Cryptocurrency faces existential threat as crackdown gathers steam

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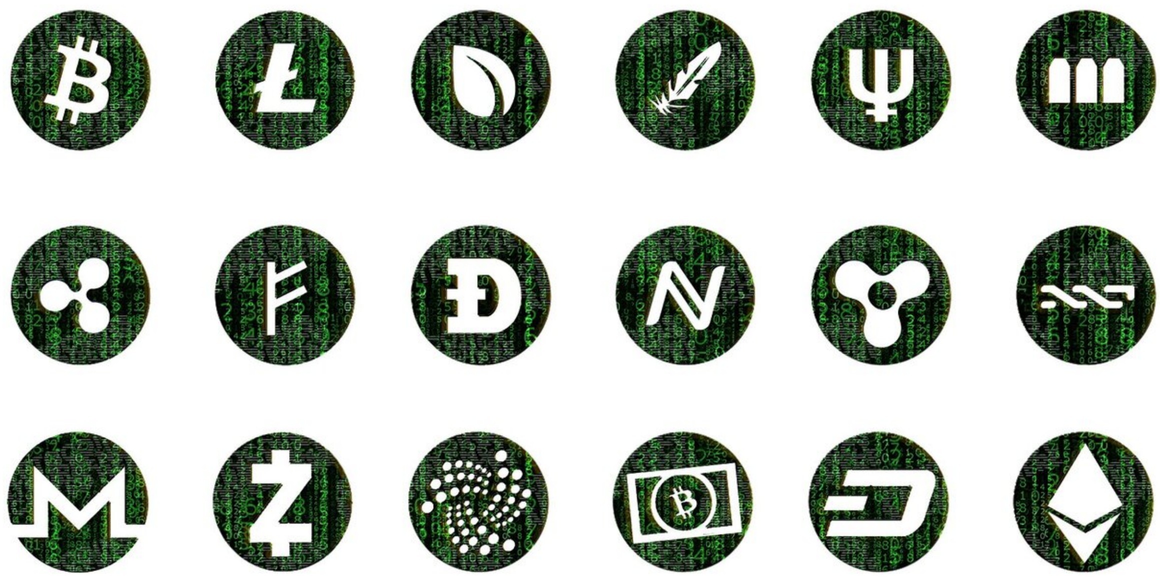

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Cryptocurrency firms are fighting for lobbyists and fielding subpoenas in what could be an existential fight over how the multitrillion-dollar industry should be regulated.

In the past month, lobbyists have been overwhelmed by firms seeking representation in Washington, as regulators threaten the cryptocurrency companies with lawsuits or cease-and-desist orders. Current and former enforcers say those warnings are likely just the beginning.

Over the last decade, the cryptocurrency market has grown from a little-known project shared among technologists and libertarians to a massive and largely unregulated industry. But even as the sector has found innovative ways to record ownership digitally and transfer money cheaply, it's also launched savings accounts and investment funds, products that regulators say ought to follow the same rules as those in traditional financial networks.

As the cryptocurrency industry gears up for a regulatory battle, some lobbyists, who asked to withhold their names to discuss client matters, said they were so deluged by crypto firms looking to hire them in August that they had to turn down some potential clients. Some of the crypto firms said they were being targeted by or expected to be targeted by regulators, the lobbyists said.

Earlier this month, the Securities and Exchange Commission sent a notice to Coinbase Global Inc. that it could be sued for offering proposed accounts with high interest rates.

"Absolutely these firms should be preparing if they aren't already," said Owen Tedford, an analyst with Washington-based Beacon Policy Advisors. "It wouldn't be surprising in the slightest bit to see the Coinbase notice in some ways being a warning shot to the entire industry."

Nearly a third of new registrations for lobbyists in the finance industry in August and September were for crypto firms or advocacy groups, according to Senate filings. Coinbase in August hired two new firms, doubling its Washington presence, with additions including Andrew Olmem, the deputy director of the National Economic Council in the Trump White House. An affiliate of the Diem Association, a group of companies including Facebook Inc. that plans to launch a new cryptocurrency, hired new lobbyists, as did the Digital Currency Group, a crypto-focused venture capital firm.

SEC Chair Gary Gensler drew first blood last week. On Friday, Coinbase quietly abandoned the lending product, announcing the move in a short update to a months-old blog post.

"Crypto lending might be the easiest way for the SEC to get its hooks into the industry, but it's very clear they're looking at cryptocurrencies themselves," said Tyler Gellasch, a former counsel at the SEC who heads the Healthy Markets Association, whose members include large asset managers. If many cryptocurrencies are deemed securities, exchanges such as Coinbase and the rest of the crypto industry "will not be able to make money the way they do today."

Crypto lending incumbents, such as BlockFi Inc. and Celsius Network Inc., have already garnered more than $35 billion in deposits of traditional cryptocurrencies such as Bitcoin, as well as stablecoins, whose values are pegged at $1 and are considered a replacement for fiat money.

Crypto industry executives have said they suspect rival firms in the traditional finance industry, such as large banks, are responsible for pushing regulators.

In a September "Ask Me Anything" event with customers, Celsius Network Chief Executive Officer Alex Mashinsky said he believed bank executives had called the SEC and state regulators to complain about crypto lending firms.

"We have to work twice as hard because these guys have the largest lobbyists working for them at both at the state and the federal level," Mashinsky said. "We'll prevail. The fight is over all the money in the world, right?"

The latest battle is over crypto lending firms, which sometimes offer depositors double-digit yields. The firms say they're able to do that by lending the deposits at even higher rates to institutional investors, who need to borrow crypto for their own trading.

Regulators believe many of the companies should have registered their products as securities, subjecting them to additional disclosure and oversight. The products are sometimes marketed as alternatives to bank savings accounts, and some regulators said investors might be fooled into thinking they were taking little risk.

The dispute came to a head earlier this month when Coinbase CEO Brian Armstrong in a series of tweets accused the SEC of "sketchy behavior" and disputed that Coinbase's proposed accounts were securities.

Gensler said during a Senate Banking hearing last week that Coinbase hasn't registered with the SEC even though "dozens of tokens" on its exchange might be securities. A Coinbase spokesperson said the firm doesn't believe it offers any securities on its platform.

Crypto executives say they're frustrated that regulators are threatening to sue them, rather than giving them guidance on how they can stay within the law.

Last week, BlockFi CEO Zac Prince at the SALT Conference in New York said the SEC and other regulators needed to give his industry clarity on what's allowed. Five states have already taken action against his firm, accusing it of offering unregistered securities to their residents. Prince at the conference said federal guidance is needed, rather than state actions. BlockFi announced Wednesday that New Jersey agreed to extend its order to stop offering the accounts until December.

Even some firms with similar products that did file with the SEC crave more agency guidance. Circle Internet Financial Inc., for example, offers high-yield deposit accounts to corporate clients and notified the SEC under an exemption geared toward accredited investors, said CEO Jeremy Allaire.

"We would love to understand if regulators in the United States want to regulate crypto lending and work with the industry to define what they care about there and define the rules of engagement," Allaire said. "The United States has been extraordinarily reluctant to provide clarity around digital assets."

Enforcers, for their part, believe the law is already clear. During the banking hearing, Gensler pointed to long-standing court decisions that helped define the agency's purview, and said many crypto products and even cryptocurrencies probably fall into its remit.

Gellasch, the former SEC counsel, said that if exchanges are found to be offering securities, that could force them to register with the agency.

Some crypto advocates in Washington said they hope spats such as the one between the SEC and Coinbase do make it to court, so that a judge, rather than agency employees, can determine what's in bounds for the firms.

"I want them to have the courage of their convictions and fight it if they really think their product isn't a security," said Jerry Brito, executive director of Coin Center, a crypto advocacy think tank.

Joe Rotunda, director of the enforcement division for the Texas State Securities Board, said that other crypto lending firms shouldn't expect his agency or other states to hold back even as the SEC starts to move.

"I'm very relieved to see that federal regulators are taking a close look at cryptocurrency depository accounts," said Rotunda, who said his agency and others are still investigating other firms that offer similar products. "At the same time, they still haven't done anything."