CFPB And FTC Take Their Place As Powerful Crypto Cops

By **Benjamin Saul, Tarrian Ellis and Aaron Hsieh** (March 22, 2023)


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The cryptocurrency and digital asset sectors have been in the headlines daily, as certain exchanges and their counterparties face significant scrutiny and financial strain.

The U.S. Securities and Exchange Commission and Commodity Futures Trading Commission are the primary federal regulators of digital asset activity. However, other federal regulators have been expanding what role they may play in the oversight of the digital asset ecosystem.

The Federal Trade Commission and the Consumer Financial Protection Bureau have begun to assert enforcement jurisdiction over certain aspects of the digital asset marketplace.

Crypto-asset businesses, particularly those offering crypto lending, non-fungible tokens, or digital wallet/payments products — which are already facing intense scrutiny from the SEC, CFTC, U.S. Department of Justice and U.S. Department of the Treasury — should not neglect the need to prepare for CFPB and FTC scrutiny. This article explores this trend by the CFPB and FTC and offers ways for companies with potential CFPB and FTC exposure to proactively manage such regulatory risk.

Background and Regulatory Jurisdiction

CFPB

The Dodd–Frank Wall Street Reform and Consumer Protection Act authorized the CFPB to supervise certain consumer financial services companies and large depository institutions that are engaged in offering or providing a consumer financial product or service.[1]

The CFPB has a broad jurisdictional mandate that includes virtually all nonbank providers of consumer financial products and services, including emerging fintechs, payment processors, marketplace lenders and platforms, and all financial institutions with assets of more than $10 billion.

FTC

The FTC was established by the Federal Trade Commission Act of 1914. Section 5 of the FTC Act prohibits "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce" and authorizes the FTC to "prevent persons, partnerships, or corporations, except banks [and certain other entities] from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce."[2]

On Nov. 10, 2022, the FTC issued a new "Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act," which replaced "all prior FTC policy statements and advisory guidance on the scope and meaning of unfair methods of competition under Section 5 of the FTC Act."[3]

The policy statement explains that the FTC may now use Section 5 of the FTC Act to regulate "conduct that tends to cause potential harm similar to an antitrust violation, but that may or may not be covered by the literal language of the antitrust laws or that may or may not fall into a 'gap' in those laws."[4]

Crypto-Related Targets

The CFPB and the FTC have been increasing their scrutiny of the digital assets sector. Summarized below are some of these agencies' increased enforcement activity in the digital assets space.

False or Deceptive Advertising

On Feb. 22, 2023, the FTC filed an objection to a proposed sale of crypto lender Voyager Digital Holdings Inc., fearing it would interfere with its probe into alleged deceptive and unfair marketing of cryptocurrency to the public by releasing the company and its employees from financial claims allegedly related to wrongdoing.

The filing states, "The FTC has commenced an investigation into certain acts and practices of Debtors and Debtors' employees, directors, and officers, for their deceptive and unfair marketing of cryptocurrency to the public" and that "the Proposed Plan grants Debtors a discharge to which they are not entitled."[5]

On Nov. 16, 2022, the FTC brought an action under Section 5(a) of the FTC Act against DK Automation and its owners, Kevin David Hulse and David Arnett, for the use of "unfounded claims of big returns to entice customers into moneymaking schemes involving … cryptocurrency."[6]

The FTC alleged that DK Automation launched a cryptocurrency program that included offering consumers a "'Crypto Automation' package, which is '[b]est for people who want to build CRYPTO WEALTH but don't want to look at charts all day'"[7] and the use of DK Automation's "'#1 secret passive income crypto trading bot' that allowed it to profit 'every single day and 'make absolute insane returns,' even during the crypto crash in January 2022 and that consumers do not need any technical skills or experience with cryptocurrency to make a profit.'"[8]

The FTC further alleged that DK Automation harmed consumers by deceiving them about potential earnings, suppressing negative reviews, and failing to provide required disclosures.[9] The proposed order would require DK Automation to pay $2.5 million to refund harmed consumers, among other relief.

Crypto Lending Platforms

On Nov. 22, 2022, the CFPB issued an administrative order denying Nexo Financial LLC's petition to modify the CFPB's civil investigative demand.[10] The Nexo order represents the first investigation by CFPB of a digital asset company made public.

In denying the Nexo petition, the CFPB asserted that Nexo's Earn Interest Product, a crypto-lending product, was within its jurisdiction to investigate.

Specifically, in the Nexo order, the CFPB stated that unless an entity's conduct is subject to an exclusion from the CFPB's authority under the Consumer Financial Protection Act[11] or an exemption to Regulation E, which implements the Electronic Fund Transfer Act,[12] such conduct is subject to the investigative reach of the CFPB.[13]

As a result, on Dec. 5, 2022, Nexo announced that it would stop offering its products and services in the U.S. over the coming months and that for its Earn Interest Product, it would suspend new registrations for all U.S. customers and immediately remove customers in eight states.[14]

Reports

On Nov. 10, 2022, the CFPB published a new bulletin analyzing consumer complaints submitted to the CFPB over the past four years related to crypto-assets and platforms.[15] The crypto bulletin found that fraud, theft, hacks and scams were a significant problem in crypto-asset markets, with "fraud and scams" making up more "than half of virtual currency complaints received thus far in 2022."[16]

Moreover, CFPB Director Rohit Chopra stated that "our analysis of consumer complaints suggests that bad actors are leveraging crypto-assets to perpetrate a fraud on the public … [and that] [the CFPB] will continue our work to keep the payments system safe from fraudsters targeting Americans."[17]

While the crypto bulletin describes risks to consumers and steps consumers can take to protect themselves, it suggests that entities that offer crypto-assets may also have culpability.

Specifically, customer service deficiencies have "create[d] opportunities" for bad actors to impersonate customer service representatives for purposes of gaining access to consumers' wallets, and failure to respond timely to customer outreach exposes consumers to unnecessary risks.

However, in an interview on Dec. 14, 2022, Chopra stated that "crypto is not a product [whereas] certain electronic consumer transactions are," that he does not anticipate expanding the CFPB's enforcement on crypto companies, and that he believes stablecoins are the number one issue that "would affect consumers and consumer financial protection … [and that policymakers need to] make sure that there are not runs like we've seen in money market funds."[18]

On Sept. 16, 2022, the White House released its first ever comprehensive framework for the federal regulation of digital assets, titled the "Digital Assets Framework," which incorporated a series of nine reports released simultaneously by various federal agencies.[19]

While the Digital Assets Framework does not create any new statutes or regulations, it may signal the likelihood of enhanced regulatory oversight by the two federal agencies that focus on consumer issues.

Specifically, Section 1 of the Digital Assets Framework, titled "Protecting Consumers, Investors, and Businesses," encouraged the CFPB and the FTC, as appropriate, to "redouble their efforts to monitor consumer complaints and to enforce against unfair, deceptive, or abusive practices" related to digital assets.

Proactive Risk Mitigation

Banks and other crypto-asset businesses should be aware of these developments, and potential CFPB and FTC scrutiny. These businesses may wish to consider compliance and regulatory requirements so as to avoid running afoul of increased enforcement activity in the digital assets space.

In particular, these businesses should evaluate their compliance management systems to ensure that they have adequate notices and disclosures; their product terms and fees are clear, understandable, and reasonable; and employees are continually trained with respect to compliance and regulatory requirements.

Attention should also be paid to anti-discrimination, including preventing algorithmic bias, and to complaint and error resolution.

Additionally, banking organizations should be aware of liquidity risks associated with crypto-asset sector participants, due to the unpredictability of the scale and timing of deposit inflows and outflows.

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[1] 12 U.S.C.§ 5511.

[2] 15 U.S.C. 45 §§ 5, 13.

[3] FTC Takes Action to Stop DK Automation and Kevin David Hulse From Pitching Phony Amazon and Crypto Moneymaking Schemes | Federal Trade Commission.

[4] Id.

[5] See, In re: Voyager Digital Holdings, Inc (stretto.com).

[6] FTC Takes Action to Stop DK Automation and Kevin David Hulse From Pitching Phony Amazon and Crypto Moneymaking Schemes | Federal Trade Commission.

[7] See Section 57 of DK Automation.

[8] See Section 58 of DK Automation.

[9] DK Automation.

[10] Nexo Financial LLC | Consumer Financial Protection Bureau (consumerfinance.gov).

[11] Under 12 U.S.C. § 5517(i)(1), "the Bureau shall have no authority to exercise any power to enforce [the CFPA] with respect to a person regulated by the Commission.' The

phrase 'person regulated by the Commission' is a defined term . . . [that means] among other things, a person who is 'a broker or dealer that is required to be registered under the Securities Exchange Act of 1934,' an investment company that is required to be registered under the Investment Company Act of 1940, and 'any employee, agent, or contractor acting on behalf of, registered with, or providing services to' such a regulated person, 'but only to the extent that [the regulated person], or the employee, agent, or contractor of such person, acts in a regulated capacity." Page 4 of https://files.consumerfinance.gov/f/documents/cfpb_nexo-financial-llc_decision-and-order-on-petition_2022-11.pdf.

[12] "Under 12 C.F.R. § 1005.3(c)(4), the term 'electronic fund transfer' does not include "[a]ny transfer of funds the primary purpose of which is the purchase or sale of a security …, if the security … is … [r]egulated by the [SEC]' or '[p]urchased or sold through a broker-dealer regulated by the [SEC].'"

[13] See Nexo at 5.

[14] Nexo Announces Gradual Departure from the United States • Nexo.

[15] CFPB Publishes New Bulletin Analyzing Rise in Crypto-Asset Complaints | Consumer Financial Protection Bureau (consumerfinance.gov).

[16] Id.

[17] Id.

[18] The Block: CFPB not planning crypto crackdown, says Bureau Director Chopra.

[19] FACT SHEET: White House Releases First-Ever Comprehensive Framework for Responsible Development of Digital Assets - The White House.