses on lending programs that involve a centralized platform operating as an intermediary and assuming the role of legacy financial institutions in conventional transactions. A legacy financial institution includes traditional banks, savings and loans, credit unions and similar businesses operating in the financial sector. Decentralized options may operate automatically, pursuant to predetermined options set out in a computer program, with no legal person or persons operating as an intermediary. Financial transactions in crypto occurring on centralized platforms are part of the more traditional centralized finance (CeFi) world, while decentralized applications are part of the decentralized (DeFi) ecosystem. *See* Ephrat Livni & Eric Lipton, *Crypto Banking and Decentralized Finance, Explained*, N.Y. TIMES,

https://www.nytimes.com/2021/09/05/us/politics/cryptocurrency-explainer.html [https://perma.cc/SV2F-CNXL] (last updated Nov. 1, 2021). Decentralized options exacerbate the difficulty of applying existing securities laws to the range of crypto lending programs.

involving fiat currency.[12] There are definite similarities between centralized crypto lending programs and conventional interest-bearing demand deposits at conventional banking institutions. However, various commentators have expressed concern that crypto intermediaries like Coinbase and BlockFi produce riskier alternatives for potential participants because they have not faced the same regulatory scrutiny.[13]

This Article considers how federal securities laws have been applied to cryptoassets generally before analyzing these two centralized crypto lending programs in depth. The planned crypto lending program that *would* have been offered by Coinbase, the largest crypto exchange in the U.S.,[14] will be considered first. BlockFi offered the other program that will be examined in detail in this Article.[15] Part I of the Article provides background on the approach taken by the Securities and Exchange Commission (SEC) in its typical enforcement actions involving cryptoassets. The SEC generally applies the *Howey* test developed by the U.S. Supreme Court, but this test has yet to yield much clarity. Part II examines how the planned Coinbase Lend program

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[12] *See infra* notes 54-62 and accompanying text for a description of such interest-bearing accounts and how they evolved. It is also worth noting that BlockFi is no longer active in this space, announcing it had filed for bankruptcy protection on November 28, 2022. Hannah Lang, Niket Nishant & Manya Saini, *Crypto Lender BlockFi Files for Bankruptcy, Cites FTX Exposure*, REUTERS (Nov. 29, 2 022, 1:59AM), https://www.reuters.com/technology/crypto-lender-blockfi-files-bankruptcy-protection-2022-11-28/. [https://perma.cc/DZ37-3958].

[13] SEC Chairman Gary Gensler is one of the commentators calling for greater oversight. "'We just don't have enough investor protection on in crypto finance, issuance, trading, or lending . . . This asset class is rife with fraud, scams, and abuse in certain applications. The crypto area is trying to stay outside of investor protection. We can do better . . . ." Ted Knutson, *SEC Chair Gensler: Crypto Assets Are Catalyst For Change But Need Greater Oversight*, FORBES (Sept. 14, 2021, 1:36 PM), https://www.forbes.com/sites/tedknutson/2021/09/14/sec-chair-gensler-crypto-assets-are-catalyst-for-change-but-need-greater-oversight/?sh=109ac8ce2f74 [https://perma.cc/Y3UY-EUVA].

[14] Lauren Aratani, *Coinbase, US's Largest Cryptocurrency Exchange, Makes Nasdaq Debut*, THE GUARDIAN (Apr. 14, 2021, 1:04 PM), https://www.theguardian.com/technology/2021/apr/14/coinbase-nasdaq-value-cryptocurrency [https://perma.cc/X3RG-GP62]. Coinbase went public in 2021 with a direct listing of its stock. *Id.*

[15] The BlockFi program was the subject of an SEC enforcement action, resulting in a landmark $100 million fine imposed by the SEC on its own behalf and for the benefit of several states. Order Instituting Cease and Desist Proceedings, *In re BlockFi Lending LLC*, SEC. ACT 1933 REL. NO.11029, INV. CO. ACT 1940 RELEASE NO. 3-20758 (2022), https://www.sec.gov/litigation/admin/2022/33-11029.pdf [https://perma.cc/XC4P-H3T4] [hereinafter SEC BlockFi Order].

would have operated, along with the SEC's reaction to the proposal. Part III describes the BlockFi lending proposal and the SEC's response to it. Part IV considers how federal securities laws should logically apply to crypto lending products. The *Reves* test, also developed by the U.S. Supreme Court, comes into play here but does not offer a simple answer. Part V explains why additional clarification is needed. Finally, the conclusion offers a plea for legislative intervention to help the evolving crypto lending industry and regulators achieve certainty and balance.

I. CRYPTO AND THE *HOWEY* TEST

According to the SEC's official website, its mission "is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC strives to promote a market environment that is worthy of the public's trust."[16] These objectives help explain the federal securities laws' general focus on accurate disclosure. As explained by the SEC, "we require public companies, fund and asset managers, investment professionals, and other market participants to regularly disclose significant financial and other information so investors have the timely, accurate, and complete information they need to make confident and informed decisions about when or where to invest."[17] In connection with these underlying objectives, the Commission has adopted relatively aggressive enforcement strategies concerning cryptoassets,[18] presumably based on concerns that, without such oversight, members of the public will lack sufficient information to make informed decisions about financial opportunities involving crypto transactions.

The SEC has repeatedly asserted its authority over transactions involving the sale of cryptoassets,[19] at first appearing to take the position

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16 *About the SEC*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/about.shtml [https://perma.cc/3BEE-PNDW] (last visited Nov. 14, 2022).

17 *What We Do*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/about/what-we-do [https://perma.cc/N837-2JSV] (last visited Nov. 14, 2022).

18 *See* Douglas S. Eakeley et al., *Crypto-Enforcement Around the World*, 94 S. CAL. L. REV. POSTSCRIPT 99, 101 (2021) (concluding that "U.S. crypto-enforcement is singularly robust.").

19 For a list of various SEC enforcement actions involving cryptoassets, *See Crypto Assets and Cyber Enforcement Actions*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/spotlight/cybersecurity-enforcement-actions [https://perma.cc/W74N-W238] (last visited Nov. 14, 2022). Note that the original releases from the SEC talked about crypto as "virtual currencies." For example, in 2014 the SEC issued an investor alert about Bitcoin and "other virtual

that virtually all cryptoassets should be regulated as securities under federal law.[20] Jay Clayton, the Chairman of the SEC from May 2017 to December 2020, was widely quoted as stating that every initial coin offering (ICO) he had seen involved the sale of securities.[21] The only

currency-related investments." *Investor Alert: Bitcoin and Other Virtual Currency-Related Investments*, U.S. SEC. & EXCH. COMM'N (May 7, 2014), https://www.sec.gov/oiea/investor-alerts-bulletins/investoralertsia_bitcoin.html [https://perma.cc/5SFP-7J9E]. *See also* OFFICE OF INVESTOR EDUC. & ADVOCACY, U.S. SEC. & EXCH. COMM'N, SEC PUB. NO. 153, PONZI SCHEMES USING VIRTUAL CURRENCIES (2013), available at https://www.sec.gov/files/ia_virtualcurrencies.pdf. More recently, the SEC has switched to using "Digital Assets." *See e.g.*, Bill Hinman & Valerie Szczepanik, *Statement on "Framework for 'Investment Contract' Analysis of Digital Assets"* U.S. SEC. & EXCH. COMM'N (Apr. 3, 2019), https://www.sec.gov/news/public-statement/statement-framework-investment-contract-analysis-digital-assets [https://perma.cc/7X2J-CALQ] [hereinafter *Framework*]. In a joint staff statement issued with the Office of General Counsel for FINRA, the SEC referred to covered cryptoassets as "digital asset securities." *See Joint Staff Statement on Broker-Dealer Custody of Digital Asset Securities*, U.S. SEC. & EXCH. COMM'N (July 8, 2019), https://www.sec.gov/news/public-statement/joint-staff-statement-broker-dealer-custody-digital-asset-securities [https://perma.cc/4C6L-HYZL] [hereinafter *Digital Asset Securities*]. This Article used the word "cryptoassets," or simply crypto, to describe the range of cryptocoins and tokens that exist because of blockchain technology, which is more in line with how other authorities tend to speak about these interests. As one commentator notes, "crypto asset is a blanket term that isn't limited to cryptocurrencies." Aashish Pahwa, *What is a Cryptoasset? Types of Cryptoassets [Ultimate Guide]*, FEEDOUGH (Jan. 15, 2022), https://www.feedough.com/what-is-a-cryptoasset-types-of-cryptoassets-ultimate-guide/ [https://perma.cc/AD7Y-GERR].

20 *Accord* Evelyn Cheng, *The SEC Just Made it Clearer That Securities Laws Apply to Most Cryptocurrencies and Exchanges Trading Them*, CNBC (Mar. 7, 2018, 5:14 PM), https://www.cnbc.com/2018/03/07/the-sec-made-it-clearer-that-securities-laws-apply-to-cryptocurrencies.html [https://perma.cc/BQ4L-GRXP]. In September 2017, the Co-Director of the SEC's Enforcement Division, Steven Peikin, analogized persons seeking quick profits from ICOs to cockroaches. *See* Rachel-Rose O'Leary, *'Roaches': SEC Chief Speaks Out Against Malicious ICOs*, COINDESK, https://www.coindesk.com/markets/2017/09/06/roaches-sec-chief-speaks-out-against-malicious-icos/ [https://perma.cc/AGK7-GPJN] (discussing the SEC's position that tokens may be classified as securities) (last updated Sept. 13, 2021).

21 Beginning in December 2017, the SEC Chairman at the time, Jay Clayton, began repeating the mantra that most, if not all, ICOs involved the sale of securities. Jay Clayton, *Statement on Cryptocurrencies and Initial Coin Offerings*, U.S. SEC. & EXCH. COMM'N (Dec. 11, 2017), https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11 [https://perma.cc/2LUP-9DUD] ("By and large, the structures of initial coin offerings that I have seen

real deviations from this position were unofficial, but relatively consistent recognition that some widely dispersed assets, such as Bitcoin and possibly Ether, would not be securities.[22] There are also a handful of no-action letters concluding that certain forms of crypto, that

promoted involve the offer and sale of securities and directly implicate the securities registration requirements and other investor protection provisions of our federal securities laws."). In February 2018, in testimony before the Senate Committee on Banking, Housing, and Urban Affairs, Chairman Clayton testified that "every ICO token the SEC has seen so far is considered a security . . . ." *See* Joseph Young, *SEC Hints at Tighter Regulation for ICOs, Smart Policies for "True Cryptocurrencies,"* COINTELEGRAPH (Feb. 9, 2018), https://cointelegraph.com/news/sec-hints-at-tighter-regulation-for-icos-smart-policies-for-true-cryptocurrencies [https://perma.cc/V25B-UTDE]. While Chairman Clayton was always careful to explain that the SEC's approach required a consideration of the facts and circumstances of each transaction, his comments were widely accepted as reflecting at least a rebuttable presumption that all ICOs involved the sale of securities. *See*, *e.g.*, Daniel C. Zinman et al., *SEC Issues Warning to Lawyers on ICOs*, BL (Feb. 22, 2018, 4:31 PM), https://news.bloomberglaw.com/tech-and-telecom-law/sec-issues-warning-to-lawyers-on-icos [https://perma.cc/XY53-PRJP] (examining a number of pronouncements and actions taken by the SEC and concluding that the Commission had "essentially adopted a rebuttable presumption that ICO tokens are securities that must comply with the registration requirements of the securities laws.").

[22] In June 2018, the SEC's Director of the Division of Corporate Finance, William Hinman, acknowledged that, in his opinion, not all cryptoassets fit the definition of investment contract, specifically pointing to Bitcoin and Ether as examples of tokens that should not be viewed as securities. *See* William Hinman, Dir. SEC, Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018) (transcript available at https://www.sec.gov/news/speech/speech-hinman-061418)[https://perma.cc/AEB2-2R9G]. In the case of those two assets, Hinman suggested that the underlying network was "sufficiently decentralized," so that "purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts . . . ." *Id.* In his April 2018 testimony before the House Appropriations Committee, Chairman Clayton appeared to acquiesce in the view that Bitcoin, at least, would not be a security. He explained that "there are different types of cryptoassets." and that "[a] pure medium of exchange, the one that's most often cited, is Bitcoin. As a replacement for currency, that has been determined by most people to not be a security." Neeraj Agrawal, *SEC Chairman Clayton: Bitcoin is not a Security*, COIN CENTER (Apr. 27, 2018), https://www.coincenter.org/sec-chairman-clayton-bitcoin-is-not-a-security/ [https://perma.cc/ZQ3Y-VJQW]. Note that neither of these are official statements of the SEC but instead explicitly reflect only the opinion of the individual speaker.

are not convertible into fiat or have no possibility of appreciation, would be outside the securities laws.[23]

After Chairman Clayton's resignation at the end of 2020, Gary Gensler was sworn into office on April 17, 2021.[24] While crypto enthusiasts were briefly hopeful that Chairman Gensler would be more favorable to crypto than his predecessor,[25] these hopes did not come to fruition. On August 3, 2021, Gensler explicitly announced his agreement with Clayton, stating that he believes the vast majority of cryptoasset sales and initial coin offerings violate U.S. securities laws.[26]

A. Investment Contracts and the *Howey* Case

The federal securities laws were drafted in the 1930s and not written with anything like cryptoassets in mind. Thus, the only option for the SEC to assert jurisdiction under federal law has been to treat cryptoassets as falling within one of the catch-all categories listed in the federal statutes.[27] Prior to recent crypto lending programs, the Commission's choice was to treat sales of cryptoassets as "investment

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[23] *See, e.g.*, No-Action Letter from SEC, to TurnKey Jet, Inc. (Apr. 3, 2019), https://www.sec.gov/divisions/corpfin/cf-noaction/2019/turnkey-jet-040219-2a1.htm [https://perma.cc/WS8B-8GVZ] (the tokens in question had a fixed price and were non-transferable, being redeemable only at a discount); No-Action Letter from SEC, to Pocketful of Quarters, Inc., (July 25, 2019), https://www.sec.gov/corpfin/pocketful-quarters-inc-072519-2a1 [https://perma.cc/EM5U-EADA] (tokens would be locked up in online gaming platforms).

[24] *Biography Chair Gary Gensler*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/biography/gary-gensler[https://perma.cc/K2E6-VQ6T](last visited Oct. 14, 2022).

[25] *See, e.g.*, Shanny Basar, *Crypto Industry Eyes Gensler at the SEC*, MARKETSMEDIAGROUP (Jan. 19, 2021), https://www.tradersmagazine.com/departments/brokerage/crypto-industry-eyes-gary-gensler-at-sec/ [https://perma.cc/XD2J-NHYQ] (including a tweet from "Machina Trader" commenting hopefully that the appointment of "crypto-savvy Gary Gensler" would be a "move that could be advantageous for the industry . . . .").

[26] Nikhilesh De, *SEC Chairman Gensler Agrees With Predecessor: 'Every ICO Is a Security*,' COINDESK, https://www.coindesk.com/markets/2021/08/03/sec-chairman-gensler-agrees-with-predecessor-every-ico-is-a-security/[https://perma.cc/D5GC-FZDL] (last updated Sept. 14, 2021, 9:34 AM) ("In a speech at the Aspen Security Forum on Tuesday, Gensler said he agreed with Jay Clayton, his predecessor at the SEC, who once famously said that in his view, 'every ICO I've seen is a security.'").

[27] *See, e.g.*, Securities Act of 1933, ch. 38, 48 Stat. 74, § 2 (codified as amended at 15 U.S.C. § 77b); Securities Exchange Act of 1934, § 3 (codified as amended at 15 U.S.C. § 78c).

contracts," but these innovative interests do not fit easily into the framework for assessing whether particular arrangements should be included within this category.[28] This has necessitated multiple changes in the SEC's approach to the issue in a relatively short period.[29] Moreover, the SEC was (as of the end of November 2022) involved in

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[28] As will be discussed *infra* at notes 31-48 and accompanying text, the applicable test originated in 1946 in the U.S. Supreme Court decision in SEC v. W.J. Howey Co., 328 U.S. 293 (1946). Now simply known as the *Howey* test, the Court's analysis has spawned hundreds of cases and clarifications, resulting in a range of disagreements among the circuits even in the case of more conventional interests. *See generally*, Marc I. Steinberg & William E. Kaulbach, *The Supreme Court and the Definition of "Security": The "Context" Clause, "Investment Contract" Analysis, and Their Ramifications*, 40 VAND. L. REV. 489 (1987); Theresa A. Gabaldon, *A Sense of A Security: An Empirical Study*, 25 J. CORP. L. 307 (2000); Miriam R. Albert, *The Howey Test Turns 64: Are the Courts Grading This Test on A Curve?*, 2 WM. & MARY BUS. L. REV. 1 (2011); Framework for "Investment Contract" Analysis of Digital Assets, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets **[**https://perma.cc/VLM9-P625] (last visited Nov. 24, 2022).

[29] At first, it appeared that the SEC was going to insist that every cryptoasset was a security. In late 2017 and 2018, SEC Chairman Jay Clayton routinely shared his belief that ICOs involved the sale of securities. *See, e.g.*, Steven Lofchie, *SEC Chair Jay Cayton Urges Caution regarding ICOs and Cryptocurrencies*, CENTER FOR FINAINCIAL STABILITY (Dec. 14, 2017), https://centerforfinancialstability.org/wp/2017/12/14/sec-chair-jay-clayton-urges-caution-regarding-icos-and-cryptocurrencies/ [https://perma.cc/F6SP-DTDP]; Jason Gottlieb, *Insight: The SEC's Paragon Coin and AirFox Settlements: a Path Forward*, BLOOMBERG LAW (Nov. 30, 2018, 9:45 AM), https://news.bloomberglaw.com/securities-law/insight-the-secs-paragon-coin-and-airfox-settlements-a-path-forward [https://perma.cc/YG7M-MHVN]**.** On February 6, 2018, the Senate heard the Chairmen testify that "every ICO token the SEC has seen so far is considered a security" and explain "that if a crypto-asset issued by a company increases in value over time depending on the performance of the company, it is considered a security." Young, *supra* note 21, A few months later, SEC Director Bill Hinman and Chairman Clayton were quoted as hinting and then saying that Bitcoin and Ethereum are probably no longer securities. Andrew Ancheta, *SEC Says Bitcoin and Ethereum Are Not Sec urities*, CRYPTO BRIEFING (June 14, 2018), https://cryptobriefing.com/sec-says-bitcoin-and-ethereum-are-not-securities/ [https://perma.cc/N4BW-JHM3] (discussing comments from Director Bill Hinman); Nikhilesh De, *SEC Chair Clayton Affirms Agency's Stance Ether Is No Longer a Security*, COINDESK, http s://www.coindesk.com/markets/2019/03/12/sec-chair-clayton-affirms-agencys-stance-ether-is-no-longer-a-security/ (last updated Sept. 13, 2021, 4:58 AM) [https://perma.cc/MV3W-C8AQ]. Even more recently, the SEC released a public framework with a convoluted, 38-factor analysis to "help" explain when crypto will be an investment contract. *Framework*, *supra* note 19.

major litigation over this approach to crypto sales as securities transactions.[30]

The phrase "investment contract" is not defined in the statute but rather by case law. In 1946, the U.S. Supreme Court defined what constitutes an "investment contract" in *SEC v. W.J. Howey*.[31] The Court concluded that "an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . . ."[32]

Now simply called the *Howey* test, this approach has been clarified over time in various ways. Modern courts have essentially explained that the *Howey* test requires the following:

(i) an investment of money (or something else of value);[33]

(ii) in a common enterprise;[34]

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30 The SEC initiated enforcement proceedings against Ripple Labs on December 22, 2020, alleging that Ripple's XRP was a security. Complaint at 1, SEC v. Ripple, 2021 WL 3693418 (S.D.N.Y. 2020) (No. 20 Civ. 10832) [hereinafter Dec. Ripple Complaint]. Note that the complaint also names the original and current CEOs (Christian A. Larson and Bradley Garlinghouse, respectively) of Ripple as defendants. They are named both for their own sales of XRP and for aiding and abetting in Ripple's alleged violations. *Id.*

31 SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946).

32 *Id*. at 298.

33 While the *Howey* test originally spoke only of "money," subsequent opinions have made it clear that "cash is not the only form of contribution or investment that will create an investment contract. Instead, the 'investment' may take the form of 'goods and services' or 'some other exchange of value.'*" See, e.g.*, Uselton v. Com. Lovelace Motor Freight, Inc., 940 F.2d 564, 574 (10th Cir. 1991) (internal citations omitted).

34 *Howey*, 328 U.S. at 299. The requirement of a "common enterprise" is the element of the *Howey* test that appears to have received the most comment over the years, in part because there is a divergence among the federal circuits. Some courts appear to require "horizontal commonality," some accept "strict vertical commonality," while others accept "broad vertical commonality." *See* Maura K. Monaghan, Note, *An Uncommon State of Confusion: The Enterprise Element of Investment Contract Analysis*, 63 FORDHAM L. REV. 2135, 2152–63 (1995) (discussing the various judicial applications of the *Howey* "common enterprise" element). Horizontal commonality requires that investors' contributions be pooled together so their fortunes rise and fall together; strict vertical commonality requires the investor and promoter or investment manager to have interests that are tied together, and broad vertical commonality generally looks to whether the investor is depending heavily on the promoter in deciding whether to invest. *Id.; see also* Benjamin Akins, Jennifer L. Chapman & Jason Gordon, *The Case for the Regulation of Bitcoin Mining as a Security*, 19 VA. J.L. & TECH. 669, 688-90 (2015). Alternatively, while cases and academic commentators alike have relied

(iii) where the purchaser expects to receive profits;[35] and
(iv) the expectation of profits is from the essential entrepreneurial efforts of others.[36]

B. Applying *Howey* to Cryptoassets

The SEC's first formal report applying this test to cryptoassets was released in 2017,[37] when the Commission concluded that the *Howey* test justified treating tokens issued by The DAO as securities.[38] Because The DAO tokens were themselves unusual, having been specifically designed as an investment vehicle for other crypto projects, this report was not sufficient to prevent widespread confusion about when the federal securities laws would apply to cryptoassets.[39]

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on these elements for decades, officials at the SEC have taken issue with the "common enterprise" requirement, suggesting in recent documents that the SEC "does not . . . view a 'common enterprise' as a distinct element of the term 'investment contract.'" *Framework*, *supra* note 19 at n.10. Ironically, the text to which note 10 is appended and the note itself specifically recognize that courts do treat the *Howey* test as requiring a common enterprise as a distinct element.

35 *Howey*, 328 U.S. at 298. The "expectation of profits" element has also been addressed numerous times. The U.S. Supreme Court held in United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 852 (1975), that in order for this element to be met, "the primary motivation for investing must be to achieve a return on the value invested." Akins, Chapman & Gordon, *supra* note 34 at 691.

36 Although the Court in *Howey* said the expectation of profits needed to be based "solely" on the efforts of others, this rule has also been modified or clarified over time. *See* SEC v. Glenn W. Turner Enterprises, 474 F.2d 476, 482 (9th Cir. 1973), *cert. denied*, 414 U.S. 821 (1973) (No. 72-1489) (finding that the appropriate inquiry is "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise"). *See also* Hocking v. Dubois, 885 F.2d 1449, 1455 (9th Cir. 1989) (holding that the test should be whose efforts are "significant" and "essential").

37 SEC, '34 Act Release No. 81207, *REPORT OF INVESTIGATION PURSUANT TO SECTION 21(A) OF THE SECURITIES EXCHANGE ACT OF 1934: THE DAO* (2017).

38 For a more detailed consideration of how the SEC applied *Howey* to The DAO tokens, *see* Carol R. Goforth, *Cinderella's Slipper: A Better Approach to Regulating Cryptoassets As Securities*, 17 HASTINGS BUS. L.J. 271, 280-83 (2021); Michael Mendelson, *From Initial Coin Offerings to Security Tokens: A U.S. Federal Securities Law Analysis*, 22 STAN. TECH. L. REV. 52, 67-68 (2019); Ethan D. Trotz, *The Times They Are A Changin': Surveying How the Howey Test Applies to Various Cryptocurrencies*, 11 ELON L. REV. 201, 210-12 (2019).

39 Despite the SEC's position to the contrary, some authorities argued that cryptocurrencies do not generally fit *Howey* at all. *See* Florian Uffer, *Application of the Howey Test to Cryptocurrency*, JOLT BLOG (Mar. 11, 2019), https://jolt.richmond.edu/2019/03/11/application-of-the-howey-test-to-

The confusion is evidenced by the many attempts to label the cryptoassets as either a utility token or a security token.[40] Under this approach, only security tokens would be subject to the SEC's jurisdiction.[41] This position was widely articulated, including some very sophisticated analyses proposed in connection with particular financing strategies designed to comply with the federal securities law.[42]

In contrast to the position taken by those authorities, the SEC maintains that a cryptoasset's utility is not determinative of whether it is a security. As the SEC recently stated, "merely calling a token a 'utility' token or structuring it to provide some utility does not prevent the token from being a security."[43] Others have even suggested that the

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cryptocurrency/ [https://perma.cc/2KHE-B7V8]. *See* Boris Richard, *What The Howey Test Misses About Crypto Assets*, LAW360 (June 28, 2019, 2:03 PM), https://www.law360.com/articles/1173358/what-the-howey-test-misses-about-crypto-assets [https://perma.cc/F6Q6-55PS]. Others simply concluded that *Howey* was a test that does not fit well enough to be applied to crypto*;* RK Reddy, *Token Issue Considerations: Why Howey Test is Ineffective for Blockchain and Crypto Space?,* CRYPTOPAS (Jan. 7, 2019) (On file with UMASS L. REV.).

40 *See* Matt Hussey, *Security Token vs Utility Tokens, what is the Difference?* DECRYPT (Jan. 16, 2019), https://decrypt.co/resources/security-token-vs-utility-tokens [https://perma.cc/RG7R-F2MV] ("A utility token is typically a token that allows an owner to use a product or service. A security token is a type of token that's regulated by financial authorities, and as such, attractive to institutional investors."). *See also* Milko Trajcevski, *A Deep Dive Into Tokenization*, ALEXANDRIA, https://coinmarketcap.com/alexandria/article/a-deep-dive-into-tokenization [https://perma.cc/T92Q-V5AB] (last visited Nov. 29, 2022) (inaccurately asserting that "[u]tility tokens are also largely unregulated, unlike security tokens . . . utility tokens may be exempted from the federal laws governing securities . . . .").

41 *See, e.g.*, Toshendra Kumar Sharma, *Security Tokens vs. Utility Tokens: A Concise Guide*, BLOCKCHAIN COUNCIL (Sept. 8, 2022), https://www.blockchain-council.org/blockchain/security-tokens-vs-utility-tokens-a-concise-guide/ [https://perma.cc/T9Z2-S4QL] (concluding without any legal authority that a "security token . . . is highly regulated [and] [u]tility tokens are highly unregulated . . . .").

42 *See* JUAN BATIZ-BENET, JESSE CLAYBURGH, & MARCO SANTORI, THE SAFT PROJECT: TOWARD A COMPLIANT TOKEN SALE FRAMEWORK 6 (2017); *See also* Alon Harnoy, *What Are ICOs and How Do They Work?,* SMITH, GAMBRELL & RUSSELL, LLP, https://www.sgrlaw.com/what-are-icos-and-how-do-they-work/ [https://perma.cc/PN6E-GSVQ] ("Utility tokens are not designed to be a standard investment for a share of the company, and, if properly structured, this feature exempts utility tokens from federal laws governing securities.").

43 *Spotlight on Initial Coin Offerings (ICOs)*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/ICO [https://perma.cc/CJL4-WYJX] (last modified July 14, 2020).

posited dichotomy between utility tokens and securities tokens is nonsense.[44]

Recognizing the need for additional explanation, in 2019 the SEC released a "Framework" designed to explain the SEC's approach in more detail.[45] The Framework came from FinHub, a portal designed to specifically engage with companies using blockchain and other innovative financial technologies.[46] It took the relatively short *Howey* test and expanded it into more than three dozen different elements,[47] most of which focus on the question of whether purchasers would have a reasonable expectation of profits derived from the efforts of others.[48]

Not surprisingly, this approach did little to address the confusion over when to classify cryptoassets as securities.[49] Even one SEC Commissioner took issue with the Framework:

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[44] Aaron Kaplan, *SEC Subpoenas Show the SAFT Approach to Token Sales is a Bad Idea*, VENTUREBEAT (Mar. 3, 2018, 12:11 PM), https://venturebeat.com/commerce/sec-subpoenas-show-the-saft-approach-to-token-sales-is-a-bad-idea/ [https://perma.cc/G5RU-DDS3] (concluding that "virtually all ICO tokens are, and always have been, investment contracts, and thus securities. The proposition that utility tokens are not securities, as posited by the SAFT White Paper, is nonsense."). *Accord* Alon Y. Kapen, *Hand it Over: SAFT-Based ICOs Challenged by SEC Subpoenas*, NY VENTURE HUB (Mar. 22, 2018), https://www.nyventurehub.com/2018/03/22/sec-subpoenas-of-ico-issuers-and-implications-for-saft-based-icos/ [https://perma.cc/GNF2-HMA3] (commenting on the dozens of subpoenas reportedly issued by the SEC in February of that year).

[45] *Digital Asset Securities*, *supra* note 19. In a joint staff statement issued with the Office of General Counsel for FINRA, the SEC referred to covered cryptoassets as "digital asset securities." This Framework was accompanied by an explanatory statement from two SEC attorneys. U.S. SEC. & EXCH. COMM'N, Bill Hinman & Valerie Szczepanik, *Statement on "Framework for 'Investment Contract' Analysis of Digital Assets*" (Apr. 3, 2019), https://www.sec.gov/news/public-statement/statement-framework-investment-contract-analysis-digital-assets [https://perma.cc/7C75-PMJ4].

[46] Hub for Innovation and Financial Technology (FinHub), U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/finhub#:~:text=The%20Strategic%20Hub%20for%20Innovation,assets)%2C%20automated%20investment%20advice%2C[https://perma.cc/VHY7-QEKM] (last visited Nov. 25, 2022).

[47] For a more involved discussion of the *Howey* test, its four elements, and the application of the test to cryptoassets, *see* Goforth, *supra* note 38.

[48] *Framework*, *supra* note 19, at 2-11.

[49] In fact, the Framework itself appeared to add to the uncertainties in the crypto space, and as one law firm contended, it confused and conflated the appropriate analysis as to when cryptoassets are securities. *See, e.g., When it Comes to Analyzing Utility Tokens, the SEC Staff's "Framework for 'Investment Contract' Analysis of Digital Assets" May Be the Emperor Without Clothes (Or, Sometimes*

> While *Howey* has four factors to consider, the framework lists 38 separate considerations, many of which include several sub-points. A seasoned securities lawyer *might* be able to infer which of these considerations will likely be controlling and might therefore be able to provide the appropriate weight to each . . . . [N]on-lawyers and lawyers not steeped in securities law and its attendant lore will not know what to make of the guidance. Pages worth of factors, many of which seemingly apply to all decentralized networks, might contribute to the feeling that navigating the securities laws in this area is perilous business.[50]

Commissioner Peirce's conclusion was that the document could "raise more questions and concerns than it answers."[51]

Such confusion comes at a cost. The lack of clarity, combined with an aggressive regulatory stance from the SEC, has caused a number of crypto entrepreneurs to structure their dealings so as to exclude U.S.-based participants. For example, reports show that, during the first quarter of 2019, 86 ICOs were specifically structured to exclude U.S.-based investors, making the U.S. the single most likely country to be excluded from crypto offerings, followed by North Korea, Iran, and Syria.[52]

The truly concerning aspect of this situation is that this confusion extends to transactions involving typical cryptoassets, which have been around for more than a decade.[53] The rules are even harder to follow or

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an Orange Is Just an Orange) (Part I), WINSTON & STRAWN LLP (Oct. 28, 2019), https://www.winston.com/en/crypto-law-corner/when-it-comes-to-analyzing-utility-tokens-the-sec-staffs-framework-for-investment-contract-analysis-of-digital-assets-may-be-the-emperor-without-clothes-or-sometimes-an-orange-is-just-an-orange.html [https://perma.cc/7PPX-5S4F]. As the firm notes, this was "the first in a series of posts critical of the SEC's approach to analyzing so-called 'utility tokens' under the federal securities laws." *Id*.

50 Hester M. Peirce, Comm'r, U.S. SEC. & EXCH. COMM'N , How We Howey, Address at Securities Enforcement Forum (May 9, 2019) (transcript available at https://www.sec.gov/news/speech/peirce-how-we-howey-050919) [https://perma.cc/DN7C-FVMS]).

51 *Id.*

52 Lukas Hofer, *Why Token Issuers Exclude U.S. Investors*, ICO.LI (Apr. 26, 2019), https://ico.li/usinvestors/#:~:text=U.S.%20authorities%20classify%20most%20token,issuers%20exclude%20U.S.%2Dbased%20investors [https://perma.cc/69SD-VHPC].

53 Consider the outrage when the SEC announced its enforcement action against Ripple's XRP token. *See* Dec. Ripple Complaint, *supra* note 30. A senior contributor at Forbes called it a "bombshell lawsuit." Roslyn Layton, *The Crypto Uprising The SEC Didn't See Coming*, FORBES (Aug. 30, 2021, 11:24 AM), https://www.forbes.com/sites/roslynlayton/2021/08/30/the-crypto-

understand when more innovative crypto products, like those relating to crypto lending, are involved.[54]

II. THE PLANNED COINBASE LEND PROGRAM.

A. Conventional Interest-Bearing Deposit Accounts

Before focusing on how crypto lending programs function when offering participants interest on their crypto deposits, it is worthwhile to briefly consider how customers of conventional financial institutions earn interest on their deposits. This analysis is useful because, in several ways, crypto lending platforms function similarly to legacy financial institutions. Banks and other financial institutions, such as savings and loans, typically offer their customers a range of interest-bearing account options including checking accounts, savings accounts, and longer-term deposits.[55] Both the financial institutions and their products are regulated at the federal and state level, albeit not by the SEC. At the federal level, banks and other financial institutions are governed by the Federal Reserve, the Office of the Comptroller of the Currency, the

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uprising-the-sec-didnt-see-coming/?sh=17c2a06d143e [https://perma.cc/6PWS-64SN]. Attorney John Deaton responded publicly saying that he could not believe the action taken by the SEC.

> I was taken aback by it because it was a departure from previous litigation . . . But the way the complaint is written and alleged, it's alleging that the token itself — XRP — is inherently a security. And so after that, I just decided that we had to fight back because I do not believe the [SEC] was actually looking out for investors.

Lawyer for 11,000 XRP Holders Pushing to Fight SEC in Ripple Lawsuit, FORKAST.NEWS (Apr. 8, 2021), https://forkast.news/video-audio/xrp-fight-sec-ripple-lawsuit/ [https://perma.cc/5P84-5HQ7]. Deaton has filed a class action lawsuit against the SEC in which thousands of XRP holders have joined. Reports indicate that more than 70,000 owners of that particular asset have joined with Deaton. Monte Stewart, *Ripple Effect: Thousands of people enter the fray against SEC*, CAPITAL.COM (Aug. 8, 2022), https://capital.com/ripple-effect—thousands-enter-fray-against-sec. [https://perma.cc/7LR2-B4NV].

54 *See* Eric Lipton & Ephrat Livni, *Crypto's Rapid Move Into Banking Elicits Alarm in Washington*, N.Y. TIMES, https://www.nytimes.com/2021/09/05/us/politics/cryptocurrency-banking-regulation.html [https://perma.cc/39AG-N5NS] (last updated Nov. 1, 2021).

55 "There are different types of accounts that pay depositors interest. They include savings accounts, high-yield online savings accounts, money market accounts and Certificates of Deposit." *What is an Interest-Bearing Account?*, HERMONEY (Jan. 20, 2022), https://hermoney.com/save/banking/what-is-an-interest-bearing-account/ [https://perma.cc/E4Z2-VALY].

Federal Deposit Insurance Corporation, and the Office of Thrift Supervision; state banking departments are also involved in the regulation of financial institutions at the state level.[56] The Financial Crimes Enforcement Network (FinCEN) oversees compliance with the Bank Secrecy Act.[57]

Although the availability of interest-paying accounts may seem to be ubiquitous at most modern financial institutions in the U.S., such accounts were highly regulated at various points in the past. As part of the response to the Great Depression, the Banking Act of 1933 prohibited banks from paying interest on deposits payable on demand.[58] It wasn't until the 1970s that the CEO of a Massachusetts bank

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56 *Supervision and Regulation*, FEDERAL RESERVE EDUCATION, https://www.federalreserveeducation.org/about-the-fed/archive-structure-and-functions/archive-banking-supervision/ [https://perma.cc/M39E-LVV4].

57 *What We Do*, FINCEN, https://www.fincen.gov/what-we-do#:~:text=FinCEN's%20mission%20is%20to%20safeguard,strategic%20use%20of%20financial%20authorities [https://perma.cc/X7AH-LFTV] [hereinafter FINCEN].

58 Banking Act of 1933, Pub. L. No. 66-73, 48 Stat. 162 (1933) (current version within 12 U.S.C). The legislation is more commonly referred to as Glass-Steagall in honor of its two sponsors. A more detailed explanation of Glass Steagall can be found at the Federal Reserve History website. Julia Maues, *Banking Act of 1933 (Glass-Steagall)*, FEDERAL RESERVE HISTORY (June 16, 1933), https://www.federalreservehistory.org/essays/glass-steagall-act#:~:text=June%2016%2C%201933,Roosevelt%20in%20June%201933 [https://perma.cc/VQ55-UDFS] [hereinafter History, Banking Act] (explaining that Glass-Steagall adopted several banking reforms; for example, effectively precluding commercial banks from engaging in investment banking, and creating the Federal Deposit Insurance Corporation). Section 11 of Glass Steagall amended section 19(i) of the Federal Reserve Act to specify that "[n]o member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand." 12 U.S.C. § 371a (2011); Banking Act of 1933, Pub. L. No. 66-73, 48 Stat. 162, 181, 81. However, interest could be paid on savings accounts, although the permissible rates were subject to caps set by the same act (codified at 12 U.S. Code § 227 (11). The Financial Services Modernization Act of 1999 (also known as the Gramm-Leach-Bliley Act) repealed the provisions of the Banking Act of 1933 that restricted affiliations between banks and securities firms. Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338, 1341-52 (1999) (repealing 12 U.S. Code § 377). Under Gramm-Leach-Bliley, member banks were no longer precluded from dealing in securities. *See* Joe Mahon, *Financial Services Modernization Act of 1999, Commonly Called Gramm-Leach-Bliley*, FEDERAL RESERVE HISTORY (Nov. 12, 1999) (giving the background and explaining the primary focus of the Gramm-Leach-Bliley Act).

successfully pushed forward the effort to allow national banks to offer interest-paying checking accounts.[59]

These interest bearing accounts, now known as Negotiable Order of Withdrawal, or "NOW" accounts, became available across the country on December 31, 1980.[60] The original permissible interest rate was capped at 5 1/4 percent interest,[61] but that ceiling was lifted in 1986.[62] As part of the Dodd-Frank Wall Street Reform and the Consumer Protection Act of 2010, the interest rate cap was lifted on checking accounts, also known as demand deposit accounts, in 2011.[63]

B. Crypto Lending

This detailed regulatory history behind uncapped interest-bearing demand accounts at conventional financial institutions[64] is certainly different from the evolution and treatment of crypto lending products.[65] Regulation of crypto lending is currently spotty at best, both in terms of how the underlying platform or institution is regulated and how the

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59 For the history of how Ronald W. Haselton, president of Consumers Savings Bank of Worcester, Massachusetts, created the first such account in Massachusetts in 1972, and how such accounts spread first to New Hampshire and eventually across the country, *see* Nancy L. Ross, *Northwest Experience Precedes 1981 NOWs*, WASH. POST, Dec. 23, 1980, at D9.

60 *Id.* at D7.

61 *Id.*

62 *Now Account*, BANKRATE, https://www.bankrate.com/glossary/n/now-account/ [https://perma.cc/JF7C-P4B5].

63 Prohibition Against Payment of Interest on Demand Deposits, 76 Fed. Reg. 20892, 20892 (proposed Apr. 14, 2011) (to be codified at 12 C.F.R. pts. 329 and 330).

64 The topic of banking regulation in the U.S. is incredibly complicated and far outside the scope of this Article. For a general introduction to federal regulation of banks, *see* Jacob H. Gutwillig, *Glass Versus Steagall: The Fight over Federalism and American Banking*, 100 VA. L. REV. 771 (2014); Lev Menand, *Too Big to Supervise: The Rise of Financial Conglomerates and the Decline of Discretionary Oversight in Banking*, 103 CORNELL L. REV. 1527 (2018); Edward L. Symons, Jr., *The United States Banking System*, 19 BROOK. J. INT'L L. 1, 1 (1993); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

65 For example, SEC Chairman Gensler has complained that crypto lending is so under-regulated that it is still like the "wild west." *Regulators Face 'Wild West' as Crypto Traders Compete with Traditional Banks*, NEWS24 (Sept. 17, 2021), https://www.news24.com/fin24/companies/regulators-face-wild-west-as-crypto-traders-compete-with-traditional-banks-20210917 [https://perma.cc/JYE7-CEW5].

product itself is treated. In fact, the range of crypto lending opportunities has been expanding rapidly,[66] often before regulators have had a chance to weigh in on how such products or platforms should be regarded. However, many of the regulations that once applied to interest-bearing accounts at conventional banks have been abandoned.

In addition, since 2013, FinCEN has actively regulated any crypto platform that acts as a money transmitter, including centralized exchanges.[67] These businesses are subject to regulations emanating from state law as well. Each state's money services business rules, which generally focus on concerns like safety and soundness, can also

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66 Lendingblock was an early leading crypto lending project. Its founders explained their motivation for developing crypto lending as being based on the "premise that the market of cryptocurrencies and digital assets would follow a similar evolution in the credit markets, but with a faster rate of adoption due to the rapid speed of market development." Alison Coleman, *Meet The Entrepreneurs Behind The World's First Crypto Asset Lending Platform*, FORBES (Feb. 15, 2018, 7:49 AM), https://www.forbes.com/sites/alisoncoleman/2018/02/15/meet-the-entrepreneurs-behind-the-worlds-first-crypto-asset-lending-platform/?sh=2f1a3a874ef2[https://perma.cc/VGS6-CM72]; Lendingblock's platform launched in 2018. *See Our Vision*, LENDINGBLOCK, https://www.lendingblock.com/company [https://perma.cc/6NWG-BL6K].

67 DEP'T TREASURY FIN. CRIMES ENF'T NETWORK, APPLICATION OF FINCEN'S REGULATIONS TO PERSONS ADMINISTERING, EXCHANGING, OR USING VIRTUAL CURRENCIES (2013), https://www.fincen.gov/sites/default/files/guidance/FIN-2013-G001.pdf [hereinafter 2013 Guidance]. This was confirmed in a more recent update from FinCEN in 2019. DEP'T TREASURY FIN. CRIMES ENF'T NETWORK, APPLICATION OF FINCEN'S REGULATIONS TO CERTAIN BUSINESS MODELS INVOLVING CONVERTIBLE VIRTUAL CURRENCIES (2019), https://www.fincen.gov/sites/default/files/20195/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf [hereinafter 2019 Guidance]. Note that the 2019 Guidance from FinCEN "reminds that *all centralized exchanges engage in money transmission* . . . " Terence M. Grugan, *New FinCEN Cryptocurrency Guidance Provides Comprehensive Overview of BSA Application to Crypto Businesses*, BALLARD SPAHR LLP (May 30, 2019), https://www.moneylaunderingnews.com/2019/05/new-fincen-cryptocurrency-guidance-provides-comprehensive-overview-of-bsa-application-to-crypto-businesses/ [https://perma.cc/8YE8-Z2VX] (emphasis in original). So long as the platform facilitates the transfer of cryptoassets that are convertible into fiat from one person to another, the parties are deemed to be engaged in money transmission, triggering application of Bank Secrecy Act requirements relative to anti-money laundering and knowing your customers. *Id*. These requirements are extensive, requiring registration with FinCEN and substantial record-keeping and reporting obligations as well as the adoption and supervision of various policies. *See* 2019 Guidance, *supra* note 67.

apply.[68] Thus, it is worth keeping in mind that these businesses are not completely unregulated.

C. Plans for Coinbase Lend

In June 2021, Coinbase announced a plan—that it eventually abandoned—to allow crypto owners the option of earning interest by depositing a particular cryptoasset with the exchange.[69] This planned program, tentatively called Coinbase Lend, would have allowed Coinbase customers to earn interest on deposits of USD Coin (USDC),[70] at predetermined rates (originally set at 4%) that would have been significantly higher than rates available on interest-bearing deposit accounts at legacy financial institutions.[71] Coinbase would have

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68 *Money Transmitter Licensing for U.S. Crypto Companies*, KELMAN L. (July 13, 2020), https://kelman.law/insights/money-transmitter-licensing-for-u-s-crypto-companies/ [https://perma.cc/YZL2-VCLH] ("After complying with all the federal level MSB procedures, FinCEN now requires your cryptocurrency MSB to obtain a license in every state you intend to do business in."). This source further explains that states have wildly differing approaches to crypto, some being friendly to the new asset class and others imposing stricter regulations than other types of money services businesses. *Id.*

69 The Coinbase Blog announced the planned Coinbase Lend program on June 29, 2021, suggesting that customers could pre-enroll to earn interest "with rates more than 50x the national average of a traditional savings account." The webpage where Coinbase made this announcement now redirects viewers to the company's homepage, but the original blog post has been archived and is accessible. *Update as of 5pm ET, Friday, September 17th: We are Not Launching the USDC APY Program Announced Below*, COINBASE BLOG, [https://archive.ph/Ef5EW] (last visited Oct. 21, 2021) [hereinafter Coinbase Announcement]. This investment information is also available at *Earn 4% APY on USDC*, WAYBACK, https://web.archive.org/web/20210909081423/https://www.coinbase.com/lend(last visited Oct. 21, 2022) [hereinafter Coinbase, WAYBACK].

70 Coinbase, WAYBACK, *supra* note 69. In essence, the plan was that Coinbase customers could lend assets to the platform, which would then pay those customers interest for the amounts that were on deposit and which were pledged to the lend program. *See id.* Coinbase promised to guarantee that it would repay those amounts on demand. *Id.*

71 "Coinbase planned to launch the Lend product with the functionality for users to stake the stablecoin USDC and earn (*as a starting rate*) 4% APY." Lucas Matney, *Following SEC Lawsuit Threat, Coinbase Cancels Launch of 'Lend' Product*, TECHCRUNCH (Sept. 20, 2021, 1:25 PM), https://techcrunch.com/2021/09/20/following-sec-lawsuit-threat-coinbase-cancels-launch-of-lend-product/ [https://perma.cc/RW85-ZAG2] (emphasis in original). Coinbase specifically told its customers that this was approximately "eight times the national average for high-yield savings accounts . . . " Peter Feltman, *SEC Seen Having Clear Case*

guaranteed the USDC designated as participating in the program, but the deposits would not have been federally insured.[72]

Coinbase claimed that the obligation it was planning to accept when it issued its proposed Lend product was the obligation to repay a loan from its customers. In the opinion of Coinbase's chief legal officer, this should have meant that the customers were lending assets to the exchange rather than investing in it:[73]

> Customers won't be "investing" in the program, but rather lending the USDC they hold on Coinbase's platform in connection with their existing relationship. And although Lend customers will earn interest from their participation in the program, we have an obligation to pay this interest regardless of Coinbase's broader business activities. What's more, participating customers' principal is secure and we're obligated to repay their USDC on request.[74]

D. The SEC Reaction

Despite early positive reactions from customers,[75] Coinbase publicly announced on September 7, 2020, that it had received a Wells Notice[76] from the SEC stating the Commission's intention to initiate an

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Against Coinbase's Lending Program, ROLL CALL (Sept. 28, 2021, 6:00 AM), https://rollcall.com/2021/09/28/sec-seen-having-clear-case-against-coinbases-lending-program/ [https://perma.cc/K6KK-3XBY].

72 Coinbase, WAYBACK, *supra* note 69. Customers who participated in the program would have had a contractual right to a repayment of the assets that were lent upon demand. Despite explicit comparisons to conventional savings accounts, the site specifically warned that "[l]end is not a high-yield USD savings account, and Coinbase is not a bank. Your loaned crypto is not protected by FDIC or SIPC insurance." *Id.*

73 Paul Grewal, *The SEC Has Told Us it Wants to Sue Us Over Lend. We Don't Know Why.*, COINBASE (Sept. 7, 2021), https://www.coinbase.com/blog/the-sec-has-told-us-it-wants-to-sue-us-over-lend-we-have-no-idea-why [https://perma.cc/SKP5-2M27].

74 This analysis also appears as part of Paul Grewal's blog post. *Id.*

75 Coinbase had reported that "hundreds of thousands of customers across the U.S. had signed up for the Lend waitlist . . . ." Parker Doyle, *Coinbase to Publish Regulatory Framework for U.S. Policy Makers*, VETTAFI, (Sept. 24, 2021), https://www.etftrends.com/crypto-channel/coinbase-to-publish-regulatory-framework-for-u-s-policy-makers/ [https://perma.cc/65SB-DG7H].

76 A Wells Notice is "a notification from a regulator that it intends to recommend that enforcement proceedings be commenced against the prospective respondent. The notice references, in broad-strokes, the violation that the Staff believes has occurred." Mark Astarita, *The Wells Notice SEC/FINRA Investigati ons*, SEC LAW.COM, https://www.seclaw.com/wells-notice-sec-finra-investigations/ [https://perma.cc/M86N-5HY4] (last visited Nov. 29, 2022).

enforcement action against the planned Coinbase Lend program.[77] According to the report, the drafting of which was credited to Coinbase's chief legal officer Paul Grewal, the SEC was less than forthcoming about why it had preliminarily concluded that the planned Coinbase Lend product would be a security.[78]

While the Wells Notice itself was not made public, Coinbase reported that the SEC had referred to two different Supreme Court decisions to support its determination that the planned lending products would be securities: *SEC v. W.J. Howey Co*.[79] and *Reves v. Ernst & Young*.[80] According to Grewal, the SEC declined to provide details of how *Howey* or *Reves* would apply to the planned lend product.[81] Unfortunately, as a result of the Wells Notice, Coinbase abandoned its plans to launch the Lend program, eliminating the possibility of further explanation from the SEC or the courts.[82]

Notwithstanding Coinbase's decision to abandon its plans, crypto lending programs have been proliferating rapidly,[83] leading some

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77 Grewal, *supra* note 73.

78 *Id.*

79 SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

80 Reves v. Ernst & Young, 494 U.S. 56 (1990).

81 Grewal, *supra* note 73.

82 Following notice from the SEC that the Commission believed the plan would violate the federal securities laws, the Coinbase Lend product was abandoned without ever being brought to market. Ben Bain & Bloomberg, *Coinbase Scraps Plans to Launch Crypto Lending \Program After SEC Pressure*, FORTUNE (Sept. 20, 2021, 2:00 PM), https://fortune.com/2021/09/20/coinbase-crypto-lending-program-sec-trading/ [https://perma.cc/67KM-HJ7S]; Sohini Podder, *Coinbase Scraps Plans for Crypto Lending Program*, REUTERS (Sept. 20, 2021, 4:22 PM), https://www.reuters.com/business/finance/coinbase-scraps-plans-crypto-lending-program-2021-09-20/ [https://perma.cc/L2CH-UFFR]. Crypto-focused news sources reported the abandonment as well. *See, e.g.*, Nate DiCamillo, *Coinbase Drops Planned 'Lend' Program After SEC Warning*, COINDESK https://www.coindesk.com/markets/2021/09/20/coinbase-drops-planned-lend-program-after-sec-warning/ [https://perma.cc/Y36Q-NDYF] (last updated Sept. 20, 2021, 5:21 PM); Turner Wright, *Following SEC notice, Coinbase abandons plan for crypto lending program*, COINTELEGRAPH (Sept. 20, 2021, 12:01 PM), https://cointelegraph.com/news/following-sec-notice-coinbase-abandons-plan-for-crypto-lending-program [https://perma.cc/AHR4-PXM5].

83 Leeor Shimron, *Exploding Past $10 Billion, Interest Income And Lending Are Bitcoin's First Killer Apps*, FORBES (May 26, 2020, 9:50 AM), https://www.forbes.com/sites/leeorshimron/2020/05/26/exploding-past-10b-interest-income-and-lending-are-bitcoins-first-killer-ps/?sh=12bcd8de3320 [https://perma.cc/Y5PM-U6J3].

observers to call for greater protection for participants through additional regulation.[84] One of the experts explicitly calling for a sterner regulatory approach is SEC Chairman Gary Gensler.[85] Given the Chairman's posture, the Commission's negative reaction to the Coinbase Lend proposal might have been predictable, but it continues to frustrate crypto entrepreneurs who are left with open questions about precisely when or how the securities laws will be applied to crypto-based products. They do not even have clear guidance on the most basic issue - ascertaining which test to apply to evaluate the program.

E. Comparing Coinbase Lend with BitConnect

Some observers might believe that Coinbase should have anticipated the SEC's reaction to its planned lending program based on prior enforcement actions. However, although crypto lending programs have been around for a few years, it was not until 2021 that the SEC first explicitly staked its claim to jurisdiction over these programs with a public enforcement action. On May 28, 2021, the SEC announced an action against the five promoters behind BitConnect for their role in marketing and selling "securities" in BitConnect's lending program.[86]

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[84] *See* Lipton & Livni, *supra* note 54. ("[T]o state and federal regulators and some members of Congress, the entry of crypto into banking is cause for alarm. The technology is disrupting the world of financial services so quickly and unpredictably that regulators are far behind, potentially leaving consumers and financial markets vulnerable.").

[85] *See* Kollen Post, *Custodial Crypto Lending and Staking Products 'take on all the indicia' of Securities, Gensler Tells The Block*, THE BLOCK (Sept. 14, 2021, 4:27 PM), https://www.theblock.co/post/117675/crypto-lending-staking-custody-gensler-sec [https://perma.cc/TYD9-UHRT].

[86] "'We allege that these defendants unlawfully sold unregistered digital asset securities by actively promoting the BitConnect lending program to retail investors,' said Lara Shalov Mehraban, Associate Regional Director of SEC's New York Regional Office." Press Release, U.S. SEC. & EXCH. COMM'N, SEC Charges U.S. Promoters of $2 Billion Global Crypto Lending Securities Offerin g (May 28, 2021), https://www.sec.gov/news/press-release/2021-90 [https://perma.cc/7YF9-Q8XE]. The complaint, filed in the Southern District of New York, named Trevon Brown, Craig Grant, Joshua Jeppesen, Ryan Maasen, Michael Noble, and Laura Mascola as defendants. Complaint, SEC v. Brown, (S.D.N.Y. 2021) (No. 21 Civ. 4791) [hereinafter Brown Complaint]. The failure to name BitConnect itself was not seen as surprising, given that the platform ceased operating in 2018 when the value of Bitcoin crashed following the dramatic rise in prices during late 2017. *See* Adam Zamecnik, *How BitConnect Became Cryptocurrency's Biggest Cautionary Tale*, VICE (May 4, 2021), https://www.vice.com/en/article/dyv8wk/what-happened-to-bitconnect-cryptocurrency [https://perma.cc/SH87-8D9Y].

This action essentially posited that under the *Howey* investment contract test, BitConnect's lending program involved unregistered securities.[87]

On September 1, 2021, the SEC brought a second action against BitConnect.[88] This action was predicated on fraud, with the issuer allegedly inducing participants to deposit funds by falsely claiming, "among other things, that BitConnect would deploy its purportedly proprietary 'volatility software trading bot' that, using investors' deposits, would generate exorbitantly high returns."[89] While settlements have been reached with a number of the promoters, and BitConnect itself has been shuttered since 2018, some of these proceedings were still on-going as of November 2022.[90]

It is worth noting that the promised BitConnect lending program was significantly different from the Coinbase Lend program as it was originally planned; it even differed from BlockFi's BIAs since BitConnect customers were apparently told that they would be paid "the resulting profits, which BitConnect promised could be as high as approximately 40% per month."[91] This, combined with promised referral fees for bringing in additional customers,[92] clearly

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87 The complaint in this action specifically referenced the *Howey* test as the legal framework for its action. Brown Complaint, *supra* note 86, at 6-7.

88 Press Release, U.S. SEC. & EXCH. COMM'N, SEC Charges Global Crypto Lending Platform and Top Executives in $2 Billion Fraud (Sept. 1, 2021)(https://www.sec.gov/news/press-release/2021-172 [https://perma.cc/W4LC-YF5M]) [hereinafter Press Release, U.S. SEC. & EXCH. COMM'N]. This time, the SEC did name BitConnect (described as an unincorporated organization), as well as its founder and another promoter (Glenn Arcaro), and a limited liability company in which Arcaro is the sole owner and director (Future Money Ltd.); Complaint, SEC v. BitConnect, (S.D.N.Y.) (No. 21 Civ. 7349) [hereinafter BitConnect Complaint]. This complaint also maintains that BitConnect's lending program involved the sale of securities but focused on fraud in connection with those sales, as well as the failure to register the securities. *Id.* at 2.

89 Press Release, U.S. SEC. & EXCH. COMM'N, *supra* note 88.

90 Andrew Hayward, *BitConnect Promoters Pay $12M in Cash, Bitcoin to Settle $2B Alleged Scam*, DECRYPT (Aug. 20, 2021)**,** https://decrypt.co/79066/bitconnect-promoters-pay-12m-bitcoin-cash-settle-sec[https://perma.cc/P9ZM-J3K8]; *SEC Obtains Judgments Against Bitconnect's Lead National Promoter and His Company for Antifraud and Registration Violations*, U.S. SEC. & EXCH. COMM'N (Dec. 9, 2021), https://www.sec.gov/litigation/litreleases/2021/lr25286.htm [https://perma.cc/H4ET-V6G7].

91 Brown Complaint, *supra* note 86, at 2.

92 *Id.*

distinguishes the BitConnect program from most crypto lending programs.[93] Thus, it is not surprising that other lending programs did not regard this action as a clear pronouncement from the SEC that it intended to treat all crypto lending programs as involving the issuance of securities.

In fact, even after receiving the Wells Notice from the SEC, Coinbase expressed confusion over the SEC's interpretation of the law,[94] specifically regarding which test to use when determining whether the program involved the issuance of securities. Notwithstanding this lack of certainty and their disagreement with the SEC's conclusions, Coinbase canceled its planned Lend product.[95] Coinbase announced that it had "made the difficult decision not to launch the USDC APY program . . . . [W]e have also discontinued the waitlist for this program as we turn our work to what comes next."[96]

The SEC soon turned its attention to another crypto lending program, this time one that had already been the target of a number of state securities actions.

III. BLOCKFI INTEREST ACCOUNTS (BIAS) AND THE SEC'S REACTION.

A. BlockFi's BIA Program

BlockFi Lending LLC[97] is a wholly owned subsidiary of BlockFi Inc., and these entities, both of which were organized under Delaware law, are part of a larger group of related entities doing business as BlockFi (jointly referred to as BlockFi in this Article).[98] Beginning in

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93 Certainly, Coinbase Lend and BlockFi BIAs were designed differently, with both platforms paying interest rather than a share of profits to the program participants. For a more detailed discussion of these programs, *see supra* Part II.C. (as to Coinbase Lend) and *infra* Part III.A. (as to BlockFi BIAs).

94 Grewal, *supra* note 73.

95 Matney, *supra* note 71.

96 Coinbase Announcement, *supra* note 69.

97 Blockfi Lending LLC is located in New York, NY, United States, and is part of the Activities Related to Credit Intermediation Industry. *See BlockFi Lending LLC*, BIZAPEDIA, https://www.bizapedia.com/md/blockfi-lending-llc.html [https://perma.cc/8S9T-6P76] (last visited Oct. 7, 2022); *BlockFi Lending LLC*, DUN & BRADSTREET DIRECTORY, https://www.dnb.com/business-directory/companyprofiles.blockfi_lending_llc.359163164d80f5e0d2c2856de48e5746.html [https://perma.cc/5DWJ-ADSP] (last visited Oct. 21, 2022).

98 *SEC Enforcement Action Against BlockFi Lending LLC Provides Clarity Regarding Digital Asset Lending but Leaves Questions Unanswered*, DECHERT

March 2019, BlockFi began offering BlockFi Interest Accounts (BIAs) to customers worldwide.[99] According to the blog post that announced the availability of BIAs, customers of the lending product would be able to earn "an industry-leading 6.2% [annual percentage yield]," compounded monthly.[100] Interest rates were adjustable by BlockFi, based in part on "the yield that [BlockFi] can generate from lending" the crypto on deposit with it to institutional borrowers.[101] BlockFi regularly classified its customers as "investors"[102] who could earn

LLP (Mar. 29, 2022), https://www.dechert.com/knowledge/onpoint/2022/3/sec-enforcement-action-against-blockfi-lending-llc-provides-clar.html [https://perma.cc/AVD2NYW4]; *BlockFi Inc*, BL, https://www.bloomberg.com/profile/company/1577411D:US [https://perma.cc/R5RY-44N4] (last visited Oct. 7, 2022) ("BlockFi Inc. specializes in consumer financing services . . . . BlockFi provides risk management, financial technology, and digital financing solutions.").

99 *BlockFi Interest Account Now Live, Offering 6.2% Interest to Cryptocurrency Holders*, BLOCKFI, (Mar. 4, 2019), https://blockfi.com/blockfi-interest-account-now-live[https://perma.cc/N7MJ-3U4F].

100 *Id.*

101 *Our BTC and ETH Rates Are Changing and Here's Why*, BLOCKFI, (Mar. 23, 2021), https://blockfi.com/our-btc-and-eth-rates-are-changing-and-heres-why[https://perma.cc/S2EG-PC2S] ("As a general rule, the interest we pay to our clients is based on the yield that we can generate from lending, which directly correlates to market demand in the space."). BlockFi also explained its interest as being "based on the yield we're able to generate." *How do the Crypto Interest Tiers work?*, BLOCKFI, https://help.blockfi.com/hc/enus/articles/360056135851-How-do-the-Interest-Tiers-work[https://perma.cc/Y23J-CYNG](last updated Sept. 26, 2022).

102 A picture of the BlockFi webpage as of 2019 appears in a New Jersey Bureau of Securities Summary Cease and Desist Order. N.J. Bureau of Sec. Summary Cease and Desist order, In re BlockFi (2021) [hereinafter BlockFi N.J. Order]. That image shows BlockFi specifically suggesting that "BlockFi's Interest Account works hardest for you as a long-term investment." *Id.* at 9. *See also BlockFi Integrates Gemini Dollar (GUSD), Offering Up to 6.2% APY*, BLOCKFI (May 29, 2019), https://blockfi.com/blockfi-integrates-gemini-dollar-gusd-offering-up-to-6-2-apy[https://perma.cc/9GNA-8SEX] (explaining that the availability of BIAs in Gemini Dollar stablecoins are "a great way for traditional investors to access the utility created by the crypto ecosystem without exposure to more volatile cryptocurrency markets. By leveraging the global nature of blockchain technology, BlockFi is offering services to retail investors worldwide that are typically only available to wealthy private banking clients."). This page was updated on Aug. 5, 2022, and after that time excluded U.S. residents from this particular opportunity.

significant amounts[103] with BIAs. BlockFi repeatedly emphasized the potential to profit from their program, describing it as "an easy way for crypto investors to earn bitcoin as they HODL" while touting BIAs as a way for investors to "bolster their returns."[104] On March 20, 2019, BlockFi announced that BIAs had garnered significant levels of attention and support since the program launch, including participation from large firms that were looking to increase their yield.[105]

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[103] Although its webpage has been thoroughly updated following a February 2022 settlement with the SEC, as described *infra* Part III.C., numerous third-party sources describe what used to be on BlockFi's webpage. "The BlockFi website opens with the claim that its platform can help cryptocurrency holders to 'earn more from your crypto.'" *BlockFi Review: Does BlockFi Work? Is It Legit or Too Risky?*, OBSERVER (Mar. 7, 2021, 12:00 PM), https://observer.com/2021/03/blockfi-review-does-blockfi-work-is-it-legit-or-torisky/ [https://perma.cc/2SLW-GAZ9] (explaining that based on their review of BlockFi descriptions, this source proclaimed that "BlockFi might make it possible for cryptocurrency holders to maximize their profits for holding the coins they believe in."). Similarly, another source describes the way that BlockFi promoted its interest accounts as follows: "The user is then paid consistently for their deposit, generating a consistent stream of revenue from their account. This account offers a level of security for more wise investors who are willing to place their crypto in a BlockFi account rather than holding it on their own without any guarantee of profit in the future." *BlockFi Review – Trustworthy Crypto Platform to Use?*, JUNEAU EMPIRE (Aug. 8, 2021, 1:04 PM), https://www.juneauempire.com/marketplace/blockfi-review-trustworthy-crypto-platform-to-use/ [https://perma.cc/Y8U5-33VG].

[104] *BlockFi Agrees to $100 Million Settlement with SEC and 32 States for Unregistered Crypto Loans*, SCHNEIDER WALLACE COTTRELL KONECKY LLP (Feb. 17, 2022), https://www.schneiderwallace.com/media/blockfi-agrees-to-100-million-settlement-with-sec-and-32-states-for-unregistered-crypto-loans/ [https://perma.cc/6TAC-SGGU]. HODL is slang popular in the crypto space, apparently originating with a typographical error in the word "hold" in the context of holding for the long term. It has also come to mean "Hold On for Dear Life," again emphasizing a long term investment strategy. Jake Frankenfield, *HODL: The Cryptocurrency Strategy of "Hold on for Deal Life" Explained*, INVESTOPEDIA, https://www.investopedia.com/terms/h/hodl.asp [https://perma.cc/AX3P-KB6C] (last visited Nov. 29, 2022).

[105] *Creating Products for the Everyday Crypto Investor*, BLOCKFI, https://blockfi.com/creating-products-for-the-everyday-crypto-investor [https://perma.cc/ET7X-ASQG] (last updated Aug., 8 2022).

B. The Regulatory Response to BlockFi's BIAs; New Jersey in Particular

The first regulatory response to BlockFi BIAs in the United States was not initiated by the SEC, but by state officials.[106] New Jersey ordered

BlockFi to stop offering interest-bearing accounts in that state effective July 22, 2021.[107] On July 30, 2021, less than two weeks later, the Division of Securities of the Kentucky Department of Financial Institutions issued a cease and desist order prohibiting BlockFi from continuing the BIA program in Kentucky.[108] Following the New Jersey

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[106] This was the initial public response. By September 2021, securities regulators in five different states had alleged or at least questioned whether BlockFi accounts were actually unregistered securities being offered and sold to residents of those states. The BlockFi website disclosed that there were enforcement proceedings in New Jersey, Texas, Alabama, Vermont, and Kentucky. *Disclosures and Complaints*, BLOCKFI.COM, https://blockfi.com/disclosures-and-complaints/ (archived on October 10, 2021, at [https://perma.cc/3S3T-VQT3]. The current page no longer includes those links. There are undoubtedly other ongoing investigations at the state level. For example, the Voyager Earn Program has been sent a cease-and-desist order from regulators in New Jersey, Alabama, Oklahoma, Texas, Kentucky, Vermont, and Washington. Baker & Hostetler LLP, *Digital Asset Platforms, Blockchain Supply Chain Initiative Grow; Enforcement Actions Target Crypto Yield Products and Fraud; DeFi Hacked for $600M*, THE BLOCKCHAIN MONITOR BLOG, *reprinted in* LEXOLOGY (Apr. 1, 20 22), https://www.lexology.com/library/detail.aspx?g=f1fe2a2f-2a0c-4b83-8002-4732503266b0 [https://perma.cc/U28T-PLSV]. Any such investigation or discussions are generally kept private, especially when a privately held company such as BlockFi is involved. In fact, as explained by the New Jersey Bureau of Securities, "Pursuant to the New Jersey Uniform Securities Law, information about an investigation is deemed private and not open to the public." N.J. Bureau of Sec., *Frequently Asked Questions for Investors*, N.J. DIV. OF CONSUMER AFFAIRS, https://www.njconsumeraffairs.gov/bos/Pages/FAQinvestor.aspx [https://perma.cc/83AM-CXWJ]. You can compare this more typical level of secrecy with the relatively unusual step that Coinbase took to publicly explain its receipt of a Wells notice from the SEC. *See supra* note 73-77 and accompanying text.

[107] Jonathan Stempel, *New Jersey Orders BlockFi Cryptocurrency Firm to Stop Offering Interest-Bearing Accounts*, REUTERS (July 20, 2021, 1:34 PM), https://www.reuters.com/legal/transactional/new-jersey-orders-blockfi-cryptocurrency-firm-stop-offering-interest-bearing-2021-07-20/ [https://perma.cc/M599-JE38].

[108] Commonwealth of KY Pub. Prot. Cabinet Div. of Sec. Cease and Desist Order, In the Matter of BlockFi, Inc. No. 2021-AH-0020 (2021). Press Release, Commonwealth of KY Pub. Prot. Cabinet Div. of Sec., Kentucky to Blockfi: 'Cease and Desist' (July 30, 2021)https://kfi.ky.gov/Documents/2021.07.30%20

Order, Alabama,[109] Texas,[110] and Vermont[111] also announced enforcement actions in the form of show cause orders and a notice of a hearing against BlockFi.[112]

The New Jersey Order included findings that are fairly representative of the positions taken in the other state actions as well.[113] The Order explained that BlockFi, Inc. is a financial services business that operated by trading, lending, and borrowing various cryptoassets.[114] According to the Order, BlockFi had investors purchase BIAs by depositing specific kinds of crypto into their BlockFi accounts in exchange for promises of interest payments.[115] The BIAs were not insured or otherwise protected by any federal agency, yet BlockFi raised $14.7 billion in value through issuing BIAs without any registration or exemption under New Jersey law, presumably because of their attractive rates.[116]

As detailed in the New Jersey Order, BlockFi reserved the right to change its interest rates, especially if the yields that it earned changed.[117] In addition, the Order specifically noted that BlockFi's website "advertises the BIAs as part of a long-term investment strategy for investors, claiming that a BIA 'provides clients with the ability to earn more crypto while holding for long-term investments. Interest is paid

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Kentucky%20to%20Blockfi%20Cease%20and%20Desist.pdf [https://perma.cc/VAN9-975E].

109 State of Ala. Sec. Comm'n Order to Show Cause, In the Matter of BlockFi, Inc., SC 2021-0006 (2021).

110 Tex. St. Sec. Bd. Notice of Hearing, In the Matter of. BlockFi, Inc., No. 312-21-2938 (2021).

111 State of Vt. Dept. of Fin. Reg. Show Cause Order, In the Matter of BlockFi, Inc., No. 21-025-S (2021).

112 At the time, BlockFi publicly stated that it disagreed with the claims that its lending products are securities, and on its website it claimed that it was engaged in discussions with regulators. *Five States Take Regulatory Action to Prevent BlockFi From Offering Unregistered Digital Asset Securities*, PRACTICAL LAW (Aug. 5, 2021), https://today.westlaw.com/Document/I3d408526f49311ebbea4f0dc9fb69570/View/FullText.html?contextData=(sc.Default)&transitionType=Default&firstPage=true&bhcp=1 [https://perma.cc/V6T2-J2UP]. The updated page deleted those statements.

113 BlockFi N.J. Order, *supra* note 102.

114 *Id*. at 1.

115 *Id.* at 2.

116 *Id.* (explaining that BIAs offered investors yields between 0.25% to 7.5% in contrast to typical nationwide savings account returns of approximately 0.06%).

117 *Id.* at 6-7.

monthly and compounds. This significantly increases the potential earnings of long-term account holders.'"[118] The Order also highlighted the fact that BlockFi's website had a chart that stated BIAs "works hardest for you as a long-term investment."[119] Because BlockFi had total control over the deposited cryptoassets, the Order concluded that purchasers were "passive investors."[120] This resulted in a cease-and-desist order under New Jersey law entered on July 19, 2021.[121]

The New Jersey action is noteworthy for multiple reasons. It was the first order issued against BlockFi's BIAs, and it triggered numerous other state actions. In addition, former New Jersey Attorney General, Gurbir Grewal, was appointed Director of the SEC Division of Enforcement just before the order was announced.[122] Commentators have speculated that Director Grewal was not only aware of, but actively involved in the investigation of BlockFi, making the SEC's recent activity in the crypto lending space even more predictable.[123]

C. Settlement with the SEC

As is true for state level investigations, a decision by the SEC to investigate a company for a potential securities violation is generally confidential. "SEC investigations are generally conducted on a confidential basis to maximize their effectiveness and protect the privacy of those involved. Because SEC investigations are generally nonpublic, Enforcement will not confirm or deny the existence of an investigation unless the SEC brings charges against a person or entity

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118 *Id.* at 8.

119 BlockFi N.J. Order, *supra* note 102, at 8.

120 *Id.* at 9.

121 *Id.* at 12.

122 The SEC announced Grewal's appointment on June 29, 2021, as Director of Enforcement, although it became effective a week after the BlockFi order was entered, on July 26, 2021. Press Release, U.S. SEC. & EXCH. COMM'N, SEC Appoints New Jersey Attorney General Gurbir S. Grewal as Director of Enforcement (June 29, 2021), https://www.sec.gov/news/press-release/2021-114 [https://perma.cc/Y6YR-QCC3].

123 *See, e.g.*, Kevin Tran, Richard B. Levin & Matthew G. Lindenbaum, *In Jersey, Anything's Legal As Long as You Don't Get Caught*, 11 THE NAT'L L. REV. 209 (July 28, 2021), https://www.natlawreview.com/article/jersey-anything-s-legal-long-you-don-t-get-caught [https://perma.cc/5UBR-BEJQ] ("Director Grewal was likely involved in the New Jersey investigation that ultimately led to the issuance of the Order and that the digital asset lending space is on his radar.").

involved."[124] After the SEC's investigation of BlockFi, the Commission announced its decision to institute a national cease-and-desist proceeding and simultaneously settled with BlockFi on February 14, 2022.[125]

The SEC Order includes basic background facts about the structure of the entities involved with the BIAs. According to the SEC, BlockFi Lending LLC was a financial services company that had begun U.S. operations on March 4, 2019.[126] The SEC characterized the BIAs as having been offered and sold to "investors," who deposited their cryptoassets with BlockFi with the expectation of receiving interest based on profits generated when BlockFi used those cryptoassets for investment purposes.[127] The SEC also noted that BlockFi held approximately $14.7 billion in BIA investor assets as of March 31, 2021, and had nearly 400,000 U.S. investors.[128]

The SEC cited both *Reves v. Ernst & Young* and *SEC v. W.J. Howey Co.* in support of its action.[129] The agency concluded that the BIAs were both "notes," as that term is used in the securities laws and that they had been sold as investment contracts.[130] This conclusion was reached despite the U.S. Supreme Court's admonition that a security should be evaluated under the appropriate test, not always as an investment contract.[131]

Another aspect of BlockFi's business was also attacked by the SEC.[132] While BlockFi had originally contemplated limiting its activity to lending out the cryptoassets that were deposited with it by BIA

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124 *Investor Bulletin: SEC Investigations*, U.S. SEC. & EXCH. COMM'N (Oct. 22, 2014), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_investigations.html [https://perma.cc/KN2L-FSVJ].

125 SEC BlockFi Order, *supra* note 15.

126 *Id.* at 2.

127 *Id.*

128 *Id.*

129 SEC BlockFi Order, *supra* note 15, at 2.

130 *Id.*

131 Reves v. Ernst & Young, 494 U.S. 56, 64 (1990) (The Court complains that using the investment contract test to determine if other interests are securities "would make the Acts' enumeration of many types of instruments superfluous, and would be inconsistent with Congress' intent . . . ." (internal quotation marks omitted)).

132 The SEC also claimed that BlockFi had made material misrepresentations in connection with its offer and sale of BIAs, but those contentions also depended on the underlying accounts being classified as securities. SEC BlockFi Order, *supra* note 15, at 2.

investors, at some point, it also began using the proceeds from those assets to invest in other securities. As explained by the SEC, "[a]s BlockFi took ownership of the loaned crypto assets from investors in the BIAs, BlockFi used the commingled assets to, among other things, make loans to institutional and retail borrowers, stake crypto assets, and purchase crypto asset trust shares and interests in private funds."[133] In fact, the SEC determined that from at least December 2019 to September 2021, BlockFi owned investment securities that exceeded 40% of the value of its total assets, making BlockFi an "investment company" under section 3(a)(1)(C) of the Investment Company Act of 1940.[134] Because BlockFi did not register with the SEC as such, it was deemed to be in violation of the Investment Company Act.[135] That determination, however, is largely independent of its involvement in offering and selling the BIAs and any determination of whether the BIAs themselves were securities.

In considering whether the BIAs were securities, the SEC relied in part on the four-part test used by the *Reves* Court to assess whether the BIAs were notes that should be regulated as securities.[136]

> First, BlockFi offered and sold BIAs to obtain crypto assets for the general use of its business, namely to run its lending and investment activities to pay interest to BIA investors, and purchasers bought BIAs to receive interest ranging from 0.1% to 9.5% on the loaned crypto assets. Second, BIAs were offered and sold to a broad segment of the general public. Third, BlockFi promoted BIAs as an investment, specifically as a way to earn a consistent return on crypto assets and for investors to "build their wealth." Fourth, no alternative regulatory scheme or other risk reducing factors exist with respect to BIAs.[137]

The Commission similarly recited the following findings in analyzing whether the BIAs had been sold via investment contracts as defined by the *Howey* test:

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133 *Id.* at 6-7.

134 *Id*. at 7. The Investment Company Act of 1940, Pub. L. No. 117-177 (codified as amended in scattered sections within 15 U.S.C.).

135 SEC BlockFi Order, *supra* note 15, at 10.

136 In *Reves v. Ernst & Young*, 494 U.S. 56 (1990), the Supreme Court applied what is known as the "family resemblance test," which sets out a test to help determine whether a particular note bears a family resemblance to notes that are not regulated as securities. This test is described in more detail *infra* at Part IV.A. of this Article.

137 SEC BlockFi Order, *supra* note 15, at 8.

> BlockFi sold BIAs in exchange for the investment of money in the form of crypto assets. BlockFi pooled the BIA investors' crypto assets, and used those assets for lending and investment activity that would generate returns for both BlockFi and BIA investors. The returns earned by each BIA investor were a function of the pooling of the loaned crypto assets, and the ways in which BlockFi deployed those loaned assets. In this way, each investor's fortune was tied to the fortunes of the other investors. In addition, because BlockFi earned revenue for itself through its deployment of the loaned assets, the BIA investors' fortunes were also linked to those of the promoter, i.e., BlockFi. Through its public statements, BlockFi created a reasonable expectation that BIA investors would earn profits derived from BlockFi's efforts to manage the loaned crypto assets profitably enough to pay the stated interest rates to the investors. BlockFi had complete ownership and control over the borrowed crypto assets, and determined how much to hold, lend, and invest.[138]

As a result of these determinations, along with findings that BlockFi had made material misrepresentations and had failed to register as an investment company, the SEC imposed a civil monetary penalty in the amount of $50 million, to be paid in installments over a period of 730 days.[139] BlockFi also agreed to cease its unregistered offers and sales immediately and to bring its business into compliance with federal law within 60 days.[140] In the press release that accompanied the Order and settlement, the SEC also noted that BlockFi was simultaneously settling parallel actions brought by 32 states and paying an additional $50 million in fines, bringing the total settlement to $100 million.[141]

IV. ARE CRYPTO LENDING PRODUCTS NOTES OR INVESTMENT CONTRACTS?

One of the most difficult issues left open by these actions is the question of precisely how the SEC determined that these crypto lending products were securities. As Part I of this Article describes, the federal securities laws cover a variety of assets. Unless the context otherwise requires, the term "security" includes not only stocks and bonds, but

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138 *Id*. at 8-9.

139 *Id.* at 13.

140 *Id*. at 12.

141 Press Release, U.S. SEC. & EXCH. COMM'N, BlockFi Agrees to Pay $100 Million in Penalties and Pursue Registration of its Crypto Lending Product (Feb. 14, 2022), (available online at https://www.sec.gov/news/press-release/2022-26 [https://perma.cc/3BNK-U282]).

also investment contracts (as defined in *Howey*[142]) and notes (a term clarified by *Reves*).[143] Prior to its involvement with Coinbase Lend, cryptoassets were assessed by the SEC (and the federal courts) under the *Howey* investment contract approach.[144] However, the SEC referenced *Reves* in addition to *Howey* in the Coinbase Wells Notice and the more recent BlockFi Order.[145]

The citation to two different cases, applying different parts of the statutory definition of security, is problematic because an asset of one type is normally not to be judged by the tests that apply to another asset class. Thus, as the Supreme Court explicitly stated in *Reves:*

> We reject the approaches of those courts that have applied the *Howey* test to notes; *Howey* provides a mechanism for determining whether an instrument is an "investment contract." The demand notes here may well not be "investment contracts," but that does not mean they are not "notes." To hold that a "note" is not a "security" unless it meets a test designed for an entirely different variety of instrument "would make the Acts' enumeration of many types of instruments superfluous," and would be inconsistent with Congress' intent . . . .[146]

This suggests that the SEC should have identified which test was being applied rather than suggesting that a single asset might be governed by either approach. While the *Howey* test[147] has generally governed classification of cryptoassets, the *Reves* test requires addition al consideration.

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142 SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946).

143 Reves v. Ernst & Young, 494 U.S. 56, 62 (1990).

144 *See supra* Part I.

145 SEC BlockFi Order, *supra* note 15, at 2. In a blog post describing the SEC's Wells Notice, the Chief Legal Officer for Coinbase explained:

> [W]e asked if the SEC would share their reasoning with us, and yet again they refused. They have only told us that they are assessing our Lend product through the prism of decades-old Supreme Court cases called *Howey* and *Reves*. The SEC won't share the assessment itself, only the fact that they have done it.

Grewal, *supra* note 73.

146 *Reves*, 494 U.S.at 64 (1990) (quoting Landreth Timber Co. v. Landreth, 471 U.S. 681, 692 (1985)).

147 *See supra* Part I.

A. What is the *Reves* Test for When Notes are Securities?

The *Reves* case determined that a note is a security based on what is called the "family resemblance test."[148] The test requires the application of four factors to determine whether a particular note looks like any of the debt instruments that are generally recognized as not being securities.[149] The four factors are:

1. the motivations of the seller and buyer of the notes regarding the planned use of proceeds and any expectations that interest will be based on a share of the venture's profits;
2. the "plan of distribution" and how widely the notes will be sold
3. the public's general perception of the notes as investments based on the way they are marketed; and
4. the existence of other regulatory schemes that reduce the risk of the investment.[150]

Reves also specified that the presumption is that a note is a security, and the issuer has the burden of proving that it bears a family

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[148] *Reves* lists all of the following kinds of notes as examples of debt instruments that will not be securities: "the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a `character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized)" and "notes evidencing loans by commercial banks for current operations." 494 U.S. at 65.

[149] My favorite law review article of all time questions whether the *Reves* family resemblance test is really functionally different from the *Howey* test, but this Article takes the two tests at face value and concludes there are some differences. *Cf.* James D. Gordon III, *Interplanetary Intelligence About Promissory Notes As Securities.*, 69 TEX. L. REV. 383, 391-96 (1990).

[150] The above list is paraphrased. These elements are identified at *Reves v. Ernst & Young*, 494 U.S. 56, 66-67 (1990). Subsequent commentary typically suggests that most of these factors are ambiguous and difficult for courts to apply consistently. *See, e.g.*, Lawrence Page, *Even After* Reves, *Securities Do Not Have Families: Returning to Economic and Legal Realities Through a Connotative Definition of a Security*, 1992 U. ILL. L. REV. 249, 289-91 (1992); Janet Kerr & Karen M. Eisenhauer, Reves *Revisited*, 19 PEPP. L. REV. 1123, 1162 (1992); John C. Cody, *The Dysfunctional "Family Resemblance" Test: After* Reves v. Ernst & Young, *When Are Mortgage Notes "Securities"?*, 42 BUFF. L. REV. 761, 796 (1994); Cori R. Haper, *Sometimes Promising Is Not So Promising: The Breakdown of the Family Resemblance Test*, 29 DAYTON L. REV. 71, 73 (2003).

resemblance to the kind of instrument that is recognized as something other than a security.[151] While each factor is important, it is important to remember that the test is supposed to be used to help identify notes that do not bear a "family resemblance" to interests like consumer or commercial notes, including those issued by banks.[152]

For context, the notes in *Reves* were part of an agricultural cooperative's "Investment Program."[153] The notes were unsecured and uninsured, payable on demand, and offered a variable interest rate consistently higher than that available from conventional financial institutions.[154] The notes were widely marketed and sold to thousands of investors, including persons who were not members of the cooperative, while the proceeds from the sales were used to fund ordinary business operations of the cooperative.[155]

In finding the notes to be securities, the *Reves* Court found that both parties to each sale and purchase of a note (the cooperative and the purchasers, respectively) would have conceived of the transaction as an investment in the business rather than a purely commercial or consumer transaction.[156] The fact that the notes were sold to a "broad segment of the public" was enough to find "common trading."[157] In addition, the fundamental character of the notes was found to be an "investment" because that is how the cooperative characterized their purchase in its advertisements.[158] The final element of the *Reves* test, the existence of another regulatory scheme, was not met by the cooperative.[159] The Court determined that the cooperative's notes were not subject to any other regulatory scheme, meaning that the notes "would escape federal regulation entirely if the [Securities] Acts were held not to apply."[160]

The fact that crypto lending programs are offered by crypto-based businesses rather than legacy financial institutions is often used as

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151 *Reves*, 494 U.S. at 67.

152 *See generally* Reves v. Ernst & Young, 494 U.S. 56 (1990).

153 This was the title for the cooperative's plan for obtaining funding necessary to keep it operating. *Id.* at 59.

154 *Id*. at 58-59.

155 *Id*. at 67-68.

156 *Id.* at 68.

157 Reves v. Ernst & Young, 494 U.S. 56, 68 (1990).

158 *Id*. at 68-69.

159 *Id*. at 69.

160 *Id*.

support for the general contention that these kinds of programs should be securities.[161] But is that supportable upon closer examination?

B. Does it Really Matter that Cypto Lenders are not Banks?

It is certainly true that neither Coinbase nor BlockFi were legacy financial institutions. That does not necessarily mean that the only realistic response is to fold their lending programs into the securities laws.

The premise behind the suggestion that crypto lenders are not like traditional financial institutions is the assumption that banks are subject to significantly more stringent regulation.[162] While it is true that banks have a much longer history of regulation, as described earlier in this Article,[163] that was not true when the federal securities laws were enacted. The Securities Act of 1933, complete with its exemption for securities issued by banks, was originally enacted on May 27, 1933.[164] The Banking Act of 1933, which imposed most of the federal regulations on interest-bearing products and speculative investments, was not signed into law until June 16, 1933.[165] Thus, the rules allowing

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161 Senator Elizabeth Warren is among those who have made this claim. "'Crypto is the new shadow bank,' Ms. Warren said in an interview. 'It provides many of the same services, but without the consumer protections or financial stability that back up the traditional system.'" Lipton & Livni, *supra* note 54.

162 *See generally*, Frances Coppola, *The SEC to Coinbase: Crypto Banking is Still Banking*, COINDESK https://www.coindesk.com/policy/2021/09/14/the-sec-to-coinbase-crypto-banking-is-still-banking/ [https://perma.cc/G6GM-WJWE](last updated Sept. 14, 2021, 5:18 PM).

163 *See supra* Part II.A.

164 At the time of original enactment, the applicable language read: "Any security issued or guaranteed . . . by any national bank, or by any banking institution organized under the laws of any State or Territory, the business of which is substantially confined to banking and is supervised by the State or territorial banking commission or similar official . . . ." Securities Act of 1933, ch. 38, 48 Stat. 74, 76 (codified as amended at 15 U.S.C. § 77(c)(a)(2)). In 1970, the provision was simplified so that it now reads "any security issued or guaranteed by any bank . . . ." Act of Dec. 22, 1970, Pub. L. 91-567, 84 Stat. 1497, 1498 (codified as amended 15 U.S.C. § 77).

165 Banking Act of 1933, Pub. L. 73-66, 48 Stat. 162 (codified as amended at 12 U.S.C. § 227). This Act, also known as the Glass-Steagall Act, was specifically designed "to provide for the safer and more effective use of the assets of banks, to regulate interbank control, to prevent the undue diversion of funds into speculative operations, and for other purposes." History, Banking Act, *supra* note 58.

bank notes to escape regulation as securities predated most regulatory requirements.[166]

While the history of banking regulation is far beyond the scope of this Article,[167] it is clear that the system of regulation in place prior to the Great Depression was insufficient to prevent the wave of bank failures in 1932 and 1933.[168] This severely undercuts the notion that the exemption from registration for bank securities in the '33 Act was due to sufficient regulatory oversight from other authorities.

Additionally, in recent years, many of the regulations that were traditionally applied exclusively to financial institutions under the Bank Secrecy Act have been extended to other kinds of businesses, including crypto exchanges.[169] Crypto trading platforms that do business in the U.S., or with U.S. residents, are now regulated by FinCEN as money transmitters.[170] Thus, Coinbase and BlockFi are already subject to significant financial oversight even without expanding the SEC's jurisdiction.

Given this background, how should interest-bearing crypto deposits be treated under the securities laws? Should they be analyzed as notes rather than investment contracts, and if so, would the lending products be properly classified as securities?

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166 The drafters of the 1933 and 1934 regulations did not envision something like crypto currency when they created the language and rules. *See* Coppola, *supra* note 162. ("Coinbase's executives argue that securities laws devised nearly a century ago shouldn't apply to crypto products that no one could have even imaged back then.")

167 For a retrospective on federal supervision and regulation of banks in the U.S., *see* Lev Menand, *Why Supervise Banks The Foundations of the American Monetary Settlement,* 74 VAND. L. REV. 951, 963, 1003 (2021).

168 *Id.* at 1003 (citing *Operation of the National and Federal Reserve Banking Systems: Hearings on S. 4115 Before the S. Comm. On Banking and Currency*, 72d Cong., 1st Sess. 358, 395 (1932) (statement of Eugene Meyer, Governor, Federal Reserve Board, Wash., D.C.)).

169 *See* 2013 Guidance, *supra* note 67, concluding that crypto exchanges are money services businesses subject to FinCEN jurisdiction.

170 *Id.*; *See also* 2019 Guidance, *supra* note 67. FinCEN is responsible for overseeing implementation and enforcement of the requirements of the Bank Secrecy Act. Its primary responsibilities are to ensure that money transmitters (i.e., businesses which transmit value to third parties on behalf of others) comply with a range of anti-money laundering requirements. FINCEN, *supra* note 57.

C. Should the Coinbase and/or BlockFi Lending Programs Have Been Subject to SEC Jurisdiction?

Some observers were unsurprised by the SEC's intervention and Coinbase's decision to abandon its project, assuming that the SEC would have eventually prevailed in the event of litigation. Matt Levine, a lawyer, investment banker, and author of the popular *Money Stuff* newsletter,[171] posed the question in the September 2021 issue of Bloomberg, "[i]s lending your Bitcoins a security?"[172] His response was, "Oh, sure, yes, absolutely."[173]

Somewhat surprisingly for an experienced securities lawyer, Levine immediately focused on the *Howey* investment contract test, before concluding that all the elements would have been met by the Coinbase Lend product:

> A Bitcoin lending program — in which (1) a bunch of people pool their Bitcoins, (2) some manager or smart contract lends those Bitcoins to borrowers who pay interest, and (3) some or all of the interest is paid back to the people in the pool — is pretty straightforwardly an investment contract and thus a security.[174]

Later in the column, Levine describes the *Reves* test for when notes are securities, although the name of the case appears only in an endnote:

> What transforms a simple loan (not a security) into the sort of "note" that is a security is a little hazy[.] . . . [T]he law involves a four-part test asking about the purpose of the loan, whom it was sold to, how it was marketed and whether there is an 'alternative regulatory scheme.'[175]

Levine does not, however, deviate from his position that under *Howey*, these crypto lend products would clearly be investment contracts, although he does suggest that a better approach would be to treat them as bank accounts.[176] While he recognizes that bank accounts are not securities, he opines that the reason for this is that "the securities laws,

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171 Press Announcement, *Matt Levine Joins Bloomberg View*, BLOOMBERG (Sept. 4, 2013), https://www.bloomberg.com/company/press/matt-levine-joins-bloomberg-view/ [https://perma.cc/9DZP-7THZ].

172 Matt Levine, *Money Stuff: Lending Bitcoins Is Tricky*, BLOOMBERG (Sept. 8, 2021, 12:57 PM), https://www.bloomberg.com/news/newsletters/2021-09-08/money-stuff-lending-bitcoins-is-tricky [https://perma.cc/SY8X-HHLQ].

173 *Id.*

174 *Id*.

175 *Id.*

176 *Id.*

ever since they were written in the 1930s, exempt bank accounts."[177] His rationale is that banks and their accounts are more tightly regulated.[178] This is relevant because one of the *Reves'* factors is whether there is "another regulatory scheme" which significantly reduces the risk of the instrument ."[179]

Lee Reiners, who serves as the executive director of the Global Financial Markets Center at the Duke University School of Law, is reported to have claimed that "Coinbase's proposal was clearly an offer of securities under what is called the *Howey* test, based on a 1946 Supreme Court case."[180] Steven Lofchie, a transactional lawyer at the firm of Cadwalader, Wickersham & Taft LLP, concluded that "[t]he SEC's authority in the Coinbase case was never in doubt," suggesting that this was not even a difficult case because it involved borrowing from retail investors. [181] Similarly, the director of Banking for Better Markets, Philip Basil, suggested that any opposition to the SEC's position would have resulted in "needless costs" being incurred by Coinbase.[182]

BlockFi's position was potentially even less tenable than that of Coinbase. Not only had multiple states already initiated enforcement actions or investigations against it (albeit under state law rather than the federal securities acts),[183] but BlockFi had apparently promoted its lending plan as a profitable investment.[184] It expressly informed participants that they would be sharing in the returns that the company earned from its lending of the assets deposited with it.[185] Moreover,

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177 *Id.,* citing section 3(a)(2) of the Securities Act of 1933, which exempts "any security issued or guaranteed by any bank" from the registration requirements. 15 U.S.C. § 77c(a)(2).

178 Levine, *supra* note 172.

179 *Id.*; Feltman, *supra* note 71 (Levine has not been the only expert to conclude that Coinbase's position vis-à-vis its proposed Lend product was weak. One commentator bluntly reported that "[l]egal experts say the agency was rightly calling for disclosure that's traditionally provided to investors for such programs. The other digital asset companies that offer similar services should take heed, they say." Among the experts consulted by that commentator were a number of academics and practicing attorneys.

180 Feltman, *supra* note 71.

181 *Id.*

182 *Id.*

183 *See supra* notes 106-11 and accompanying text.

184 *See supra* notes 101-03 and accompanying text.

185 *See supra* note 101 and accompanying text.

BlockFi was never a publicly traded company and made no disclosures through the SEC.[186] Also, unlike Coinbase, BlockFi did not seek or obtain a BitLicense from New York, instead declining to do business with New York residents.[187] Each of these facts makes BlockFi's BIA more likely to be a security under the potentially applicable tests.[188]

SEC Chairman Gensler appears to be certain that all crypto lending products – and the platforms proposing to issue such interests – are subject to the Commission's jurisdiction,[189] even though neither he nor the SEC has publicly explained whether the *Howey*, *Reves*, or some other test supports this conclusion. The real question is whether this certainty is justified.

D. Would Coinbase Lend Have Involved Notes or Investments?

As discussed throughout this Article, the starting point for determining how the federal securities laws should apply to a crypto lending program is to ask whether the transaction in question involves a

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186 *See* Jessica Elliot, *BlockFi vs. Coinbase*, INVESTOPEDIA, https://www.investopedia.com/blockfi-vs-coinbase-5188425#:~:text=While%20BlockFi%20is%20privately%20owned,services%20and%20interest%2Dbearing%20accounts [https://perma.cc/SF5Q-JTKZ] (last updated May 20, 2022). Only after a company goes public does it become subject to the '34 Act's ongoing reporting requirements. *See Going Public*, U.S. SEC. & EXCH. COMM'N https://www.sec.gov/smallbusiness/goingpublic [https://perma.cc/KWN3-3UML] (last visited Nov. 28, 2022). Contrast this with Coinbase's reporting obligations following its decision to go public via a direct listing in 2021. *See* Aratani, *supra* note 14.

187 New York has a rigorous licensing requirement for crypto businesses, called BitLicense. For a recent explanation of what it entails, see Emma Roth, *PayPal Gets its Full New York BitLicense, and now lets users transfer crypto to external wallets*, THE VERGE (June 8, 2022, 3:11 PM), https://www.theverge.com/2022/6/8/23159519/paypal-crypto-transfers-new-york-bitlicense-bitcoin-ethereum [https://perma.cc/QT4A-DW4L]. For a listing of companies that have been awarded a BitLicense by complying with New York's relatively rigorous requirements. *See* N.Y. State Dept. of Fin. Serv., *Virtual Currency Businesses Regulated Entities*, N.Y. STATE https://www.dfs.ny.gov/virtual_currency_businesses [https://perma.cc/7STX-HMHK] (updated Feb. 21, 2022) (listing Coinbase, effective January 2017, but not including BlockFi).

188 *See infra* Part IV.D.

189 Katelynn Bradley et al., *SEC Chair Gensler Signals Greater Regulation of Cryptocurrency Under Existing Authorities*, BROWNSTEIN (Sept. 21, 2021), https://www.bhfs.com/insights/alerts-articles/2021/sec-chair-gensler-signals-greater-regulation-of-cryptocurrency-under-existing-authorities[https://perma.cc/KF4Z-VKAQ].

"note" or an "investment contract." If it is properly considered to be a note, only the *Reves* test should apply.[190]

Neither the Securities Act of 1933 (the '33 Act)[191] nor the Securities Exchange Act of 1934 (the '34 Act)[192] define "note," but this is a term that has a commonly understood meaning.[193] In very general terms, a note is a promise to repay a debt,[194] as evidenced by the kinds of notes that the U.S.

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190 *See* Reves v. Ernst & Young, 494 U.S. 56, 65 (1990).

191 Securities Act of 1933, ch. 38, 48 Stat. 74, § 2 (codified as amended at 15 U.S.C. § 77b).

192 Securities Exchange Act of 1934, § 3 (codified as amended at 15 U.S.C. § 78c).

193 There are some relatively slight differences between the wording of the definition of security in 15 U.S.C. § 77b(a)(1) and 15 U.S.C. § 78c(a)(10). The two statutes have, however, been generally interpreted as being "essentially the same." In Tcherepnin v. Knight, the Supreme Court noted that "[t]he same Congress which passed the Securities Act in 1933 approved the Securities Exchange Act in 1934, and the definition of security contained in the 1934 Act is virtually identical to that in the earlier enactment." Tcherepnin v. Knight, 389 U.S. 332, 342 (1967) (footnote omitted.) In Marine Bank v. Weaver, 455 U.S. 551, 553 n.3 (1982) the Court reiterated that "we have consistently held that the definition of security in the 1934 Act is essentially the same as the definition of security in § 2(a)(1) of the Securities Act of 1933." Even more definitive language was used in Landreth Timber Co. v. Landreth, 471 U.S. 681, 686–87 n.1 (1985), where the Court proclaimed that "the definitions of 'security' in § 3(a)(10) of the 1934 Act and § 2(a)(1) of the 1933 Act are virtually identical and will be treated as such in our decisions dealing with the scope of the term." This position was also adopted in *Reves* itself. Reves v. Ernst & Young, 494 U.S. 56, 61 n.1 (1990). *Accord* SEC v. Edwards, 540 U.S. 389, 393 (2004) (explaining that the definitions are to be treated as "essentially identical"). This could be important in the context of what constitutes a "note" within the meaning of the securities laws, because the '34 Act (but not the '33 Act) includes the following exclusion from the definition of security: "[it] shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months . . . ." Securities Exchange Act of 1934, § 3 (codified as amended at 15 U.S.C. § 78c(a)(10)).

194 Consider this explanation of promissory notes:

> Any commercial loan will require a debt instrument (known as a promissory note) evidencing the debt and outlining the obligations of the borrower to repay the funds. These documents will generally include all relevant terms of the lending relationship, including interest rate and repayment schedule . . . .This adds formality to the relationship that aids in setting the expectations of all parties. Further, the promissory note is the best way to memorialize the creditor-debtor relationship for tax purposes.

Supreme Court has declared not to be securities under the family resemblance test.[195] So when a customer participates in a crypto lending project where there is an understanding that interest will be paid on deposited assets, which are to be returned to the customer on demand, is the business issuing a note?

As described above, the proposed Lend program would have obligated Coinbase to repay cryptoassets lent to it by its customers.[196] This position coincides with the very terminology used to describe these kinds of programs: crypto lending.

While Coinbase contended that the SEC failed to communicate the rationale behind its disagreement with this analysis,[197] SEC Chairman Gensler has offered his perspective on the kinds of programs considered by Coinbase. In an explanation that has been described as a "not your keys, not your coins argument," Gensler has been quoted as saying:

> "I would note . . . that if you're investing on a centralized exchange or a centralized lending platform, you no longer own your token. You've transferred ownership to the platform. All you have is a counterparty risk. And that platform might be saying, as many of them do, we'll give you a four percent or seven percent return if you stake your coins with us or you actually transfer ownership and we the platform will stake your tokens. That takes on all the indicia of what Congress is trying to protect under the securities laws."[198]

Jason Gordon, *Fund a Business with Promissory Notes – Explained*, THE BUSINESS PROFESSOR, https://thebusinessprofessor.com/en_US/business-transactions/using-promissory-notes [https://perma.cc/5EDS-USBW] (last updated Apr. 15, 2022).

195 The *Reves* Court held*:*

> The list of notes the Court has determined not to be securities include the following: (1) the note delivered in consumer financing; (2) the notes secured by a mortgage on a home; (3) the short-term note secured by a lien on a small business or some of its assets; (4) the note evidencing a character loan to a bank customer; (5) short-term notes secured by an assignment of accounts receivable; (6) a note that simply formalizes an open account debt incurred in the ordinary course of operations; and (7) notes evidencing loans by commercial banks for current operations.

Reves, 494 U.S. at 65.

196 *See* Grewal, *supra* note 73 and accompanying text.

197 *Id.*

198 Post, *supra* note 85.

"The expression 'not your keys, not your coins' refers to needing to own the private keys associated with your funds" in the crypto space to maintain control over the underlying cryptoasset.[199] However, while depositing cryptoassets and handing over control over the associated keys certainly transfers possession and control, that is, in fact, no different than what happens when currency is deposited by a customer into their bank account. Absent special circumstances or a specific agreement to the contrary, the bank becomes a debtor, owing the amount deposited back to the customer.[200] Similarly, a crypto exchange would become a debtor, owing its customers the crypto that was deposited or lent to it.[201]

Consider this explanation of the relationship that exists between a customer who deposits fiat currency with a bank and the bank:

> In the absence of special circumstances or a special agreement, the relation between a bank and a depositor therein is that of debtor and creditor, at least in the case of general deposits. If money is deposited in a bank without any special agreement, it is a general deposit, the bank becomes the owner of the money, the funds are mingled with the bank's other funds, and the relationship between the bank and the depositor is a relationship of debtor, the bank, and creditor, the depositor. Money deposited in a general account becomes the property of the bank and the depositor becomes the bank's creditor to the extent of the deposit. Thus, the bank acquires title to the money deposited, and becomes the depositor's debtor for the amount deposited . . . . In making payments on the depositor's order, the bank pays its own money as a debtor and not its depositor's money as an agent, and pays its own money rather than specific money of the maker. The bank's obligation is merely to repay the amount due out of its general funds and it is not contemplated that the identical bills or money deposited will be

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199 Kirsty Moreland, *Not Your Keys, Not Your Coins. It's That Simple.* LEDGER ACADEMY, https://www.ledger.com/academy/not-your-keys-not-your-coins-why-it-matters [https://perma.cc/97LE-HMEV] (last updated Oct. 27, 2022). The phrase was reportedly popularized by Andreas Antonopoulos, who said, "Your keys, your bitcoin. Not your keys, not your bitcoin." *Not Your Keys, Not Your Coins*, MEDIUM (May 21, 2020), https://medium.com/stakefish/not-your-keys-not-your-coins-fad3d43c2713 [https://perma.cc/6XK2-A7NG].

200 John Bourdeau et al., *Debtor-Creditor relationship between bank and depositor*, 9 C.J.S. BANKS AND BANKING § 283 (Aug. 2022 update).

201 *See generally Crypto-Assets: Implications for Consumers, Investors, and Business*, U.S. DEP'T OF THE TREASURY (Sept. 2022), https://home.treasury.gov/system/files/136/CryptoAsset_EO5.pdf [https://perma.cc/22B8-6WMF].

> returned to the customer. A deposit or account is therefore not actual cash, but a debt . . . . [202]

This does not mean that the depositor — either of fiat into a bank or crypto onto a lending or other crypto platform — has no equitable claim to the value of what has been deposited. While not directly on point, it relates to the definition of "beneficial ownership" as used in particular provisions of the '34 Act requiring reports of ownership,[203] the federal securities laws specifically define beneficial ownership. That phrase includes "any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares" investment power over the security.[204] This would certainly point to a depositor as having equitable or beneficial rights in the deposited property, even though the asset has been lent to the platform, since the depositor has the contractual right to control the ultimate disposition of the asset.

Contrast this with sales that involve an investment contract. In a loan, the participants expect — and are contractually entitled to — a return of their principal.[205] No such guarantee is associated with investment capital, which is riskier because there is no contractual right to repayment.[206] The *Howey* investment contract test begins by requiring an investment,[207] which makes this a critical inquiry for classifying arrangements such as the Lend Program proposed by Coinbase.

Using this analysis, it seems relatively clear that transactions in the planned Coinbase Lend program should have been evaluated as part of

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202 Bourdeau et al., *supra* note 200.

203 The following definition, by its terms, applies to sections 13(d) and (g) of the Securities Exchange Act of 1934, § 3 (codified as amended at 15 U.S.C. § 78m(d), (g)).

204 17 C.F.R. § 240.13(d)(3)(a).

205 "Loans are fixed obligations that must be repaid . . . ." James Woodruff, *Investor vs Loan: Which Is Smarter for Your Business?*, NATIONAL FUNDING (Aug. 25, 2020), https://www.nationalfunding.com/blog/investor-vs-loan-which-is-smarter-for-your-business/ [https://perma.cc/6J2A-GEFS]. In a case such as the proposed Coinbase Lend program, participants had the contractual right to withdraw their assets on demand. Coinbase, WAYBACK, *supra* note 69.

206 "[A]n investment . . . allows the business to use your money without the obligation to have to pay you back right away." Jean Murray, *Investing vs. Lending Money to Your Business*, THE BALANCE, https://www.thebalancemoney.com/loan-or-invest-money-in-my-business-398053[https://perma.cc/W8QQ-YV3Q] (last updated Sept. 17, 2020).

207 SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946).

the platform's obligation to repay a debt. In other words, the platform would have issued a note in exchange for the deposited crypto that was deposited with it. The process is analogous to the obligation of legacy financial institutions to repay amounts deposited with them. Therefore, the determination of whether the Coinbase Lend program involved a security should have triggered the application of the *Reves* test.

Although the BlockFi BIA program was promoted and described differently from the Coinbase Lend program, some of the same analysis applies. While BlockFi described its BIA as an investment, its process was also widely compared to services available at conventional banks.[208] BlockFi certainly described its program as involving crypto lending,[209] although the company was not always consistent in this. For example, in the Tweet announcing the launch of the BIA, BlockFi inaccurately linked the concept of "storing" users' crypto with BlockFi to the ability to earn "an industry-leading APY of 6.2%."[210]

However, according to the agreement between BlockFi and its BIA customers, BlockFi was obliged to repay amounts deposited whenever the customer decided to withdraw the deposit.[211] Thus, for the most part, crypto deposited with BlockFi as part of the BIA program was treated similarly to fiat currency deposits with legacy financial institutions. Customers expect their principal to be returned along with interest in these cases. It is true, however, that there is no guarantee of repayment such as that provided by the federal deposit insurance corporation for deposits (up to $250,000) with regulated banks.[212]

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208 "At BlockFi, you can earn up to 8.6% interest per year on your cryptocurrency holdings, borrow cash, buy and sell crypto, and access other bank-like services." *BlockFi Review: Does BlockFi Work? Is It Legit or Too Risky?*, OBSERVER (Mar. 7, 2021, 12:00 PM). https://observer.com/2021/03/blockfi-review-does-blockfi-work-is-it-legit-or-too-risky/ [https://perma.cc/M774-E6DG].

209 Even the SEC Order acknowledged this characterization explaining that through BIAs, BlockFi customers "could lend crypto assets to BlockFi and in exchange, receive interest . . . ." SEC BlockFi Order, *supra* note 15 at 3.

210 BlockFi (@BlockFi), TWITTER (Mar. 5, 2019, 8:43 AM), https://twitter.com/BlockFi/status/1102927702510706688 [https://perma.cc/BKY4-WR2Y].

211 The New Jersey Cease and Desist order against BlockFi, entered July 19, 2021, noted that BIA purchasers had the right to "withdraw their digital assets at any time, subject to a maximum seven-day processing time specified by BlockFi." BlockFi N.J. Order, *supra* note 102, at 5.

212 *FDIC Insurance Limits in 2022*, THE AM. DEPOSIT MGMT. CO. https://americandeposits.com/fdic-insurance-limits-2022/ [https://perma.cc/A7CV-GEUT] (last visited Oct. 12, 2022). It is also worth noting that federal deposit insurance was not in existence when the Securities Act

Regarding BlockFi, the fact that the company referred to the BIA as an investment opportunity early on complicates the issue of whether this is enough to characterize the program as involving notes.[213] Rather than simply describing the program as one involving the repayment of a loan with interest, the company explicitly claimed that customers could earn a share of the profits that BlockFi earned from its use of the deposited assets.[214] Thus, while Coinbase Lend clearly seems to have involved loans rather than investment contracts, BlockFi's own language casts some doubt on how its program should have been classified.

E. Would Coinbase Lend Have Involved the Issuance of Securities?

As described earlier, a strong case can be made that Coinbase Lend involved the issuance of notes, meaning that the *Reves* test should be applied when analyzing the program. *Reves* requires consideration of four factors to classify notes appropriately.[215] A close evaluation of the planned Coinbase Lend program under that test suggests that the SEC was incorrect in determining that Coinbase Lend would have involved securities.[216]

The first element of *Reves* concerns the purpose of the note and asks whether the lender is primarily interested in the profits the note is expected to generate.[217] Paul Grewal, chief legal counsel for Coinbase, explained that the company had no intention of sharing profits from its planned use of deposited assets.[218] Rather, it promised a flat interest rate on deposited crypto, irrespective of whether the company earned a profit

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of 1933 was enacted. It became the law on January 1, 1934, so this could not have been the basis on which Congress determined not to regulate bank notes as securities. *See* THE FEDERAL DEPOSIT INSURANCE CORPORATION , A BRIEF HISTORY OF DEPOSIT INSURANCE IN THE UNITED STATES (1998), https://www.fdic.gov/bank/historical/brief/brhist.pdf[https://perma.cc/9MF9-WDWT].

213 *See supra* notes 15, at 3, 101-03 and accompanying text.

214 *See BlockFi Interest Account Now Live, Offering 6.2% Interest to Cryptocurrency Holders*, *supra* note 99.

215 Reves v. Ernst & Young, 494 U.S. 56, 66-67 (1990).

216 *Id.*

217 *Id*.

218 This helps distinguish Coinbase Lend from the previously investigated BitConnect program. *See supra* notes 86-93 and accompanying text. *See also supra* notes 73-74.

or how much that profit might be.[219] That information would appear relevant in understanding the purpose of the notes and the expectations of the creditors. However, it would be a mistake to treat "profits" under *Reves* like they are treated under *Howey*.[220]

The *Reves* Court concluded that the cooperative in that case had sold notes to raise funds for ordinary business purposes and that the purchasers participated to earn interest, which satisfied the first part of the family resemblance test.[221] The *Reves* Court explicitly rejected the narrower definition of "profits" that might have applied under the *Howey* test.[222] Therefore, because participants in a crypto lending program will anticipate the promised interest, this element is likely to always be met in a crypto lending program such as Coinbase Lend.

The second part of *Reves* looks at the distribution plan and whether there will be a public market in the notes. However, this test is also somewhat oddly construed in the context of notes. In *Reves*, the Court explained that "the Co-Op offered the notes over an extended period to its 23,000 members, as well as to nonmembers, and more than 1,600 people held notes when the Co-Op filed for bankruptcy. Admittedly, the notes were not traded on an exchange. They were, however, offered and sold to a broad segment of the public, and that is all we have held to be necessary . . . ."[223] How would that relate to Coinbase Lend?

The planned Coinbase Lend program was set up to accept deposits of USDC from a large range of retail customers. Though it is becoming increasingly common, it is worth noting that interested customers would

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219 It is worth noting that some other annuities may also structure payouts in this way, but they differ from the Coinbase Lend program by not including any obligation to repay the initial deposit (in the case of the Lend program) or payment (in the case of an annuity). Grewal, *supra* note 73.

220 Laura Anthony, *What Is A Security? The Howey Test And Reves Test*, LAWCAST, https://lawcast.com/2014/11/25/what-is-a-security-the-howey-test-and-reves-test/ [https://perma.cc/4BD7-BBAF] (last visited Oct. 23, 2022). *See also* Reves v. Ernst & Young, 494 U.S. 56, 66-67 (1990); SEC v. W.J. Howey Co., 328 U.S. 293, 296-97 (1946).

221 "The Co-Op sold the notes in an effort to raise capital for its general business operations, and purchasers bought them in order to earn a profit in the form of interest." *Reves*, 494 U.S. at67-68. (Footnote 4 is referenced at the end of this sentence, and it specifically defines "profit" in the context of notes to include interest). *Id.* at 68 n.4.

222 *Id.* at 67-68.

223 *Id.* at 68.

have had to be owners of USDC in order to participate.[224] Certainly, indications were that Coinbase expected its planned program to be quite popular with a large number of participants.[225] Therefore, Coinbase Lend would presumably have met this element of the *Reves* test.

The third element, however, plays out somewhat differently. It asks whether the notes were marketed as investments. As described in *Reves*, "[t]he advertisements for the notes here characterized them as 'investments,' and there were no countervailing factors that would have led a reasonable person to question this characterization."[226] An analysis of the Coinbase Lend program paints a different picture. Notwithstanding Coinbase's abandonment of its product prior to launch, "investment" is a label it had never applied to Lend. Instead, it compared the planned product to high-yield savings accounts.[227]

In addition, Coinbase consistently explained that customers would have a right to a return of assets credited to *their* accounts on demand.[228] The obvious comparison to conventional demand deposit accounts makes it unlikely that a reasonable person would have viewed the program as soliciting investments, given that bank customers know they do not "invest" in a bank simply by depositing funds into their account. The obligation incurred by banks to repay deposited amounts is outside the scope of the securities laws. There is therefore an argument that the Coinbase program would have borne a family resemblance to notes that

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224 According to CoinMarketCap, as of December 19, 2021, there were nearly 42.5 billion USDC in circulation. *Today's Cryptocurrency Prices by Market Cap*, COINMARKETCAP, https://coinmarketcap.com/historical/20211219/ [https://perma.cc/4K8F-HKMB](last visited Oct. 14, 2020) (showing the historic market price of cryptocurrencies on Dec. 19, 2021). This source tracks growing interest and participation in the wider crypto markets in the U.S. One recent source says that more than one out of every ten Americans has invested in crypto. Elisabeth Buchwald, *More than 1 in 10 Americans Invested in Crypto This Year — Here's How They Differ From Stock Market Investors*, MARKETWATCH (last updated July 26, 2021, 3:20 PM), https://www.marketwatch.com/story/more-than-1-in-10-americans-invested-in-crypto-this-year-heres-how-they-differ-from-stock-market-investors-11626980261 [https://perma.cc/B8D8-GC3W] (suggesting that 13% of Americans have invested in cryptoassets).

225 *Doyle*, *supra* note 75.

226 Reves v. Ernst & Young, 494 U.S. 56, 69 (1990) (internal citation omitted).

227 *Feltman*, *supra* note 71.

228 The demanding nature of the program was highlighted in the original description of the Lend program on Coinbase's website. Customers were allowed to "opt-out at any time," and still send and sell their crypto without delays or fees. Coinbase, WAYBACK, *supra* note 69.

are outside the reach of the securities laws, which is precisely what application of the *Reves* factors determines.

The final element of the *Reves* test is the potential existence of risk-reducing factors, such as other regulatory oversight.[229] Here, too, a more careful look at the Coinbase Lend program is needed. In *Reves*, the Court found "no risk-reducing factor," in that the notes in question were uncollateralized, uninsured, and not "subject to substantial regulation" such that "the notes here would escape federal regulation entirely if the [Securities] Acts were held not to apply."[230]

While Coinbase is not a federally insured financial institution, it is subject to regulation at both the federal and state level. For example, the Financial Crimes Enforcement Network (FinCEN) has authority over Coinbase under the Bank Secrecy Act (BSA)[231] to regulate the exchange's money transmission services.[232]

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229 *Reves*, 494 U.S. at 67.

230 *Id.* at 69.

231 The Bank Secrecy Act (BSA), the common label for the Currency and Financial Transactions Reporting Act of 1970, as amended by Title III of the USA PATRIOT Act of 2001 and other legislation, is codified at 31 U.S.C. §§ 5311 et seq. In very general terms, the BSA authorizes the Secretary of the Treasury to adopt regulations requiring certain businesses to adopt precautions against financial crimes. This authority has been delegated to the Director of FinCEN, who is also responsible for administering and enforcing these regulations and other requirements of the BSA. *FinCEN's Legal Authorities*, FINANCIAL CRIMES ENFORCEMENT NETWORK, https://www.fincen.gov/fincens-legal-authorities [https://perma.cc/5SX2-4PLZ] (last visited Nov. 16, 2022).

232 An MSB includes several types of businesses, including money transmitters. *See* 31 C.F.R. § 1010.100(ff). "Money transmitters" are defined as:

> (i) In general.
>
> (A) A person that provides money transmission services. The term "money transmission services" means the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means. "Any means" includes, but is not limited to, through a financial agency or institution; a Federal Reserve Bank or other facility of one or more Federal Reserve Banks, the Board of Governors of the Federal Reserve System, or both; an electronic funds transfer network; or an informal value transfer system; or
>
> (B) Any other person engaged in the transfer of funds.

31 C.F.R. § 1010.100(ff)(5).

In addition, FinCEN finalized a rule in 2011 that expanded "money transmission" to include "the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value

FinCEN was one of the first U.S. regulators to explain when crypto business would be subject to its authority, providing guidance on that topic in 2013.[233] In its 2013 Guidance, FinCEN defined a crypto exchanger as

> "a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency."[234] The 2013 Guidance unambiguously states that an "exchanger *is* an MSB [Money Services Business] under FinCEN's regulations, specifically, a money transmitter, unless a limitation to or exemption from the definition applies to the person."[235] It is irrelevant whether

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that substitutes for currency to another location or person by any means." Bank Secrecy Act Regulations; Definitions and Other Regulations Relating to Money Services Businesses, 76 Fed. Reg. 140 (2011) (codified at 31 C.F.R. §§ 1010 &1021-22). In addition, in January 2021, the U.S. government passed the Anti-Money Laundering Act of 2020 as part of the National Defense Authorization Act of 2021, and this legislation changed the BSA's definition of money to include convertible virtual currencies and digital assets such as cryptocurrencies like Bitcoin. Anti-Money Laundering Act of 2020, Pub. L. No. 116-283, 134 Stat. 4547.

233 2013 Guidance, *supra* note 67. Note that neither Coinbase nor any other crypto business actually "holds" crypto assets for their clients since crypto has no tangible existence, being nothing more than a string of numbers in digitized form, memorialized on a blockchain. Andrew Lisa, *Where Does Cryptocurrency Come From*?, GOBANKINGRATES (June 8, 2022), https://www.gobankingrates.com/investing/crypto/ economy-explained-where-does-cryptocurrency-come-from/ [https://perma.cc/A639-WF99]. A crypto wallet is "a piece of software that keeps track of the secret keys used to digitally sign cryptocurrency transactions for distributed ledgers . . . . [T]hose keys are the only way to prove ownership of digital assets – and to execute transactions that transfer them or change them in some way . . . ." Lucas Mearian, *What's a Crypto Wallet (and how does it manage digital currency)?*, COMPUTERWORLD (Apr. 17, 2019, 3:00AM), https://www.computerworld.com/article/3389678/whats-a-crypto-wallet-and-does-it-manage-digital-currency.html [https://perma.cc/SBA5-GEYR]. A wallet service does this for its customers. These services act as either crypto exchanges or hosted wallet providers with customer accounts credited with amounts of crypto that are "on deposit" with it. A crypto exchange is a platform on which customers create accounts to facilitate exchanges for fiat currency or other forms of crypto. Kendall Little, *Want to Buy Crypto? Here's What to Look for In a Crypto Exchange*, NEXT ADVISOR (May 3, 2022), https://time.com/nextadvisor/investing/cryptocurrency/what-are-cryptocurrency-exchanges/ [https://perma.cc/9QY9-FPPY].

234 2013 Guidance, *supra* note 67, at 1.

235 *Id.* (appearing in the initial paragraph of the 2013 Guidance, along with notice that exemptions for sellers of prepaid access and dealers in foreign exchange, are not available to persons who exchange crypto).

> the exchange acts as a broker or dealer in facilitating such transactions.[236] A company classified as an exchange by FinCEN, including Coinbase (and BlockFi),[237] becomes subject to regulation by FinCEN under the BSA.[238] FinCEN's updated guidance, issued in 2019, does not change this analysis.[239]

In addition to federal oversight by FinCEN, states can also impose requirements on money services businesses and often do.[240] While some states have specifically elected to exempt crypto-based businesses from the scope of their MSB regulations,[241] others

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236 On October 27, 2014, FinCEN explained:

> An exchanger will be subject to the same obligations under FinCEN regulations regardless of whether the exchanger acts as a broker (attempting to match two (mostly) simultaneous and offsetting transactions involving the acceptance of one type of currency and the transmission of another) or as a dealer (transacting from its reserve in either convertible virtual currency or real currency).

FINCEN, FIN-2014-R011, REQUEST FOR ADMINISTRATIVE RULING ON THE APPLICATION OF FIN CEN'S REGULATIONS TO A VIRTUAL CURRENCY TRADING PLATFORM (2014), https://www.fincen.gov/sites/default/files/administrative_ruling/FIN-2014-R011.pdf [https://perma.cc/6PTJ-3QL9] (concluding that the company in question was an exchanger even though payments would come from the company's crypto reserves).

237 Both Coinbase and BlockFi are (or were, given that BlockFi is now in bankruptcy) Money Services Businesses registered as such with FinCEN. Their registration can be confirmed with an MSB Registrant Search on FinCEN's website. MSB Registrant Search, FIN. CRIMES ENFORCEMENT NETWORK, https://www.fincen.gov/msb-registrant-search [https://perma.cc/N7LW-W8N9].

238 2013 Guidance, *supra* note 67.

239 2019 Guidance, *supra* note 67.

240 "Forty-seven states and the District of Columbia have money transmitter licensing requirements . . . ." Meghan E. Griffiths, *Virtual Currency Businesses: An Analysis of the Evolving Regulatory Landscape*, 16 TEX. TECH. ADMIN. L. J. 303, 309 (2015).

241 Wyoming, for example, has enacted legislation excluding crypto from the state's money transmission requirements. *See* WYO. STAT. ANN. § 40–22–104(a)(vi) . Several other states have taken similar steps. *See* N.H. REV. STAT. ANN. § 399–G:3.; ILLINOIS DEPARTMENT OF FINANCIAL AND PROFESSIONAL REGULATION, DIGITAL CURRENCY REGULATORY GUIDANCE (2017) https://idfpr.illinois.gov/Forms/DFI/CCD/IDFPR%20-%20Digital%20 Currency%20Regulatory%20Guidance.pdf [https://perma.cc/48R3-SQWB]; N.D. FINANCIAL INSTITUTIONS, FAQS—NON-DEPOSITORY, https://www.nd.gov/dfi/about-dfi/non-depository/frequently-asked-questions-non-depository [https://perma.cc/5PH5-4YJ8] (answer in response to the question:

have taken a more nuanced approach and excluded some businesses but covered exchanges.[242] In addition, several states treat crypto exchanges as money transmitters under state law.[243] A handful of states provide additional requirements. For example, New York state has an extensive

"Do I need a money transmitter license to purchase, sell, or operate an exchange for virtual currency?").

242 *See, i.e.*, Kansas Office of the State Bank Commissioner, *Guidance Document* MT 2014-01 (June 6, 2014, updated May 18, 2021) [https://perma.cc/SW5Z-JSS4] (concluding that exchanges that permit conversion of crypto into any form of fiat would be money transmitters); Texas Dept. of Banking, *Supervisory Memo* 1037 (Apr. 1, 2019) (rev.) [https://perma.cc/F5Y5-YBGJ] (concluding that exchanges are regulated even though other crypto businesses are not); and La. Office of Fin. Inst., *Consumer and Investor Advisory on Virtual Currency* (Aug. 2014) [https://perma.cc/DKN9-MRH7] (also including crypto exchanges within the scope of state money transmitter regulation).

243 *See* N.C. GEN. STAT. ANN. §§ 53-208.41, 42(19); OR. REV. STAT. §§ 717.200-.320, 905; REV. CODE WASH. Ch. 19.230.; H.B. 215, 389th Reg. Sess. (Ala. 2017) (adopting the Alabama Monetary Transmission Act which includes in CODE OF ALA. § 8-7A-2(8) virtual currencies as monetary value); S.B. 150, 2021 Reg. Sess. (Ark.) (amending A.C.A. § 23-55-102(12) to add virtual currencies to the definition of money transmission); H.B. 811, 2016 Reg. Sess. (Ga. 2016) (amending O.C.G.A. § 7-1-680 to add virtual currency as a representation of monetary value in the money transmission statute); H.B. 182, 2017 Reg. Sess. (Vt.) (amending 8 V.S.A. § 2500(13)) to add a definition of virtual currency, thereby including it as prepaid access which in turn is included as a kind of money transmission). Some states have also interpreted their statutes as covering crypto without amending statutory language. *See* COLO. DEP'T. OF REGUL. AGENCIES, INTERIM REGULATORY GUIDANCE CRYPTOCURRENCY AND THE COLORADO MONEY ACT(2018); *Idaho Money Transmitters Section*, IDAHO DEP'T OF FIN. [https://perma.cc/PLB5-2D84]; Fin. Instit. Div., *Money Services Businesses*, N.M. REGUL. & LICENSING DEP'T [https://perma.cc/9TA9-DBS5].

licensing program for crypto businesses,[244] with which Coinbase complies, having become the second BitLicense holder in 2017.[245]

Coinbase, as a public reporting company, is also subject to additional requirements that reduce some of the risks associated with information disparity. As explained by the SEC, a public company is required under the '34 Act "to file annual reports on Form 10-K and quarterly reports on Form 10-Q with the SEC on an ongoing basis. These reports require much of the same information about the company as is required in a registration statement for a public offering."[246] Current reports are also required for material financial developments.[247]

This analysis provides strong reasoning as to why the repayment obligations that Coinbase assumed under its Lend program should not have been classified as securities under *Reves*, notwithstanding the SEC's apparent conclusion to the contrary.

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244 For a description of the BitLicense program, *see* Sarah Jane Hughes & Stephen T. Middlebrook, *Advancing a Framework for Regulating Cryptocurrency Payments Intermediaries*, 32 YALE J. ON REGUL. 495, 503 (2015). The BitLicense requirements apply to anyone who engages in "virtual currency business activity." Regulation of the Conduct of Virtual Currency Businesses, 23 N.Y. COMPILATION CODES RULES & REGULS § 200.3(a). *See also* Samantha J. Syska, *Eight-Years-Young: How the New York Bitlicense Stifles Bitcoin Innovation and Expansion with Its Premature Attempt to Regulate the Virtual Currency Industry*, 17 J. HIGH TECH. L. 313 (2017) (expressing worry that New York's infamous BitLicense requirements are so extensive that they are stifling crypto competition and innovation).

245 Juan Suarez, *Coinbase Obtains the Bitlicense*, THE COINBASE BLOG (Jan. 17, 2017), https://blog.coinbase.com/coinbase-obtains-the-bitlicense-f1c3e35c4d75 [https://perma.cc/ZW3L-YT6Q].N.Y. DEP'T OF FIN. SERVICES, *Virtual Currency Businesses*, N.Y. STATE, https://www.dfs.ny.gov/virtual_currency_businesses[https://perma.cc/CXQ4-P67F] (last updated June 10, 2022). Press Release, Dep't of Fin. Services, DFS Authorizes Coinbase, Inc. to Provide Additional Virtual Currency Products and Services (Mar. 22, 2017), https://www.dfs.ny.gov/reports_and_publications/press_releases/pr1703221[https://perma.cc/CXQ4-P67F] (discussing Coinbase's status as the second BitLicense holder).

246 *Exchange Act Reporting and Registration*, U.S. SEC. & EXCH. COMM'N, (Apr.28, 2022), https://www.sec.gov/education/smallbusiness/goingpublic/exchangeactreporting#:~:text=SEC%20rules%20require%20your%20company,statement%20for%20a%20public%20offering [https://perma.cc/9G6H-3QRP] [hereinafter *Exchange Act Reporting*]. Coinbase became a reporting company by registering a direct sale of its shares on April 14, 2021. Samyuktha Sriram, *Coinbase Goes Public April 14: What You Need To Know*, YAHOO (Apr. 2, 2021), https://finance.yahoo.com/news/coinbase-goes-public-april-14-200526144.html?fr=yhssrp_catchall [https://perma.cc/SB56-7HWH].

247 *Exchange Act Reporting*, *supra* note 246.

Even under *Howey*, the conclusion that the Lend program would have involved securities is not necessarily accurate. First, as described above, Coinbase did not seek an "investment"; instead, it talked only about demand deposits, the value of which the participant had a contractual right to have returned.[248] Thus, *Howey*'s first element, which requires an "investment,"[249] could have been missing, although the value associated with being able to use the deposited assets could have met that requirement.[250]

The second element, the requirement of a common enterprise,[251] depends on how the jurisdiction in question defines that concept.[252] If a determination that the investors are entitled to "share in the profits and risks of the enterprise" (horizontal commonality)[253] or proof that the investor's fortune is dependent on the promoter's profit (narrow vertical commonality) is needed,[254] it is not clear that this is present. Coinbase took care to not promise a share of the profits to participants in the planned Lend program.[255] Thus, Coinbase could have lost money while its Lend customers earned interest. Alternatively, Coinbase could have made much more or highly variable rates of return, while the Lend participants would see only a fixed interest rate on their deposited assets. Thus, it is not clear that there would be the kind of common enterprise sufficient to satisfy the *Howey* test in all jurisdictions, although in a minority of circuits if the investors' return is tied jointly to the promoter's efforts, this could suffice.[256] As of November 2022, the

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248 *See supra* notes 225-28 and accompanying text.

249 SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946).

250 *See supra* note 33 for a discussion of the scope of this requirement.

251 *Howey*, 328 U.S. at 299.

252 *See supra* note 34 for a discussion of this element.

253 JAY B. SYKES, CONG. RSCH. SERV. R45301, SECURITIES REGULATION AND INITIAL COIN OFFERINGS: A LEGAL PRIMER (2018), https://sgp.fas.org/crs/misc/R45301.pdf [https://perma.cc/N8E6-3Y9H] (internal quotation marks omitted).

254 *Id.*

255 *See supra* notes 218-19 and accompanying text.

256 Only the Fifth and Eleventh Circuits have held that broad vertical commonality is sufficient. *See* SEC v. ETS Payphones, Inc., 408 F.3d 727, 732 (11th Cir. 2005); Long v. Shultz Cattle Co., Inc., 881 F.2d 129, 140-41 (5th Cir. 1989). The Third, Sixth, and Seventh Circuits require horizontal commonality for a "common enterprise." Newmyer v. Philatelic Leasing, Ltd., 888 F.2d 385, 394 (6th Cir. 1989); Salcer v. Merrill Lynch, Pierce, Fenner and Smith, Inc., 682 F.2d 459, 460 (3d Cir. 1982); Hirk v. Agri-Research Council, Inc., 561 F.2d 96, 102-03 (7th Cir. 1977). The First, Fourth, and D.C. Circuits have held that horizontal commonality

Supreme Court has declined to resolve the split in authority among the circuits as to what is required to prove a common enterprise.[257]

The third prong of *Howey* asks whether there is an expectation of profits.[258] While there was probably enough of a return to show a profit motive for Lend participants under the first prong of *Reves*,[259] under *Howey*, profits are a more limited concept.[260] There was no direct linkage between the yield that Coinbase may or may not see and the interest promised to investors. Therefore it appears this element would not have been present under *Howey*.

Admittedly, the final facet of the investment contract test—which asks whether the anticipated return depends on the issuer's managerial expertise[261]—would have been met here, as the Coinbase Lend participants had no control over how their assets were deployed after being deposited.[262] The real problem with *Howey*, of course, is that it is simply not the applicable test when notes are involved.

F. And What About BlockFi's BIAs?

As previously stated, when settling its enforcement action against BlockFi, the SEC addressed a number of claims. The SEC alleged that BlockFi sold unregistered non-exempt securities and that the company had made materially false and misleading statements in violation of

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is sufficient but have not addressed the issue of vertical commonality. SEC v. SG Ltd., 265 F.3d 42, 50 n.2 (1st Cir. 2001); SEC v. Banner Fund Int'l., 211 F.3d 602, 614 (D.C. Cir. 2000); Teague v. Bakker, 35 F.3d 978, 986 n.8 (4th Cir. 1994). The Ninth Circuit has held that either horizontal or narrow vertical commonality is sufficient. Hocking v. Dubois, 885 F.2d 1449, 1459 (9th Cir. 1989). The Second Circuit has held that horizontal commonality is sufficient, and broad vertical commonality is insufficient, but has not addressed narrow vertical commonality. *See* Revak v. SEC Realty Corp., 18 F.3d 81, 87-88 (2d Cir. 1994).

257 ALAN S. GUTTERMAN, BUSINESS TRANSACTIONS SOLUTIONS loc. § 151:43 (2022) (ebook).

258 SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946).

259 Reves v. Ernst & Young, 494 U.S. 56, 67-68 (1990).

260 The Court in *Reves* specifically recognized the payment "interest" as a sufficient measure of profit sharing, while noting that profit sharing under *Howey* is more narrowly defined. "We have, of course, defined "profit" more restrictively in applying the *Howey* test to what are claimed to be 'investment contracts.' *See, e.g.*, United Housing Foundation, Inc. v. Forman, 421 U.S. 837 852, ("'[P]rofit' under the *Howey* test means either 'capital appreciation' or 'a participation in earnings'"). *Reves*, 494 U.S. at 82 n.4

261 *Howey*, 328 U.S. at 298-99.

262 *See* Coinbase, WAYBACK *supra* note 69 (warning that the participants' funds may be left out).

federal securities laws.[263] The SEC also claimed that BlockFi had operated as an unregistered investment company, violating the Investment Company Act of 1940.[264] While the last claim is independent of the determination of whether the BIA program involved securities, the first two claims depend squarely on the answer to that question.

Assuming that the *Reves* test applies, the BIA program analysis would depend on the same four questions discussed above in the context of Coinbase Lend. However, the outcome of this analysis would not necessarily be the same.

As stated in Section IV. E. of this Article, the first part of the *Reves* test asks whether the purpose of the notes is to raise capital for general business use and whether the lenders expect to share profits as a result of lending assets to the issuer.[265] Interest payments can satisfy this requirement under *Reves*.[266] In the case of BlockFi, there were also explicit statements indicating that the participants in the BIA program would share in the proceeds from the deposited amounts.[267] Although BlockFi's blog posts were updated to note that U.S. customers could no longer increase their participation in BIAs, the company continued to explain that it set payment terms based on its own earnings. It stated that "[r]ates on cryptoassets held in BIA are primarily driven by demand of institutional investors borrowing for these assets."[268] This looks far

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263 SEC BlockFi Order, *supra* note 15, at 2-3.

264 *Id.*

265 This element is explained in *Reves* as follows:

> First, we examine the transaction to assess the motivations that would prompt a reasonable seller and buyer to enter into it. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a 'security.'

Reves v. Ernst & Young, 494 U.S. 56, 66 (1990).

266 *See supra* note 259-60.

267 SEC BlockFi Order, *supra* note 15, at 2 ("Investors in the BIAs had a reasonable expectation of obtaining a future profit from BlockFi's efforts in managing the BIAs based on BlockFi's statements about how it would generate the yield to pay BIA investors interest.").

268 *Update to BlockFi Interest Account (BIA) Rates*, BLOCKFI, https://blockfi.com/update-to-blockfi-interest-account-bia-rates[https://perma.cc/7EZQ-7A5L](last visited Nov. 29, 2022) [hereinafter *BIA Rates*]. Note that it is anticipated that all of this language will shortly be updated as BlockFi has filed for bankruptcy protection. See Liam J. Kelly & Daniel Roberts, *Crypto Lender BlockFi Filing*

more like a promise to share profits rather than a simple promise to repay a loan with interest, thus supporting the argument that BIAs are a profit-sharing arrangement.

Application of the second element of *Reves*, which asks whether the notes were being sold to a significant number of persons, also suggests that the BIA program may have involved the sale of securities.[269] According to the SEC Order, as of December 8, 2021, BlockFi had approximately 572,160 investors in its BIA program, including 391,105 in the United States.[270] This significantly exceeds the distribution of notes to a total of 23,000 persons in *Reves*, of whom only about 1,600 held notes at the time of the issuer's bankruptcy,[271] and is equivalent to the "hundreds of thousands" of customers that had expressed preliminary interest in the Coinbase Lend program.[272] Thus, this element would presumably also be present for BlockFi's BIA program, as it probably was for the planned Coinbase Lend product.

The third part of the test, which this Article suggests was missing in the case of Coinbase Lend, asks whether the notes were marketed as investments.[273] The SEC stated that BlockFi "promoted the BIAs as an investment."[274] BlockFi touted the returns that participants could earn as "crypto investors."[275] The references to investments have now been deleted from BlockFi's description of its program on its amended website and updated blog posts.[276] Still, the focus of its blog continues to be on the potential for profit (now described as "yields") from

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for Bankruptcy and Conducting Major Layoffs as FTX Contagion Claims Another: Source, DECRYPT (Nov. 28, 2022), https://decrypt.co/115744/crypto-lender-blockfi-files-bankruptcy-ftx-contagion-claims-another [https://perma.cc/2A78-ABVW].

269 The element is described in the opinion as an examination of "'plan of distribution' of the instrument, to determine whether it is an instrument in which there is 'common trading for speculation or investment.'" *Reves*, 494 U.S. at 66 (citations omitted).

270 SEC BlockFi Order, *supra* note 15, at 2.

271 Reves v. Ernst & Young, 494 U.S. 56, 68 (1990).

272 *See supra* note 75.

273 This test requires the court to "examine the reasonable expectations of the investing public." *Reves*, 494 U.S. at 66.

274 SEC BlockFi Order, *supra* note 15, at 2.

275 *Id.* at 5.

276 *Buy, Sell, and Earn Crypto*, BLOCKFI, https://blockfi.com/ [https://perma.cc/PRP6-VX8N] (last visited Nov. 30, 2022) [hereinafter BlockFi Website]

participating for those still eligible for the program.[277] Though U.S. investors are no longer allowed to increase their participation in BIAs, BlockFi continued to proclaim that the objective of the BIA program (available to persons outside the U.S. until the bankruptcy filing on November 28, 2022) was to "balanc[e] prudent risk management principles amid shifting market conditions."[278] This express linkage of yield to the managerial efforts of BlockFi would certainly seem to have made it reasonable for purchasers to believe that they were investing in BlockFi's business when they elected to participate in a BIA.

The last part of the *Reves* test asks whether there is another regulatory scheme at play that reduces the risk of the investment. [279] BlockFi's case is weaker than Coinbase's. Unlike Coinbase, BlockFi was never a public reporting company, so there exists little public information about the company and its operations.[280] BlockFi was not a BitLicense holder, having decided to exclude New York residents from participating in its offerings rather than complying with the extensive BitLicense requirements.[281] Thus, that regulatory regime did not protect participants in the BIA program.

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277 "Our goal is to practice sound risk management and maintain earning opportunities for you with our BlockFi Interest Account (BIA)." *BIA Rates*, *supra* note 268. This blog post and the BlockFi homepage both prominently noted that U.S. persons were no longer allowed to invest in BIAs. The disclaimer on this particular post said that "[t]he BIAs have not been registered under the Securities Act of 1933 and, unless otherwise exempt from those registration requirements, may not be offered or sold in the United States, to U.S. persons, for the account or benefit of a U.S. person or in any jurisdiction in which such offer would be prohibited." *See also* BlockFi Website, *supra* note 276. It is expected that BlockFi's bankruptcy will result in additional changes to the disclosures and this website.

278 *BIA Rates*, *supra* note 268.

279 As explained by the Court, "[f]inally, we examine whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary." Reves v. Ernst & Young, 494 U.S. 56, 67 (1990).

280 Elliot, *supra* note 186.

281 An archived 2020 post in a Reddit discussion room, from a moderator purporting to speak on behalf of BlockFi, explained that "BlockFi accounts are not available for New York State residents. We're hopeful that some of the state rules and regulations surrounding crypto change in the near future so we will be able to offer our interest account in New York!" Isabelle_BlockFi (Moderator), *BlockFi in New York State?*, BLOCKFI COMMUNITY REDDIT (Nov. 27, 2020),

https://www.reddit.com/r/blockfi/comments/k22xs3/blockfi_in_new_york_state/ [https://perma.cc/F6PT-CZNM].

On the other hand, BlockFi was registered with FinCEN as a money services business.[282] In addition, its parent company was located and licensed in Bermuda, as explained on BlockFi's website:

> BlockFi International Ltd. holds a Class F digital assets business license under the Digital Assets Business Act, 2018 (as amended) and is licensed by the Bermuda Monetary Authority to conduct the following digital assets business activities: (i) issuing, selling or redeeming virtual coins, tokens or any other form of digital assets (ii) operating as a digital asset exchange (iii) providing custodial wallet services (iv) operating as a digital asset derivative exchange provider and (v) operating as a digital assets services vendor.[283]

Although these other regulatory structures are in place, the SEC has long taken the view that foreign businesses interacting with U.S. citizens must comply with U.S. law.[284] Thus, the relative lack of applicable U.S. regulation makes BlockFi's arguments for falling outside the *Reves* test weaker than Coinbase's. Still, it should be noted that the SEC's conclusion that BlockFi's BIAs were securities under *Reves* is not completely clear-cut.

In addition, if a court determines that BlockFi's BIAs should be evaluated under *Howey* as investment contracts, the circumstances surrounding this program make it more likely to involve the sale of securities than Coinbase Lend's planned program did. BlockFi marketed its BIAs as investments.[285] There was more linkage between the participants[286] and the company than in the case of Coinbase,[287] meaning that it is far likelier a court would have found a common

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282 *Terms of Service*, BLOCKFI, https://blockfi.com/terms (last updated Nov. 2, 2022) [https://perma.cc/F5AE-26DF].

283 BlockFi Website, *supra* note 276.

284 As noted by the SEC in 2004, "the number of foreign companies accessing the U.S. public markets has increased dramatically." U.S. SEC. & EXCH. COMM'N, *International Reporting and Disclosure Issues* (Nov. 1, 2004), https://www.sec.gov/divisions/corpfin/internatl/cfirdissues1104.htm[https://perma.cc/72KL-DM7W]. This document explicitly notes that the '34 Act "requires companies to register each public offering of securities in the U.S." *Id.* While there are various "accommodations" for foreign reporters, there is no exemption simply because a foreign company complies with the laws of its home nation.

285 *See supra* notes 101-04 and accompanying text.

286 *Id. See also* BlockFi N.J. Order, *supra* note 102 and accompanying text.

287 BlockFi linked its operations to the return promised to investors by repeatedly explaining how its interest rates were based on the returns that BlockFi itself could generate. *See supra* notes 99-101 and accompanying text.

enterprise.[288] The "interest" payments on BIAs were also linked to the company's profitability, making it clear that the third element of *Howey*—the expectation of profits[289]—would also have been present in the case of the BIAs. Further, any such return on investment would have been due to the exclusive managerial efforts of the company, indicating that the final element would be present, just as it presumably was with Coinbase.[290]

This analysis, however, bypasses the central argument of this paper, which is that the appropriate way to analyze lending products, such as Coinbase Lend and BlockFi's BIAs, is through the *Reves* test and not *Howey* at all.

V. THE SEARCH FOR REGULATORY CLARITY

The SEC's failure to be transparent in its approach to crypto lending products is problematic. Moreover, regardless of what test the SEC decides to apply, there is, at the very least, room to debate the appropriate conclusion as to whether crypto lending products should be classified as securities. Additional clarity is almost certainly needed to assist businesses that desire to operate in compliance with the applicable regulations.

While this Article argues that *Reves* is the appropriate test for lending products such as Coinbase Lend and BlockFi's BIAs, the SEC felt it necessary to bolster its position by arguing that the *Howey* test should apply if *Reves* is not met. Assuming that *Reves* is the correct test, this Article suggests that the Coinbase Lend program should not have been classified as a security, even though the BIA program may have met the requirements to be classified as such. These conclusions do not agree with the Commission's apparent position.

This only touches the complexity and uncertainty inherent in the question of which crypto lending products might fall under the SEC's

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288 The common enterprise requirement stems directly from *SEC v. W.J. Howey Co*., 328 U.S. 293, 299 (1946). The difficulties in applying this element are discussed *supra* at notes 34 and 256.

289 *Howey*, 328 U.S at 298. *See also supra* text accompanying notes 35 and 260.

290 *Howey*, 328 U.S. at 299. S*ee also supra* note 36 and accompanying text. *See* Grewal, supra note 73 (claiming that the SEC cited both *Reves* and *Howey* in its Wells Notice to Coinbase). In its order against BlockFi, the Commission proclaimed that "the BIAs were securities because they were notes under *Reves*," but it argued that the conclusion was appropriate "because BlockFi offered and sold the BIAs as investment contracts under *SEC v. W.J. Howey Co*. . . . ." SEC BlockFi Order, *supra* note 15, at 2.

jurisdiction. While this Article suggests that the Coinbase Lend product should not have been classified as a security, no such argument is made regarding the product offered by BitConnect and its promoters. In addition, the argument that the securities laws do not apply is much weaker in the case of BlockFi's BIA.[291] Many crypto lending products are designed to work differently from the planned Coinbase program. Those products may or may not be classified as securities either under *Reves* or *Howey,* or potentially under some other test. [292]

Consider some of the other CeFi options currently or recently in existence. Celsius, for example, locked in deposits for lengthy periods of time, substantially increasing the risk associated with participating in the program.[293] Because the Celsius platform was riskier and looked so dissimilar to conventional interest-bearing bank accounts, the Celsius products may still be included in the definition of security.[294] This may occur because they do not bear a family resemblance to anything we

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[291] The Wells notice sent by the SEC to Coinbase, for example, cited both *Howey* and *Reves* and reportedly declined to articulate which of the two tests should apply. *See supra* text accompanying notes 76-82.

[292] Included in the statutory definition are interests that amount to a "participation in any profit-sharing agreement," and "any interest or instrument commonly known as a 'security.'" Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. § 77b(a)(1)).

[293] Customers on this platform were required to choose between term limits that were significantly longer than regular financial institutions. *1.7 Million People Call Celsius Their Home for Crypto*, CELSIUS, https://celsius.network/ [https://perma.cc/B5GY-WCXM] (last visited Oct. 12, 2022) ("Loan Term" options showing "12 mo.," "24 mo.," "48 mo.," or "60 mo."). *Compare with* Spencer Tierney, *Short-Term vs. Long-Term CD: Which Do I Choose?*, NERDWALLET (Sept. 18, 2020), https://www.nerdwallet.com/article/banking/short-term-or-long-term-cds [https://perma.cc/UH8F-N84E] (stating that bank certificates of deposit generally range from three months to five years). The past tense is used when describing Celsius because on July 13, 2022, Celsius filed for bankruptcy protection in the Southern District of New York, an apparent victim of the prolonged downturn in crypto markets and its own business model. Olga Kharif & Joanna Ossinger, *Crypto Lender Celsius Files for Bankruptcy After Cash Crunch*, BLOOMBERG, https://www.bloomberg.com/news/articles/2022-07-14/crypto-lender-celsius-files-for-bankruptcy-in-cash-crunch [https://perma.cc/Y2L3-J24L]. (last updated July 14, 2022).

[294] Ana Nicenko, *Celsius Reportedly Was Built on High Risk – Investor Documents Show*, CRYPTOCURRENCY NEWS (June 29, 2022), https://finbold.com/celsius-reportedly-was-built-on-high-risk-investor-documents-show/ [https://perma.cc/4QU7-L5FE].

know and should not be regulated as a security under the *Reves* four-part analysis.[295]

Lendingblock also offers a riskier program that differs from the demand-deposit options described above. Lendingblock's website describes a commitment with locked-in terms of one, three, or six months, and resembles the Celsius model (albeit with shorter durations).[296] However, to receive the maximum interest rates at Lendingblock, participants must hold and stake a sufficient balance of LND, the governance and utility token used on the Lendingblock platform.[297] Because this company actively asks participants to buy LND tokens to work in conjunction with its interest program, it is likely that this program is affirmatively seeking investment in the company and that participants, or potential participants, would regard the program as requiring an investment.[298] This would mean that, under *Reves*, the interest is more likely to be a security because of how purchasers would view it.[299] Furthermore, under section 3 of the '34 Act, there is a statutory exemption for notes with "a maturity at the time of issuance of not exceeding nine months."[300] It is therefore more likely that the SEC

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295 This assumes that *Reves* continues to be the appropriate test, even though the lengthy terms required to participate in the Celsius program made the entire project look more like the sale of investment contracts. Thus, an added complication is the possibility that the entire test could shift from the *Reves* analysis of notes to the *Howey* investment contract test.

296 These terms are, at least, somewhat consistent with the conventional longer-term deposits at legacy financial institutions, which seem to make it more likely that *Reves* would be the appropriate test.

297 *Boost Your Earn & Borrow With LND*, LENDINGBLOCK, https://www.lendingblock.com/lnd-boost [https://perma.cc/QZ9Q-EAPK] (last visited Oct. 12, 2022). Gold tier offers a 20% interest boost, while silver and bronze offer smaller boosts.

298 *Id.* The requirement to purchase the company's token could be enough to make regulators and courts evaluate this program as an investment contract under *Howey*. *See supra* Part I for information about what that would entail.

299 As described earlier in this Article, the first factor under *Reves* asks how the issuer and purchasers view the arrangement. *See* Reves v. Ernst & Young, 494 U.S. 56, 66 (1990).

300 Securities Exchange Act of 1934, § 3 (codified as amended at 15 U.S.C. § 78c(a)(10)). Although there is no corresponding language in the definition of "security" in the '33 Act," there is an exemption from registration for "note[s] . . . "which arise out of a current transaction . . . and which [have] a maturity at the time of issuance of not exceeding nine months[.] . . . " Securities Act of 1933, ch. 38, 48 Stat. 74, (codified as amended at 15 U.S.C. §§ 77a-77aa). Short term notes are likely to be interpreted similarly since the two statutes have been construed to

would seek to apply *Reves* to interests like those offered by Lendingblock since they fall so far outside the statutory exemption based on duration.

A change in the design of any given lending product could mean that the appropriate test would be more likely to shift from *Reves* to *Howey.* For example, the product might not have a contractual obligation to repay deposited assets, or it might have the right to hold them for extended periods.[301] Alternatively, a program might promise a share of profits rather than a flat interest rate, much as the BitConnect program was supposed to do.[302] This approach could easily make the program look more like it involves investment contracts than notes.

Not only is the application of the tests relied upon by the SEC unclear, but the lack of certainty as to which test applies significantly increases the difficulty of predicting how the SEC will characterize a particular interest. This could be further complicated if the Commission or reviewing court decides that the analysis should turn on whether there is an interest in a profit-sharing arrangement or some other part of the statutory definition of security that does not involve *Howey* or *Reves*.[303]

The weaknesses with the current approach seem relatively obvious. If the SEC must cite two conflicting tests to support its conclusion that a particular lending program involves a security, then the analysis is not "clear." In fact, it means that businesses cannot even ascertain which test actually applies to their programs. Additionally, the SEC has, at times, refused to explain how it applies whichever test it utilizes. Thus, the problem involves both a lack of information regarding the appropriate test and how it should be applied.[304]

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be in pari materia. *See* Ballard & Cordell Corp. v. Zoller & Danneberg Exploration, Ltd., 544 F.2d 1059, 1066 (10th Cir. 1976); Axelrod & Co. v. Kordich, Victor & Neufeld, 451 F.2d 838, 843 (2d Cir. 1971); Brown v. Gilligan, Will & Co., 287 F. Supp. 766, 775 (S.D.N.Y. 1968).

301 Some existing crypto lending programs require customers to deposit their assets for a term of years, as Celsius did. *See* CELSIUS *supra* note 293.

302 *See* Brown complaint at 3, *supra* note 86. *See also supra* note 87-88 and accompanying text.

303 For example, the definition of security in the '33 Act includes (in addition to traditional stock, notes, and investment contracts) "evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement . . . [and] any interest or instrument commonly known as a 'security[.]'" Securities Act of 1933, ch. 38, 48 Stat. 74, § 2 (codified as amended at 15 U.S.C. § 77b(a)(1)).

304 While this Article relies on the accuracy of Coinbase's description of the Wells notice, the lack of official guidance from the SEC is telling. As of this writing, while the Chair of the Commission has repeatedly claimed in public speeches and

The repeated insistence from the SEC, or at least from its Chair, that the test is clear and that it already covers lending programs diminishes any impetus for Congress to act at a time when Congressional action could truly clarify the situation. This is particularly problematic because CeFi lending programs are simpler to resolve than other crypto lending alternatives that might operate without a business enterprise offering the interest payments. What happens when crypto lending is arranged in a DeFi model where the closest thing to an issuer of the loan is the computer program rather than a centralized enterprise?[305]

When there is no intermediary and only a computer program facilitating the crypto loans, who is the "issuer" when securities are involved? The federal securities laws have a circuitous definition of an issuer, which "means every person who issues or proposes to issue any security." With certain limited exceptions, the term "issuer" means the "person" or "persons" responsible for creating or managing the interests.[306] However, "person" is defined to include only "an individual, a corporation, a partnership, an association, a joint-stock company, a trust, any unincorporated organization, or a government or political subdivision thereof."[307] It does not mention any possibility of a computer program acting as a person and therefore being a potential issuer.[308]

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testimony that the authority of the agency is "clear," there has been no official explanation of the appropriate test for businesses to apply. *See* Bradley, *supra* note 189 (describing Chair Gensler's position).

305 DeFi (which stands for decentralized finance) exists without intermediaries. In DeFi lending protocols, persons lending cryptoassets are matched directly with borrowers. There is no middleman like Coinbase operating at the center of the program. In the context of securities exchanges, the SEC has attempted to address this issue by substantially broadening the definition of "exchange" to include persons who "make available" a "computer program" through which trading of securities occurs. *See* Amendments Regarding the Definition of "Exchange" and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities, 17 Fed. Reg. 526 (proposed Sept. 2022) (to be codified at 17 C.F.R. pt. 232, 240, 242, and 249), https://www.sec.gov/rules/proposed/2022/34-94062.pdf [https://perma.cc/T42Z-F8LS] (amending the definition of terms used in the '34 Act).

306 Securities Act of 1933, ch. 38, 48 Stat. 74, § 2 (codified as amended at 15 U.S.C. § 77b(a)(4)).

307 Securities Act of 1933, ch. 38, 48 Stat. 74, § 2 (codified as amended at 15 U.S.C. § 77b(a)(2)).

308 The decision not to recognize computer programs as legal persons is not limited to securities laws. The Restatement (Third) of Agency, for example, explicitly

Additionally, to be an underwriter, there must first be a purchase from an issuer.[309] Similarly, one cannot control or be under common control of the issuer unless there is such a person.[310] Nor can one be considered an affiliate, except to the extent that there is a person with whom to be affiliated,[311] and aiding and abetting is impossible unless another person has committed a primary violation.[312]

Nevertheless, in a DeFi crypto loan, the transaction that might involve a security is arranged through the operation of a computer program, which is not a person. Who, then, is the issuer that might be subject to the SEC's jurisdiction? Unless the law is clarified, this difficult issue will be left unresolved and may leave a large swath of transactions unregulated.[313]

The reality is that even with an issuer who can be clearly identified, the securities laws do not clearly indicate how to treat DeFi transactions.[314] Similar to how centralized models operate, DeFi lending programs are also structured in a wide variety of ways. A platform might, for example, simply match up depositors and borrowers and allow them to make their own arrangements. For example, INLOCK

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notes in a comment to the section defining "agents" that "a computer program is not capable of acting as a principal or an agent as defined by the common law. At present, computer programs are instrumentalities of the persons who use them." RESTATEMENT (THIRD) OF AGENCY § 1.04 cmt. e (AM. L. INST. 2006).

309 Securities Act of 1933, ch. 38, 48 Stat. 74, § 2 (codified as amended at 15 U.S.C. § 77b(a)(11)).

310 *Id*.

311 17 C.F.R. § 230.405 ("An affiliate of, or person affiliated with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified.")

312 Gregory E. Van Hoey, *Liability for "Causing" Violations of the Federal Securities Laws: Defining the Sec's Next Counterattack in the Battle of Central Bank*, 60 WASH. & LEE L. REV. 249, 257 (2003).

313 In fact, the Chair of the SEC has publicly opined that DeFi is particularly concerning. In August 2021, he specifically called for greater legislative guidance for crypto lending and DeFi. At that time, he said, "[i]n my view, the legislative priority should center on crypto trading, lending, and DeFi platforms. Regulators would benefit from additional plenary authority to write rules for and attach guardrails to crypto trading and lending." Gary Gensler, *Remarks Before the Aspen Security Forum*, U.S. SEC. & EXCH. COMM'N (Aug. 3, 2021), https://www.sec.gov/news/speech/gensler-aspen-security-forum-2021-08-03 [https://perma.cc/G4MK-JQGX].

314 Commissioner Caroline A. Crenshaw, *Statement on Defi Risks, Regulations, and Opportunities*, U.S. SEC. & EXCH. COMM'N (Nov. 9, 2021), https://www.sec.gov/news/statement/crenshaw-defi-20211109 [https://perma.cc/RKW5-JFY5].

facilitates peer-to-peer crypto-backed loans in this manner.[315] Meanwhile, other DeFi programs place deposits into pools, with participants in each pool sharing returns from that particular pool. Aave, for instance, uses liquidity pools to handle customers deposits and arrange loans.[316] Thus, the open questions for DeFi crypto lending include all of the following. If a security is being sold, who is the issuer? What test is applied to determine whether the loans or other transactions should be classified as securities? And whatever test is chosen, how does it apply to the specific facts and circumstances of the program under consideration? None of those questions has a clear-cut, obvious answer.

The entire area of crypto lending is ripe for legislative reform. The laws are opaque, uncertain, and inconsistently applied.[317] Moreover, the most compliant companies appear to be subjected to the strictest enforcement and penalties. The SEC asks for cooperation and

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315 *Unlock Your Crypto's Potential*, INLOCK, https://inlock.io/?cf_chl_captcha_tk__=pmd_b3_tQjqwCX08ueWTak13RMjdyE1QU6xSAD_gXSoTnis-1634146122-0-gqNtZGzNAxCjcnBszQi9[https://perma.cc/4EQ6-8R5Y] (describing a DeFi program).

316 *See Liquidity Protocol*, AAVE, https://aave.com/ [https://perma.cc/LA39-A8QV] (last visited Sept. 15, 2022).

317 A growing number of commentators have complained about the difficulty in understanding the SEC's approach to crypto regulation. *See* Yuliya Guseva, *The SEC, Digital Assets, and Game Theory*, 46 J. CORP. L. 629, 630 (2021) (noting that the SEC "has not provided a clear rule to digital-asset market participants concerning the nature of cryptoassets . . . "); Goforth, *supra* note 38 (criticizing the current SEC approach as being opaque); James J. Park & Howard H. Park, *Regulation by Selective Enforcement: The SEC and Initial Coin Offerings*, 61 WASH. U. J. L. & POL'Y 99, 102 (2020) (noting that "the SEC's effort with respect to ICOs was distinctively selective because it left some significant violations of the securities laws unaddressed."); Chris Brummer & Yesha Yadav, *Fintech and the Innovation Trilemma*, 107 GEO. L. J. 235, 306 (2019) (suggesting that conflicting regulatory mandates may explain some of the difficulties in having a coherent response to crypto transactions).

communication,[318] but then seems to punish those who comply.[319] For example, in the Coinbase action, the reality is that other enterprises with similar lending crypto programs were still operating even as the SEC pressured Coinbase to shut down its plans.[320] In addition, some of the recent enforcement actions have not benefited U.S. residents.[321]

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[318] *Stategic Hub for Innovation and Financial Technology (FinHub)*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/finhub [https://perma.cc/4WFH-6HKA] (last visited Sept. 15, 2022) (As of August 25, 2020, this page "encourages anyone working with RegTech solutions or implementations to engage with FinHub as part of this initiative."). *See also FinHub to Host Virtual Meet-Ups*, U.S. SEC. & EXCH. COMM'N (June 11, 2020), https://www.sec.gov/news/press-release/2020-130 [https://perma.cc/VN35-TX89] (This page "encourages anyone working with RegTech solutions or implementations to engage with FinHub as part of this initiative.").

[319] Coinbase is a case in point. *See* Grewal, *supra* note 73. Nor is this the only example of the SEC reacting harshly to companies with a history of cooperation. Telegram Group Inc. planned a two-stage offering, the first of contractual rights and the second of functional tokens to be known as Grams. Yuliya Guseva, *A Conceptual Framework for Digital-Asset Securities: Tokens and Coins As Debt and Equity*, 80 MD. L. REV. 166, 188 (2021). *See also* Carol Goforth, *SEC vs. Telegram: Part 1 — Key Takeaways for Now*, COINTELEGRAPH (Sept. 21, 2020), https://cointelegraph.com/news/sec-vs-telegram-part-1-key-takeaways-for-now [https://perma.cc/W3UJ-W4BN]. When the SEC first requested its preliminary injunction, the response by Telegram detailed how the company had spent the preceding 18 months in voluntary talks with, and soliciting feedback from, the SEC, "consistent with the SEC's publicly stated desire to engage with developers of digital asset technologies." Defendants' Response In Opposition to Plaintiff's Emergency Application for Preliminary Injunction, SEC v. Telegram Grp. & TON Issuer Inc., No. 19 Civ. 9439 (S.D.N.Y. Oct. 16, 2019). It is also noteworthy that the Telegram's response claimed that, despite being fully aware of the terms of the proposed offering, "the SEC (i) never requested that Telegram delay the launch of the TON Blockchain; [and] (ii) never advised Telegram of its intention to seek injunctive relief[.]" *Id.* at 3.

[320] For example, as of June 1, 2022, centralized lending programs included those offered by Celsius (unavailable in NY, KY, or WA); Nexo (no new startups in a number of states); Ledn (unavailable in nine states and the District of Columbia); Crypto.com (unavailable in N.Y. and capped at $500,000); Gemini; Earn; and Voyager (unavailable in NY). *Compare the Best Crypto Interest Acco unts*, CEFI RATES, https://www.cefirates.com/ [https://perma.cc/4CGE-2STQ] (last visited Sept. 15, 2022). This is not a complete listing of CeFi crypto lending programs, and it does not include DeFi options. It should also be noted that Voyager was the target of multiple state actions, although as of this writing, the SEC has not made any public announcement about its operations. In addition, since that list was compiled both Celsius and Voyager have declared bankruptcy. *See* Lang, Nishant & Saini, *supra* note 12.

[321] For another critique of SEC actions along these lines, *see* Carol R. Goforth, *Regulation of Crypto: Who Is the Securities and Exchange Commission*

Consider again the Coinbase program. The planned Coinbase Lend program was shut down, meaning that U.S. customers no longer have access to the higher yields that might have been available. There were no allegations that the program was illegitimate, overly risky, under-capitalized, or trying to avoid enforcement.[322] So, who is protected by a decision to eliminate this option?

The real winners are legacy financial institutions because they no longer have to face the potential competition of higher rates offered by Coinbase, and other players in the crypto lending markets who are currently unwilling to market lending products to U.S. participants.[323] Enforcing securities laws against programs like Coinbase Lend does not protect U.S. investors – who can still access such programs,[324] just not from Coinbase – which ironically is a public corporation and therefore a more transparent issuer.[325] Moreover, it places U.S. residents at a competitive disadvantage with much of the world, where crypto lending programs are not regarded with such hostility.[326]

For example, YouHodler has been described as offering "high interest" on crypto savings deposited with it.[327] At one time, the company offered returns on crypto loans of up to 12%

Protecting?, 58 AM. BUS. L. J. 643, 645 (2021) (criticizing the SEC's actions against Telegram Group and Kik Interactive Inc. as not advancing the interests of American consumers).

322 Grewal, *supra* note 73.

323 *See infra* note 329 for a list of some of these programs.

324 *See supra* note 320 for a listing of alternatives.

325 Coinbase became a publicly registered company in 2021 and is therefore subject to on-going public reporting requirements. Aratani, *supra* note 14.

326 Susannah Hammond & Todd Ehret, *Cryptocurrency regulations by country*, THOMAS REUTERS (2022), https://www.thomsonreuters.com/en-us/posts/wp-content/uploads/sites/20/2022/04/Cryptos-Report-Compendium-2022.pdf [https://perma.cc/4FWZ-BD4H].

327 Robert Farrington, *YouHodler Review – Worldwide Crypto Savings And Lending*, THE COLLEGE INVESTOR, https://thecollegeinvestor.com/36901/youhodler-review/ [https://perma.cc/7SNA-8U2W] (updated Nov. 13, 2022).

APR."[328] However, YouHoldler does not serve U.S. citizens.[329] In fact many programs exclude U.S. participants,[330] giving crypto owners in other jurisdictions access to programs that may have additional risk but may offer higher rates of return.

Coinbase is also reportedly proceeding with a program that is at least somewhat similar to its originally planned Lend program, with the caveat that users in the new program will not come from the U.S.[331] In December 2021, Coinbase announced on its blog that it would enable "eligible customers in more than 70 countries to access the attractive yields of DeFi from their Dai with no fees, lockups, or set-up hassle."[332] Under this new program, Dai is to be deposited into "an industry-leading DeFi protocol," Compound Finance.[333] Coinbase states clearly that although it monitors the protocols, it does not guarantee against losses, meaning that this may be a riskier alternative than the original Lend program where Coinbase had indicated that it would guarantee the return of deposited tokens.[334]

It is anomalous to "protect" American investors by preventing them from being able to choose a higher level of risk in return for higher rates of return, while it allows others outside the U.S. to invest in opportunities with less information. It is especially ironic when one of

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328 *Keep Crypto. Use Cash*, YOUHOLDLER, https://www.youhodler-swiss.com/#:~:text=Keep%20HODLing%20and%20get%20instant,%2C%20or%20Bitcoin%20(BTC) [https://perma.cc/4D6L-HN2P] (last visited Oct. 14, 2022). YouHoldler has recently reduced available rates. *See YouHodler Review - Is YouHodler Safe*, P2P EMPIRE, https://p2pempire.com/en/review/youhodler [https://perma.cc/38V6-BQP7] (last updated Oct. 31, 2022).

329 *The Ultimate List of Cryptocurrency Lending Platforms*, SELFKEY BLOG (July 9, 2020), https://selfkey.org/the-ultimate-list-of-cryptocurrency-lending-platforms/ [https://perma.cc/8NS7-7JZ2].

330 *Crypto Lending in the United States*, SELFKEY BLOG (June 12, 2020), https://selfkey.org/crypto-lending-in-the-united-states/ [https://perma.cc/6BVA-UEX2].

331 Mitchell Clark, *Coinbase Will Let Users Earn Interest on Crypto but not in the US*, THE VERGE (Dec. 9, 2021, 6:15 PM), https://www.theverge.com/2021/12/9/22826888/coinbase-defi-interest-non-us-compound-lending-program [https://perma.cc/984S-G8E8].

332 Rhea Kaw, *Coinbase Makes it Easy to Earn Yield with DeFi*, COINBASE BLOG (Dec. 14, 2021, 8:24 PM), https://www.bitcoininsider.org/article/138664/coinbase-makes-it-easy-earn-yield-defi [https://perma.cc/C6H8-AZH8].

333 *Id.*

334 *See supra* note 69-72 and accompanying text.

the most recent Congressional pronouncements on related topics concerned the need to "restore investor confidence and to ensure that the financial abuses would not be repeated."[335] The Sarbanes-Oxley Act of 2002 was enacted with "the explicitly stated goal . . . not to substantively regulate corporate behavior, but 'to protect investors by improving the accuracy and reliability of corporate *disclosure*s . . . .'"[336]

VI. CONCLUSION: THE NEED FOR LEGISLATIVE INTERVENTION

The preceding observations explain why the SEC's current approach has not resulted in the clarity that the crypto industry deserves and needs going forward. However, it seems unrealistic to expect the SEC to change its course midstream without external pressure. Courts could force the Commission to reevaluate its approach by determining that *Reves* is the appropriate test, but this would probably require multiple enforcement actions in multiple jurisdictions. Moreover, not only would the named defendants have to spend time and resources to oppose the SEC at the trial court level, but appeals would also likely be necessary. To extend the result across the Circuits, multiple appeals would have to be decided or the Supreme Court would need to step in. Given that there is no record of judicial interpretation concerning the issue of how crypto lending products should be handled, this seems an undesirable approach, and one that is unlikely to be realistic in the near term.

That leaves Congressional action as the most likely way to change the direction that the SEC has chosen to take regarding crypto lending. The SEC, or at least its Chair, seems to have bought into the rhetoric that crypto is for criminals, thereby suggesting that the ecosystem is both unregulated and "rife with fraud."[337] These comments have been made despite research that appears to indicate that, as a percentage of activity in cryptoassets, fraud is actually declining.[338] The disconnect

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335 Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward A More Substantive Approach to Securities Regulation*, 58 BAYLOR L. REV. 139, 141 (2006), (citing Tamar Frankel, *Regulation and Investors' Trust in the Securities Markets*, 68 BROOK. L. REV. 439, 442 (2002)).

336 Ripken, *supra* note 335, at 143.

337 *See* Aratani, *supra* note 14.

338 The blockchain data platform Chainalysis has prepared annual reports evaluating the linkage between crime and crypto since 2019. *Reports*, CHAINALYSIS, https://blog.chainalysis.com/reports/[https://perma.cc/E56P-FSPN] (containing a list of the company's reports). Its 2021 report found that, as a percent of all cryptocurrency activity, scams and other illicit activity accounted for 0.34% by value, as compared to 2.1% of transactions in 2019. Kim Grauer & Henry

between substantially reduced rates of fraud and significantly increased enforcement indicates that a more balanced regulatory approach is desirable.

Despite clear differences of opinion among Congressional leaders,[339] there is some indication that sentiment may be increasingly shifting towards a lighter regulatory response. A December 2021 hearing before the House Financial Services Committee specifically considered how the U.S. government should improve crypto regulations.

> The general sentiment of the hearing was positive towards the cryptocurrency industry, a dramatic shift from past years. This disposition surprised some, but it reflects an evolving view of the benefits of cryptocurrency technology and the fear that the US is falling behind other countries such as China that have made noticeable progress towards launching a sovereign digital currency.[340]

In addition, in March 2022, President Biden issued an executive order directing federal regulators to work together to ensure

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Updegrave, *The 2021 Crypto Crime Report*, *CHAINALYSIS 1, 5* (Feb. 16, 2021) [https://perma.cc/V5LM-LDKS].

339 For example, Senator Elizabeth Warren (D-Massachusetts) has been particularly vocal in expressing concerns about cryptoassets. In a prepared statement from July 2021, she claimed, "While demand for cryptocurrencies and the use of cryptocurrency exchanges have sky-rocketed, the lack of common-sense regulations has left ordinary investors at the mercy of manipulators and fraudsters. These regulatory gaps endanger consumers and investors and undermine the safety of our financial markets." Ajibola Akamo, *US Senator Elizabeth Warren Gives SEC Ultimatum to Regulate Cryptocurrency Trading*, NAIRAMETRICS (July 9, 2021), https://nairametrics.com/2021/07/09/us-senator-elizabeth-warren-gives-sec-ultimatum-to-regulate-cryptocurrency-trading/ [https://perma.cc/2KLW-2R38]. At the other end of the spectrum, Senator Patrick Toomey (R-Pennsylvania) has characterized distributed ledger technology behind cryptoassets as a "powerful technological innovation." Daniel Moore, *Sen. Toomey Buys into Crypto Craze, Praising Potential of Technology Driving Digital Currency*, PITTSBURGH POST-GAZETTE (July 27, 2021, 5:48 PM), https://www.post-gazette.com/news/politics-nation/2021/07/27/Pat-Toomey-cryptocurrency-bitcoin-memestock-banking-committee/stories/202107270021 [https://perma.cc/DZ38-KHYX].

340 Hailey Lennon, *Capitol Hill Warms Up To Crypto*, FORBES (Dec. 9, 2021, 10:15PM), https://www.forbes.com/sites/haileylennon/2021/12/09/capitol-hill-warms-up-to-crypto/?sh=461f0ffb790c [https://perma.cc/C8SA-W2GT].

"responsible development of digital assets."[341] The objectives outlined in the order include protecting consumers, investors, businesses, and financial markets, but also supporting "technological advances that promote responsible development and use of digital assets,"[342] while "fostering international cooperation and Unites States competitiveness with respect to digital assets and financial innovation."[343] While the bulk of the order sets out obligations for various parties to prepare reports, the fact that there has been Presidential recognition of the need to promote responsible development and regulation of cryptoassets suggests that excessive or inconsistent regulation – by the SEC or otherwise – does not advance federal policy objectives.[344] Moreover, it makes the possibility of Congressional action that clarifies the regulatory treatment of cryptoassets in a balanced way somewhat more realistic, although by no means certain.

There are several options for Congressional action, ranging from an amendment to the definition of what constitutes a security, to specific allocation of regulatory authority over crypto lending to a different authority. Recently, the President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, jointly issued a Report on Stablecoins,[345] explicitly noting that there are gaps in the existing

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341 Joseph R. Biden, Jr., Presidential Action, *Executive Order on Ensuring Responsible Development of Digital Assets*, THE WHITE HOUSE (Mar. 9, 2022), https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/ [https://perma.cc/KF6D-WEDW].

342 *Id.* at § 2(f).

343 *Id*. at § 8(a).

344 Petition for Rulemaking – Digital Assets Securities Regulation from Paul Grewal, Chief Legal Officer of Coinbase, to Vanessa A. Countryman, Secretary of SEC (July 21, 2022) (available at https://www.sec.gov/rules/petitions/2022/petn4-789.pdf [https://perma.cc/AD7E-SSCC]) (arguing that it is inconsistent with federal policy objective). Nicholas Anthony, *The Trap of the Trilemma of Cryptocurrency Regulation: Government Control Is Not the Default*, CATO INSTITUTE (Dec. 20, 2021, 9:19AM), https://www.cato.org/blog/trap-trilemma-cryptocurrency-regulation-government-control-not-default [https://perma.cc/55PK-TQN3].

345 PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS, THE FEDERAL DEPOSIT INSURANCE CORPORATION, AND THE OFFICE OF THE COMPTROLLER OF THE CURRENCY, REPORT ON STABLECOINS, U.S. DEPARTMENT OF THE TREASURY (Nov. 1, 2021).

regulations of Stablecoins, and cryptoassets in general.[346] One of the recommendations of this report was that "legislation should provide for supervision [of stablecoins] on a consolidated basis."[347] It is possible that Congress might choose to exempt from the SEC's authority transactions involving interest payments on deposits of stablecoins that themselves are under the regulation of appropriate authorities, as suggested by the Stablecoin Report. Alternatively, interest payments by crypto exchanges regulated by FinCEN and operating in compliance with its requirements (again, like Coinbase) might be exempted from the definition of security, without the need to wait for legislative clarification about how stablecoins are regulated.

A decision to allow the SEC to continue its pattern of enforcement against crypto lending programs without clearly articulating how it is interpreting or applying the laws is detrimental to crypto investors and market participants, who deserve the same opportunities to earn interest on their holdings that persons outside the U.S. can access. There is risk associated with some of these programs, but it should not be up to the SEC to tell the American public how much risk they are allowed to accept.[348] In the absence of fraud or manipulation, that decision should be left to market participants.

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346 *Id.* at 15.

347 *Id*. at 16.

348 Risk is not a negative. As explained in a recent blog post by the Wharton School at the University of Pennsylvania, "Risk-taking enables and encourages innovation, which can be an important product/service differentiator." *Is Risk-Taking Behavior Key to Entrepreneurial Spirit?*, WHARTON ONLINE (Feb. 4, 2020), https://online.wharton.upenn.edu/blog/is-risk-taking-behavior-key-to-entrepreneurial-spirit/ [https://perma.cc/2V6F-QH5H]. PayPal co-founder Peter Thiel is also quoted as saying, "[i]n a world that's changing so quickly, the biggest risk you can take is not taking any risk." *Id.*