

**HOW YIELD FARMING PRODUCTS OFFERED BY CRYPTO COMPANIES
FIT IN WITH THE FINANCIAL REGULATORY SCHEME IN THE U.S.**

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ABSTRACT

In a little over a decade, cryptocurrency has gone from a brand-new innovation to a major force in the financial world. In the world of crypto, innovation happens quickly, and regulators are often left playing catch up. One of the newer innovations in the crypto scene is called yield farming. Yield products work by consumers giving their cryptocurrency to companies that then lends the assets out. The crypto companies pay their customers a rate of return while customers are free to demand their cryptocurrency back at any point in time.

These products have become standard offerings from large crypto companies. However, they have also become the target of action by the Securities and Exchange Commission. Major crypto companies Coinbase and BlockFi have had to deal with SEC enforcement actions in the last year, resulting in Coinbase shutting down its yield product and BlockFi paying \$100 million to settle. With stakes so high, companies must comply with the appropriate regulations. However, with new products such as these, it can be hard to determine the proper guidelines for a company to follow. Are yield products actually securities as the SEC claims? Are yield products deposit accounts, and resulting in companies offering them illegally operating as a bank? If both options are valid, what happens when banking and securities regulations overlap?

TABLE OF CONTENTS

ABSTRACT.....	139
INTRODUCTION	140
I. BACKGROUND	141
A. <i>The History of Crypto Regulation</i>	141
B. <i>What is a yield product?</i>	144
II. ANALYSIS	146
A. <i>Are Stablecoin Yield Products a Commodity?</i>	146
B. <i>Are Stablecoin Yield Products a Security?</i>	146
1. <i>The Howey Test</i>	147
2. <i>The Landreth Test</i>	150
3. <i>The Reves Test</i>	150
4. <i>Other Regulatory Schemes</i>	153
C. <i>Are Yield Products a Deposit?</i>	154
1. <i>What is a deposit?</i>	155
2. <i>Application to a “yield product”</i>	158
III. CONCLUSION.....	159

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INTRODUCTION

In June 2021, Coinbase, a publicly traded company operating a cryptocurrency exchange, announced it was launching a new product called Lend.¹ Lend would give users the option to buy and hold USD Coin with Coinbase and earn interest well above the national average for traditional savings accounts.² Lend promised customers a fixed 4% APY on their assets.³ Coinbase planned on providing this high interest rate by taking customers' assets and lending them out to various unidentified third parties.⁴ However, the project never left the pre-enrollment phase.

On September 1, the Securities and Exchange Commission ("SEC") sent a Wells Notice to Coinbase letting it know that if it continued the launch of Lend, the SEC would bring an enforcement action against it.⁵ The SEC alleged that Lend was an unregistered security under the *Howey* and *Reves* tests.⁶ In response to the SEC's Wells Notice, Coinbase's CEO Brian Armstrong launched a flurry of posts on Twitter both criticizing the SEC and defending the company's product.⁷ Among Armstrong's complaints was the SEC's use of the *Howey* and *Reves* tests, which he felt were too old to adequately be applied to crypto products such as Lend.⁸ Additionally, Armstrong was upset because he thought the SEC was being inconsistent by targeting Coinbase's Lend product, but not bringing action against other similar yield products.⁹ Ultimately, Coinbase decided to shut down its Lend product on September 17, avoiding litigation with the SEC.¹⁰

SEC action in the crypto lending space would remain somewhat quiet until February 2022, when the SEC announced that BlockFi agreed to pay \$100 million in penalties for failing to register its BlockFi Interest Accounts as a security.¹¹ Without admitting or denying the allegations

¹ *Sign Up to Earn 4% APY on USD Coin with Coinbase*, COINBASE (last updated Sept. 17, 2021, 5:00 PM), <https://blog.coinbase.com/sign-up-to-earn-4-apy-on-usd-coin-with-coinbase-cdad79e5f5eb>.

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ Paul Grewal, *The SEC Has Told Us It Wants to Sue Us Over Lend. We Don't Know Why.*, COINBASE (Sept. 7, 2021), <https://blog.coinbase.com/the-sec-has-told-us-it-wants-to-sue-us-over-lend-we-have-no-idea-why-a3a1b6507009>.

⁶ *Id.*

⁷ Brian Armstrong (@brian_armstrong), TWITTER (Sept. 7, 2021, 11:06 PM), https://twitter.com/brian_armstrong/status/1435439291715358721.

⁸ *Id.*

⁹ *Id.*

¹⁰ COINBASE, *supra* note 1.

¹¹ Press Release, Sec. & Exch. Comm'n, BlockFi Agrees to Pay \$100 Million in Penalties and Pursue Registration of its Crypto Lending Product (Feb. 14, 2022) (available at <https://www.sec.gov/news/press-release/2022-26>).

against it, BlockFi also agreed to pursue registration for BlockFi Interest Accounts.¹²

As a result of Lend shutting down and BlockFi choosing to settle, the question of whether crypto yield products are securities remains without a definitive answer. However, there is another possible avenue for regulating these products. It is possible that companies offering yield products in the business of taking deposits are acting as banks and are thus subject to banking regulations.

This note explores how this innovative product interacts with various current regulatory schemes for financial products. It will analyze whether this product is subject to commodities regulations, securities regulations, or banking laws and how these different laws might interact with each other. The securities section of the analysis will apply the facts of yield products to the *Howey*, *Landreth*, and *Reves* tests for securities. The banking section of the analysis will define what a deposit account is and apply that definition to yield accounts. Finally, this paper will conclude by determining which laws apply to yield accounts, and what crypto companies can do to comply with regulations.

I. BACKGROUND

A. *The History of Crypto Regulation*

The story of yield products begins with the invention of crypto assets. Bitcoin, the first widely adopted cryptocurrency, was first minted in January 2009 shortly after its creator, Satoshi Nakamoto, introduced the idea in 2008.¹³ Bitcoin was designed to allow online payments between two parties without the need to rely on a third-party financial institution.¹⁴ Bitcoin and other cryptocurrencies accomplish this feat using a few new innovations. Cryptocurrency owners access their cryptocurrency tokens using online wallets with private keys. These keys are unique to each owner, and if another user gains access to these keys, they can control the associated cryptocurrency.¹⁵ Transactions involving cryptocurrency are recorded publicly in chronological order on the blockchain.¹⁶ The blockchain is a public record of all the transactions of a particular

¹² *Id.*

¹³ Benjamin Wallace, *The Rise and Fall of Bitcoin*, WIRED (Nov. 23, 2011, 2:52 PM), <https://www.wired.com/2011/11/mf-bitcoin/>; SATOSHI NAKAMOTO, BITCOIN: A PEER-TO-PEER ELECTRONIC CASH SYSTEM, BITCOIN 1 (2008), <https://bitcoin.org/bitcoin.pdf>.

¹⁴ Wallace, *supra* note 13; NAKAMOTO, *supra* note 13.

¹⁵ See, e.g., *How Does Bitcoin Work?*, BITCOIN (last visited Nov. 17, 2021), <https://bitcoin.org/en/how-it-works>; *Some Bitcoin Words You Might Hear*, BITCOIN (last visited Nov. 17, 2021), <https://bitcoin.org/en/vocabulary#address>.

¹⁶ See, e.g., *How Does Bitcoin Work?*, BITCOIN, *supra* note 15; *Some Bitcoin Words You Might Hear*, BITCOIN, *supra* note 15.

cryptocurrency.¹⁷ Much like stock exchanges, viewers of the blockchain can see the time and size of transactions but not the identities of the parties involved.¹⁸ Finally, the security and integrity of the blockchain and crypto wallets are enforced with cryptography, high-level mathematical proofs that make it impossible for another user to spend someone else's cryptocurrency or corrupt the blockchain.¹⁹

New cryptocurrencies sprung up in Bitcoin's wake. They were inspired by Bitcoin's vision of decentralized finance. These new crypto assets had desires beyond just a peer-to-peer payment method. Innovators who were frustrated by Bitcoin's limitations built more programmable blockchains.²⁰ One of the innovations to come out in the years following Bitcoin was smart contracts that "digitize agreements by turning the terms of an agreement into computer code that automatically executes when the contract terms are met."²¹ Smart contracts allow for much of the innovation towards new products in the crypto space, including making the development of stablecoins possible.²² Since the beginning of Bitcoin in 2009, crypto assets have grown prolifically into a massive unignorable economic force.²³

With the rise of prices and popularity of digital assets, companies were founded to take advantage of the boom. Coinbase was an early entrant into the scene. Brian Armstrong founded Coinbase in 2012 with the goal of making it easier to send and receive Bitcoin.²⁴ Another early entrant in 2011 was the Bitcoin exchange, Kraken.²⁵ The crypto boom even caught the eye of the Winklevoss twins of Facebook fame, who set up their crypto exchange, Gemini, in 2014.²⁶ Over time, more players entered the scene to serve an increasingly diverse set of cryptocurrencies and digital assets. Zac Prince founded BlockFi in 2017 with the mission of providing credit services to markets with limited access to simple financial products.²⁷ Another current large player in the scene, FTX, was founded in 2018 to

¹⁷ See, e.g., *How Does Bitcoin Work?*, BITCOIN, *supra* note 15; *Some Bitcoin Words You Might Hear*, BITCOIN, *supra* note 15.

¹⁸ NAKAMOTO, *supra* note 13.

¹⁹ *Some Bitcoin Words You Might Hear*, BITCOIN, *supra* note 15.

²⁰ See, e.g., Vitalik Buterin, *Ethereum Whitepaper*, ETHEREUM (Nov. 5, 2021), <https://ethereum.org/en/whitepaper/>.

²¹ *Introduction to Smart Contracts*, ETHEREUM (last updated Oct. 19, 2021), <https://ethereum.org/en/smart-contracts/#smart-contracts>.

²² *Id.*

²³ *Global Cryptocurrency Charts*, COINMARKETCAP, <https://coinmarketcap.com/charts/> (last visited Nov. 17, 2021) (The total market cap of all cryptoassets as of November 2021 is over \$2.5 trillion).

²⁴ *About – Coinbase*, COINBASE, <https://www.coinbase.com/about> (last visited Jan. 29, 2022).

²⁵ *Why Kraken?*, KRAKEN, <https://www.kraken.com/why-kraken> (last visited Jan. 29, 2022).

²⁶ Cade Metz, *With Winklevoss Bitcoin Exchange, Digital Currency Grows Up*, WIRED (last visited Nov. 17, 2021), <https://www.wired.com/2015/10/winklevoss-bitcoin-exchange-digital-currency-grows/>.

²⁷ *Own Mission | BlockFi*, BLOCKFI (last visited Jan. 29, 2022), <https://blockfi.com/mission>.

primarily operate in the market for crypto derivatives.²⁸ All of these companies have set up, or attempted to set up, yield products as part of their portfolio of services for customers.

However, a rise in concerns has mirrored the rise in crypto assets. Due to the anonymity it provides, as well as its digital nature, Bitcoin and other cryptocurrencies have long been the preferred method to buy and sell illegal goods online.²⁹ Additionally, the SEC has warned investors over the increased risk in fraud involving cryptocurrency transactions and investment opportunities.³⁰ Further, hackers can and do steal large amounts of cryptocurrency on a regular basis.³¹ These concerns and more have forced regulators to become increasingly active in the crypto space.

Traditionally, the regulation of cryptocurrency products has been left to two different de facto agencies, the SEC and the Commodities Futures Trading Commission (“CFTC”). The SEC has been involved in the crypto space since at least 2013.³² In 2017, the SEC first concluded that digital tokens could be securities, and therefore subject to the United States’ securities laws.³³ The DAO Report found that tokens sold by The DAO, an unincorporated organization, amounted to unregistered securities.³⁴ The profits from the sale of these tokens were going to be used to fund projects, and the earnings from these projects would be returned to those who invested in The DAO tokens.³⁵ The SEC determined that these tokens met the definition of an “investment contract” which is a form of security included in the Securities Act Section 2(a)(1) definition of a security.³⁶ An “investment contract” is defined as “an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.”³⁷ This definition has become known as “The *Howey* Test” and is the most common way for the SEC to find a digital asset to be a security.

²⁸ *FTX Raises 900M*, INSIDE (last visited Jan. 29, 2022),

<https://inside.com/campaigns/inside-tech-2021-07-21-28706/sections/243700>.

²⁹ Sean Foley et al., *Sex, Drugs, and Bitcoin: How Much Illegal Activity is Financed Through Cryptocurrencies?*, 32 REV. FIN. STUD. 1798, 1805 (2019).

³⁰ See *Investor Alert: Bitcoin and Other Virtual Currency-Related Investments*, INVESTOR.GOV (May, 7 2014), <https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/investor-39>.

³¹ E.g., Niket Nishant, *Coinbase Says Hackers Stole Cryptocurrency From at Least 6,000 Customers*, REUTERS (Oct. 1, 2021, 6:02 PM), <https://www.reuters.com/business/finance/coinbase-says-hackers-stole-cryptocurrency-least-6000-customers-2021-10-01/>.

³² SEC v. Shavers, No. 4:13CV00416, 2013 WL 3810441, 1 (E.D.Tex. July 23, 2013) (trial pleading).

³³ Report of Investigation: The DAO, Exchange Act Release No. 81,207, 2017 WL 7184670, *8 (July 25, 2017).

³⁴ *Id.* at *1.

³⁵ *Id.*

³⁶ *Id.* at, *11.

³⁷ SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

The CFTC uses its jurisdiction when a cryptocurrency product is considered a “commodity.”³⁸ They consider Bitcoin, the original cryptocurrency, a commodity.³⁹ Furthermore, they consider Ethereum, another large cryptocurrency, to be a commodity under its jurisdiction.⁴⁰ Although it is not in the news as often as the SEC, the CFTC still plays a large role in crypto regulation.

Bank regulators have been slower to get involved in the scene but are starting to take a serious look at crypto assets. At the federal level, the Federal Deposit Insurance Corporation (“FDIC”), the Federal Reserve, and the Office of the Comptroller of the Currency (“OCC”) are coordinating guidance on when and how banks can be engaged with crypto assets.⁴¹ Meanwhile, certain states have been active in proposing legislature and regulation for crypto banking activity. For example, Wyoming and Nebraska have created special-purpose bank charters and enacted new rules for existing banks, while New York offers a BitLicense, a license that allows its holder to engage in virtual currency activities.⁴²

B. What is a Yield Product?

Yield farming takes cryptocurrency from a customer and lends it out in hopes of earning interest.⁴³ Coinbase’s Lend was just one of several new products offered in the cryptocurrency space being called yield products, or yield farming. Many other companies currently offer yield farming

³⁸ 7 U.S.C. § 1a(9) (The term “commodity” means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, *Solanum tuberosum* (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by (7 U.S.C. § 13-1)) and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in).

³⁹ Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan, CFTC Docket No. 15-29 (2015).

⁴⁰ Press Release, COMMODITIES FUTURES TRADING COMM’N, IN CASE YOU MISSED IT: Chairman Tarbert Comments on Cryptocurrency Regulation at Yahoo! Finance All Markets Summit (Oct. 10, 2019) <https://www.cftc.gov/PressRoom/PressReleases/8051-19>.

⁴¹ Luke McGrath, *FDIC is Preparing Guidance on Banks and Crypto*, BLOOMBERG (Oct. 26, 2021, 3:43 PM), <https://www.bloomberg.com/news/articles/2021-10-26/fdic-is-preparing-guidance-on-banks-and-crypto-chief-says>.

⁴² Penny Crossman, *States Take Lead on Crypto Bank Charters and Digital Asset Rules*, AM. BANKER (Oct. 18, 2021, 9:00 PM), <https://www.americanbanker.com/news/states-take-lead-on-crypto-bank-charters-and-digital-asset-rules>.

⁴³ Olga Kharif, *What’s ‘Yield Farming’? (And How Do You Grow Crypto?)*, BLOOMBERG (July 25, 2020, 5:00 AM), <https://www.bloomberg.com/news/articles/2020-07-25/what-s-yield-farming-and-how-do-you-grow-crypto-quicktake>.

products, including BlockFi, Kraken, and the formerly solvent FTX exchange.⁴⁴

Yield products are similar to traditional lending except, instead of giving money to a traditional financial institution, yield farmers give their crypto to companies that lend the cryptocurrency out using automated computer programs.⁴⁵ These automated computer programs are called “smart contracts.” The creator of the smart contracts idea described them as “a set of promises, specified in digital form, including protocols within which the parties perform on these promises.”⁴⁶ A smart contract is similar to a normal contract, except its terms are written in code and it is executed on the blockchain.⁴⁷ These smart contracts link lenders and borrowers in yield products without the need for an intermediary such as a bank.⁴⁸

Companies can offer yield farming products for a variety of different assets, but this paper will focus on yield products where the user stakes a stablecoin asset. Stablecoins are a type of digital asset that are designed to keep a stable value.⁴⁹ Stablecoins accomplish this by promising holders that they can redeem their stablecoin for some fiat currency or other reference asset upon request.⁵⁰ The most popular stablecoin, Tether, is pegged 1 to 1 to the United States Dollar.⁵¹ This means that every token of Tether, also called USDT, should be redeemable for 1 United States Dollar. Stablecoins have risen in popularity due to their ability to connect the advantages of decentralized, rapid, online payment of traditional cryptocurrency with the stability of traditional fiat currencies.⁵²

For purposes of this note, a “yield product” is a financial product offered by a company. A customer buys stablecoin assets and gives them to the company. Through the use of a smart contract, the customer’s smart tokens are lent out to borrowers in hopes of earning a rate of return for the customer. The customer can demand the return of their given assets at any

⁴⁴ *BlockFi Interest Account*, BLOCKFI (last visited Nov. 18, 2021), <https://blockfi.com/crypto-interest-account>; *Staking Coins*, KRAKEN (last visited Nov. 18, 2021), <https://www.kraken.com/features/staking-coins>; *FTX Earn*, FTX (Sept. 2020), <https://help.blockfolio.com/hc/en-us/articles/4407082596891-FTX-Earn>.

⁴⁵ Alexander Osipovich, *Crypto ‘Yield Farmers’ Chase High Returns, but Risk Losing It All*, WALL ST. J. (July 17, 2021, 5:30 AM), <https://www.wsj.com/articles/crypto-yield-farmers-chase-high-returns-but-risk-losing-it-all-11626514200>.

⁴⁶ Nick Szabo, *Smart Contracts: Building Blocks for Digital Markets* (1996), <http://www.truevaluemetrics.org/DBpdfs/BlockChain/Nick-Szabo-Smart-Contracts-Building-Blocks-for-Digital-Markets-1996-14591.pdf>.

⁴⁷ *What is a Smart Contract?*, COINBASE, <https://www.coinbase.com/learn/crypto-basics/what-is-a-smart-contract> (last visited Jan. 28, 2021).

⁴⁸ *Id.*

⁴⁹ See generally PRESIDENT’S WORKING GRP. ON FIN. MKT., FED. DEPOSIT INS. CORP., OFF. OF THE COMPTROLLER OF THE CURRENCY, REPORT ON STABLECOINS (2021) [hereinafter REPORT ON STABLECOINS].

⁵⁰ *Id.* at 4.

⁵¹ TETHER (last visited Nov. 18, 2021), <https://tether.to/> (last visited Nov. 18, 2021).

⁵² REPORT ON STABLECOINS, *supra* note 49, at 8.

time. In the analysis section, this framework will be applied to commodities, securities, and banking laws to determine how crypto lending products fit into these systems.

II. ANALYSIS

A. Are Stablecoin Yield Products a Commodity?

When looking at the regulation of crypto related products, one of the two major players is the CFTC, which regulates commodities. The CFTC has been very vocal about its interest in the crypto area and its belief that many crypto assets fall under its jurisdiction.⁵³ However, this particular crypto asset does not fit within its jurisdiction because it fails to meet the definition of commodity set forth in the Commodities Exchange Act (“CEA”).

The CFTC’s jurisdiction comes from the CEA.⁵⁴ The definition for “commodity” is found in 7 U.S.C. § 1a(9).⁵⁵ According to the statute, a “commodity” includes a number of enumerated agricultural products, as well as a more general, “all other goods and articles . . . and all services rights and interests . . . in which contracts for future delivery are presently or in the future dealt with.”⁵⁶ Courts have read this definition broadly to include certain virtual currencies.⁵⁷ While yield products potentially involve crypto assets, they do not involve any futures, swaps, or derivatives – as yield products do not deal with contracts for the future delivery of a commodity. Commodities regulation is not the right fit for these products, the next section will examine whether yield products fit under securities laws.

B. Are Stablecoin Yield Products a Security?

The definition of “security” comes from Section 2(a)(1) of the Securities Act of 1933. According to the act, a “security” is

⁵³ Brian Quintenz (@CFTCquintenz), TWITTER (Aug. 4, 2021, 9:30 AM), <https://twitter.com/CFTCquintenz/status/1422912721637580803>.

⁵⁴ 7 U.S.C.S. § 2.

⁵⁵ 7 U.S.C.S. § 1a(9).

⁵⁶ The full text reads: Commodity. The term “commodity” means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, *Solanum tuberosum* (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by the first section of Public Law 85-839 (7 U.S.C. 13-1)) and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in.

⁵⁷ CFTC v. McDonnell, 281 F. Supp 3d. 213 (E.D.N.Y. 2018).

[A]ny note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security,” or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.⁵⁸

Based on the language “or, in general, any interest or instrument commonly known as a security,” the Supreme Court gave the previously undefined term “investment contract” a definition that was “flexible rather than static.”⁵⁹ When determining whether a given financial product is a security or not, the emphasis should be on substance and not form.⁶⁰ This means consumers should disregard how the product refers to itself, and instead focus on the economic realities of how the product works.⁶¹ There are a few different tests that courts use with new financial products in order to establish whether they are securities. The most important ones are the *Howey* test for “investment contracts,” the *Landreth* test for “stocks,” and the *Reves* family resemblance test for “notes.”

1. The Howey Test

If regulators classify digital assets as a security, they are most often considered “investment contracts.” The test for what an “investment contract” is comes from the Supreme Court’s ruling in *SEC v. W.J. Howey Co.*⁶² The Supreme Court held that an investment contract forms when there is “(1) an investment of money (2) in a common enterprise (3) with a reasonable expectation of profits to be derived from the efforts of others.”⁶³

⁵⁸ 15 U.S.C. § 77b(a)(1).

⁵⁹ *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298 (1946).

⁶⁰ *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

⁶¹ *Id.*

⁶² *W.J. Howey*, 328 U.S. at 298.

⁶³ *Id.* at 301.

An “investment of money” refers to the offer or sale of an asset in exchange for value.⁶⁴ This prong is satisfied even if the value is not a traditional fiat currency.⁶⁵ The customer’s purchase of stablecoins that are then given to the company offering the yield product would satisfy the investment requirement.

A common enterprise within the meaning of *Howey* can be established by a showing of “horizontal commonality”: the tying of each individual investor’s fortunes to the fortunes of the other investors by the pooling of assets, usually combined with the pro-rata distribution of profits.⁶⁶ Additionally, some courts have found common enterprise through a “vertical commonality”: the relationship between the promoter and the body of investors.⁶⁷ Vertical commonality can be further split into two different variations, “broad vertical commonality” and “narrow vertical commonality.” Broad vertical commonality requires that the success of all investors is affected by the promoter’s efforts, while narrow vertical commonality requires that the promoter’s success be interwoven with the investor’s success.⁶⁸

Yield product schemes fit both the definition of horizontal commonality and broad vertical commonality. Horizontal commonality is satisfied because customer’s stablecoins are pooled together before they are lent out.⁶⁹ Broad vertical commonality is also satisfied because the ability of all customers to receive their promised rate of return depends on the promoter’s efforts in successfully lending out their stablecoins.⁷⁰

The third prong of the *Howey* test contains two sub-prongs. They are (1) reliance on the efforts of others and (2) reasonable expectation of profits. The inquiry into whether a purchaser is relying on the efforts of others focuses on two key issues. First, does the purchaser reasonably expect to rely on the efforts of an Active Participant (“AP”), and second, are those efforts “the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise,” as opposed to efforts that are more ministerial in nature?⁷¹ Despite the language of *Howey* reading “solely through the efforts of others,” it just has to be that the customer expects to be dependent on the efforts of others.⁷² An evaluation of the digital asset should also consider whether there is a

⁶⁴ Strategic Hub for Innovation & Fin. Tech., *Framework for “Investment Contract” Analysis of Digital Assets*, SEC (April 3, 2019), https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets#_ednref1.

⁶⁵ *Id.*

⁶⁶ *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994).

⁶⁷ *Id.*

⁶⁸ *SEC v. SG Ltd.*, 265 F.3d 42, 49 (1st Cir. 2001).

⁶⁹ *Osipovich*, *supra* note 45.

⁷⁰ *Id.*

⁷¹ Strategic Hub for Innovation & Fin. Tech., *supra* note 64.

⁷² *SEC v. Merchant Capital*, 483 F.3d 747, 755 (11th Cir. 2007).

reasonable expectation of profits. Profits can mean a number of different returns on investment, including but not limited to profits, capital appreciation, and participation in earnings.⁷³

Yield products meet the first part of the second prong. Here, customers expect the company to which they pay stablecoins to act as an AP on their behalf. The companies go and find third parties in need of loans, set the terms of the loans, and handle all aspects of the servicing of the loan.⁷⁴ These efforts are undeniably significant, and the success of the whole system relies on them.

However, this logic only applies if the work of a smart contract counts as the efforts of others. If the use of the smart contract replaces the role of an active intermediary in connecting borrowers and lenders, then there might not be any “efforts of others.” It could be argued the lines of code are doing all the work and not the businesses behind them. However, this argument does not hold up as it ignores the effort to write the smart contract code and then implement the smart contract into a final product. Additionally, these companies likely have active oversight of these smart contracts in case bugs or hackers compromise the functionality of the contract. The SEC and state regulators have already taken action against potential security products operating using smart contracts, but courts have not made a final ruling on this issue.⁷⁵

There is also a reasonable expectation of profit associated with these products. The companies that offer these services promise a rate of return.⁷⁶ The interest earned on the stablecoin deposit counts as profit.⁷⁷ Additionally, the promise these companies give makes the expectation of profit reasonable.

At a first glance, the *Howey* test appears to fit well. The product required an “investment” from customers in the form of the stablecoins that they deposit with the company. The common enterprise prong is met because yield products pool together assets in order to make loans. Customers rely on the efforts of Coinbase or another party to find other parties and make loans. Finally, customers have a reasonable expectation of profit because the companies have promised them a certain annual return. While *Howey* suggests that yield products are securities, it is not the only test that the SEC can rely upon.

⁷³ *Id.*

⁷⁴ Osipovich, *supra* note 45.

⁷⁵ *Blockchain Credit Partners d/b/a/ DeFi Money Market*, Securities Act Release No. 10961, Exchange Act Release No. 92588 (ALJ Aug. 6, 2021) (order instituting cease and desist proceedings); *BlockFi Inc.*, (State of New Jersey Bureau of Sec. July 19, 2021)) (summary cease and desist order).

⁷⁶ See e.g. BLOCKFI, *supra* note 44; COINBASE, *supra* note 1.

⁷⁷ *United Housing Found., Inc. v Forman*, 421 U.S. 837, 852 (1975) (holding that profit can mean the participation in earnings resulting from the investor’s funds).

2. The Landreth Test

A second test used to determine if a given financial instrument is in fact a security is the *Landreth* test or the “stock” test. It analyzes whether products have stock-like qualities and should be treated as stock, which is one of the enumerated forms of a security.⁷⁸ The *Landreth* court adopted five characteristics, referenced in *Forman*, that are associated with identifying a stock. The characteristics are: (1) the right to receive dividends contingent upon an apportionment of profits; (2) negotiability; (3) the ability to be pledged or hypothecated; (4) the conferring of voting rights in proportion to the number of shares owned; and (5) the capacity to appreciate in value.⁷⁹

Although this test may be useful for other crypto and decentralized finance products, it is a poor fit for yield products. Products such as FTX’s Earn and Coinbase’s Lend make no promises of any dividends or voting rights.⁸⁰ They lack the negotiability of stocks, the ability to be pledged or hypothecated. They do not have the capacity to appreciate in value, rather they accrue interest. Yield products do not have any meaningful stock-like qualities. Beyond *Howey* and *Landreth*, there is one more test that is frequently used to determine whether a financial product is a security.

3. The Reves Test

A “note” is a specifically enumerated form of security within the definition of security supplied in the Securities Act.⁸¹ Unlike other enumerated forms of securities, notes can be securities or not be securities depending on the context in which they are issued. The relevant test for whether a note is a security is the *Reves* or “Family Resemblance” Test. The Court in *Reves* concluded that “[a] note is presumed to be a ‘security,’ and that presumption may be rebutted only by a showing that the note bears a strong resemblance to one of the enumerated categories of instrument.”⁸² The four factors to be considered in the “Family Resemblance” test are: (1) “the motivations that would prompt a reasonable seller and buyer to enter into [the transaction]”; (2) “the plan of distribution of the instrument”; (3) “the reasonable expectations of the investing public”; and (4) “the existence of another regulatory scheme [to reduce] the risk of the instrument, thereby rendering application of the Securities Act unnecessary.”⁸³ Unlike the *Howey* test, the *Reves* test is a balancing test. A

⁷⁸ 15 U.S.C. § 77b(a)(1).

⁷⁹ *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 697–98 (1985).

⁸⁰ See COINBASE, *supra* note 1.

⁸¹ 15 U.S.C. § 77b(a)(1).

⁸² *Reves v. Ernst & Young*, 494 U.S. 56, 67 (1990).

⁸³ *Id.* at 66-67.

note does not have to meet all factors. Instead, a note must only appear more like a security than another form of debt.

The first factor of the *Reves* test considers the motivations that prompt the parties to enter into the deal.⁸⁴ The *Reves* court explains this factor by saying if the company issues the debt for the “general use of a business enterprise or to finance substantial investments” and the buyer purchases the note because “they are primarily interested in the profit the note is expected to generate,” then the note is likely a security.⁸⁵ With yield products, the motivation of buyers is to use this product so that they can get the promised an above market interest rate. However, the motivations for the issuers line up a somewhat less cleanly with the language of *Reves*. The stablecoins proceeds received would not go directly into the companies offering the yield products, but instead would then be used as loans. Although the funds are not staying within the company, they are going towards a business function of the company for the purpose of earning the company a return. The first factor of the test should point towards the product being a security.

The second factor is “the plan of distribution of the instrument.”⁸⁶ In order to show that note’s distribution is like that of security, “common trading” must be established.⁸⁷ Common trading occurs when notes are offered to a broad segment of the public.⁸⁸ Yield products are typically offered to anyone in the public, therefore they easily meet this factor of the test.⁸⁹

The third factor, “the reasonable expectations of the investing public,” is met when consumers purchase a note that they reasonably believe they are purchasing an investment product.⁹⁰ The court in *Reeves* points to advertisements of the notes, which referred to the notes as “investments,” as evidence that they were securities.⁹¹ Nowhere on Coinbase’s Lend page are the words “investment,” “security” or “note” even mentioned.⁹² Similar products offered by FTX and BlockFi also fail to mention anything about the product being an investment or a note.

While the companies do not hold the products out to be “investments,” the presence of “countervailing factors” can be used to show that the investing public would consider them investments.⁹³ Here, the products are held out as a chance for customers to earn a profit on their crypto assets by

⁸⁴ *Id.* at 67.

⁸⁵ *Id.* at 60.

⁸⁶ *Id.* at 66.

⁸⁷ *Id.* at 62.

⁸⁸ *Id.*

⁸⁹ McGrath, *supra* note 44.

⁹⁰ *Reves*, 494 U.S. at 66.

⁹¹ *Id.*

⁹² COINBASE, *supra* note 1.

⁹³ *Reves*, 494 U.S. at 69.

offering a rate of return higher than the market rate.⁹⁴ Given these facts, a court could find that the reasonable expectation of the investing public believe that the securities laws apply to this product despite the fact that there is a lack of language clearly expressing that they are investments.

Finally, the fourth factor is whether another regulatory scheme already applies to the product. Currently, there is no regulatory oversight for these products. Unlike similar money market and savings accounts, these accounts are not insured by the FDIC and are not currently subject to strict banking laws. Without securities laws applying to these notes, no current regulatory scheme would apply to them. This would be another factor that weighs in favor of finding the product to be a security.

Additionally, a note can avoid the security label if it “bears a strong family resemblance” to one of the types of notes recognized by the court to be outside the definition of a security.⁹⁵ The court adopts the list from the *Exchange National Bank* decision. The decision stated

[t]he 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).⁹⁶

Yield products do not match any of these other types of loans, and thus the balancing test should apply.

Overall, the factors of the *Reves* Test point towards finding yield products to be a security. First, customers are entering into this transaction in pursuit of profit in the form of the promised interest rate. Yield products are offered to the general public and would thus meet the second factor. However, reasonable expectations of investors might have been that these products are not a security. Although customers might expect a profit from these products, there is a lack of language indicating that these products are investments. Additionally, the structure of the product closely resembles other products, such as savings accounts, which are not securities. Further, if the product is a “deposit” similar to a traditional savings account, that would bring it under the purview of Banking Regulations. If the product is

⁹⁴ *Id.* at 68 (finding that customers would view the product as an investment because the products were offered with a variable interest rate designed to always be above the market rate).

⁹⁵ *Id.* at 59.

⁹⁶ *Exchange Nat'l Bank v. Touche Ross & Co.*, 544 F.2d 1126, 1138 (2nd Cir. 1976).

already subject to Banking Regulations, then it would be exempted from securities regulation.⁹⁷

4. Other Regulatory Schemes

Under both the *Howey* test and the *Reves* test, there is an exception for financial products already regulated by other regulatory schemes.⁹⁸ In *Marine Bank*, the Court explained that the protection provided by securities laws were unnecessary because the presence of comprehensive regulations from the banking industry has reduced the risk of insolvency so much that the deposit is virtually guaranteed.⁹⁹ This exemption extends to products regulated by foreign regulators as well.¹⁰⁰ The exemption for products regulated by foreign regulators is significant for the crypto scene as some crypto companies are already based overseas.¹⁰¹

However, it is still possible to offer a security despite part of the product already being regulated by another regulatory scheme. In *Gary Plastics*, the Second Circuit found the Certificates of Deposits (“CDs”) sold by Merrill Lynch were securities despite the prior ruling in *Marine Bank*.¹⁰² Merrill Lynch had created a product that allowed for a secondary market for CDs to be sold before their maturity date, thus solving the liquidity issue of the asset.¹⁰³ This new dimension to the asset also gave rise to a new concern. Before, there was only the risk that if the issuer of the CD went insolvent the purchaser would not get their money. The FDIC mitigated these risks with guarantees. Now, the CDs carried the risk that if Merrill Lynch went insolvent, the CDs would become illiquid again. This new aspect of the product opened up investors to risk that was currently unprotected by regulators, and thus the exemption from *Marine Bank* no longer applies.¹⁰⁴

Gary Plastics shows that the presence of government regulation alone is not enough to defeat being considered a security. Instead, the regulatory scheme must eliminate or mitigate the product’s potential risks.¹⁰⁵ For yield products, this might be relevant if a non-SEC entity is already regulating

⁹⁷ 15 U.S.C. § 77(a)(2). See generally *Reves*, 494 U.S. 56.

⁹⁸ See generally *Marine Bank v. Weaver*, 455 U.S. 551 (1982) (holding that a certificate of deposit was not a security despite passing the *Howey* test because the bank was regulated by federal banking laws and the deposits were insured by the FDIC); *Reves*, 494 U.S. at 66–67.

⁹⁹ *Marine Bank*, 455 U.S. at 557–58.

¹⁰⁰ *Wolf v. Banco Nacional de Mexico, S.A.*, 743 F.2d 1458, 1463 (9th Cir. 1984) (holding that foreign CDs were not securities as long as the foreign institution proves that there is an adequate regulatory structure in place).

¹⁰¹ *About | FTX*, FTX, (last visited Jan. 29, 2022 2:00 PM) <https://about.ftx.com/> (FTX is headquartered and based in the Bahamas).

¹⁰² *Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 756 F.2d 230, 240–43 (2d Cir. 1985).

¹⁰³ *Id.*

¹⁰⁴ *Id.* at 241.

¹⁰⁵ *Id.*

the deposited cryptocurrency, such as Bitcoin with CFTC.¹⁰⁶ Additionally, stablecoins such as Tether, which would have been part of Coinbase's Lend product, have come under increasing scrutiny from regulators.¹⁰⁷ This new regulation could require issuers to ensure that stablecoin issuers have the necessary assets to support the outstanding stablecoins.¹⁰⁸

Even if the deposited stablecoins come under regulation, that will likely not change the security analysis. The risk involved in these products is the risk that these companies go insolvent and cannot pay back the deposits owed to the customers. Regulators would have to ensure that yield product providers have enough assets on hand or insure the deposits themselves to mitigate the risk. Further, there is the risk that the loans made by the companies running the yield products turn out bad, and there becomes no assets to repay investors. The potential fact that the stablecoins are riskless would not change the risk of the yield products. Yield products meet the requirements of *Howey* and *Reves*, but there is still a question of whether they should be subject to banking law.

C. Are Yield Products a Deposit?

Much like the certificates of deposits from *Marine Bank*, deposits held at registered banks and insured by either a private deposit insurer or the FDIC would be exempt from being a security. This option is not likely preferable for crypto companies as inspection and reserve holding requirements for banks is typically more burdensome than securities disclosure.

Although it is not their intention, crypto companies that offer yield products might be illegally operating as a bank. It is unlawful for any corporation or organization to be in the business of taking deposits unless:

- (1) they are incorporated under, and authorized to engage in such business, by the laws of the United States, or of any State, Territory, or District, or
- (2) shall be permitted by the United States, any State, territory, or district to engage in such business and shall be subjected by the laws of the United States, or such State, territory, or district to examination and regulations or,

¹⁰⁶ See generally *CFTC v. My Big Coin Pay, Inc.*, 334 F. Supp. 3d 492 (D. Mass. 2018).

¹⁰⁷ See generally REPORT ON STABLECOINS, *supra* note 49.

¹⁰⁸ *Id.* at 16.

(3) shall be subject to periodic examination by the Banking Authority of the State, Territory, or District where their business is carried out.¹⁰⁹

This prohibition applies regardless of whether the person or organization receiving a deposit holds themselves out to be a bank, as the business of taking deposits is distinctive to banks.¹¹⁰ Generally, states do not permit businesses to be in the business of taking deposits unless they are registered either federally or with the state in which they operate.¹¹¹ Further, many states require these deposits to be insured by either the FDIC or another insurer.¹¹²

1. What is a “deposit”?

The act of taking a deposit will subject a company to banking regulation as it is a core part of a banking operation, but what exactly does it mean to take a deposit?¹¹³ A deposit is ordinarily understood to mean the act of giving money or other property to another party, especially a bank,

¹⁰⁹ 12 U.S.C. § 378; Securities Industry Ass’n v. Bd. of Governors of Fed. Rsrv. Sys., 468 U.S. 137, 154 (1984).

¹¹⁰ *United States v. Jenkins*, 943 F.2d 167, 173–74 (2d Cir. 1991); *State v. Northwestern Nat’l Bank*, 219 N.W.2d 471, 482 (Minn. 1945).

¹¹¹ *See e.g.* ALA. CODE § 5-1A-4 (1975) (“No person, firm, corporation or other entity except a bank or if otherwise lawfully authorized...receive deposits...at its principal office or branch in this state”); CAL. FIN. CODE § 1005 (West 2012) (“It shall be unlawful for any person, corporation, ... or any other form of business entity allowed by law, to engage in or transact commercial banking business, industrial banking business, or trust business within this state except by means of a corporation duly organized for that purpose”); N.J. STAT. ANN. § 17:9A-2(A) (West 1948) (“No corporation, other than a national banking association, shall hereafter be organized to transact the business of a bank or savings bank in this State, except as provided in this act”); OHIO REV. CODE ANN. § 1101.16(A) (West 2018) (“No person shall solicit, receive, or accept money or its equivalent for deposit as a business in this state, except a state bank, an entity doing business as a bank, savings bank, or savings association under authority granted by the bank regulatory authority of the United States, another state of the United States, or another country, or a credit union as defined in section 1733.01 of the Revised Code that is authorized to accept deposits in this state”).

¹¹² *See e.g.* COLO. REV. STAT. ANN. § 11-10.5-106(2)(a) (West 1989) (“No bank shall be designated an eligible public depository unless the bank meets the following criteria: The deposits of such bank are insured or guaranteed by federal deposit insurance”); MINN. STAT. ANN. § 46.045 Subdivision 1 (West 2014) (“Every bank shall at all times maintain in effect insurance of its deposits by the Federal Deposit Insurance Corporation, an agency of this state or a federal agency established for the purpose of insuring deposits in banking institutions...”); VA. CODE ANN. § 6.2-601 (West 2010) (“Notwithstanding any other provisions contained in this title, no bank or savings institution doing business in the Commonwealth shall accept deposits unless its deposit accounts are insured by the Federal Deposit Insurance Corporation or other federal insurance agency...”); WIS. STAT. ANN. § 214.025 (West 2022) (“A savings bank shall secure insurance of its deposit accounts by a deposit insurance corporation before commencing business and may, subject to rules of the division, obtain insurance of deposits in excess of the amount eligible for insurance by a deposit insurance corporation”).

¹¹³ *See generally* *First Fiduciary Corp. v. Off. of the Comm’r of Banks*, 684 N.E.2d 1 (Mass. App. Ct. 1997).

who promises to preserve the property, and where the money or property is withdrawable at the will of the depositor.¹¹⁴

The Federal Deposit Insurance Act defines the term “deposit” to mean:

[T]he unpaid balance of money or its equivalent received or held by a bank or savings association in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account, or which is evidenced by its certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar name, or a check or draft drawn against a deposit account and certified by the bank or savings association, or a letter of credit or a traveler’s check on which the bank or savings association is primarily liable: provided that, without limiting the generality of the term ‘money or its equivalent’, any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for checks or drafts or for a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable, or for a charge against a deposit account, or in settlement of checks, drafts, or other instruments forwarded to such bank or savings association for collection.¹¹⁵

States often have their own definition for what a deposit is. Some state definitions include California’s which defines a “deposit account” as

[A]n account in a depository institution on which the account holder is permitted to make withdrawals from time to time in person by negotiable or transferable instrument, payment orders of withdrawal, telephone transfers, or other similar items for the purpose of making payments or transfers to third persons or others.¹¹⁶

In Georgia a “depositor” is, “any person or corporation who shall deposit money or items for the payment of money in any financial institution, which funds are subsequently (allowing time for collections) withdrawable either on demand or after a stated notice or lapse of time, whether interest is allowed thereon or not.”¹¹⁷ Texas defines a “deposit” to mean, “the establishment of a debtor-creditor relationship represented by the

¹¹⁴ *Deposit*, Black’s Law Dictionary (11th ed. 2019); *Jenkins*, 943 F.2d at 174.

¹¹⁵ 12 U.S.C. § 1813.

¹¹⁶ CAL. FIN. CODE § 1420(b) (West 2022).

¹¹⁷ GA. CODE ANN. § 7-1-4 (17) (West 2022).

agreement of the deposit debtor to act as a holding, paying, or disbursing agent for the deposit creditor.”¹¹⁸ Wisconsin’s definition of a “Deposit account” is, “any monetary interest that a depositor maintains in a savings bank, including a demand, time, money market, savings, certificate or negotiable order of withdrawal account.”¹¹⁹ Ohio, however, merely adopts the FDIC’s definition of a deposit.¹²⁰ Although different states employ different wording, these definitions contain many shared elements. All state definitions essentially define a deposit to be an instrument where a depositor entrusts an institution with a monetary interest which they are free to demand the return of from the institution at any time.

Courts historically have also defined what constitutes a deposit. According to courts, a “deposit” is a contractual relationship.¹²¹ This contract is between the “depositor” and the bank.¹²² The depositor delivers money, funds, or things to the bank.¹²³ The bank then has an obligation to repay the deposit on demand of the depositor or at a time set forth in the bank’s rules.¹²⁴

A “deposit” has to have a number of key characteristics, which are represented in both statutory definitions and in the way courts look at deposits. (1) There must be an agreement between the depositor and the company taking the deposit. (2) The depositor must provide the company with money, funds, or things to the company. (3) The company must then allow the deposit to be withdrawable on demand of the depositor.¹²⁵ These three characteristics seem to underlie all of the above definitions, and any product meeting this definition would likely be found to be a deposit relationship.

¹¹⁸ TEX. FIN. CODE ANN. § 31.002 (15) (West 2022).

¹¹⁹ WIS. CODE ANN. § 214.01 (g) (West 2022).

¹²⁰ OHIO REV. CODE ANN. § 1101.01 (J) (West 2022) (“‘Deposit’ has the same meaning as in 12 C.F.R. 204.2, as amended”).

¹²¹ *Saint Bernard Sch. of Montville, Inc. v. Bank of Am.*, 95 A.3d 1063, 1074-76 (Conn. 2014).

¹²² *Wharton v. Poughkeepsie Sav. Bank*, 31 N.Y.S.2d 598 (N.Y. App. Div. 1941) (holding that a depositor’s intestate was not entitled to the same rights as the depositor).

¹²³ *Producers Inv. Co. v. Colvert*, 100 P.2d 1005, 1008 (Okla. 1940).

¹²⁴ *Gimbel Bros., Inc. v. White*, 10 N.Y.S.2d 666, 669 (App. Div. 1939) (holding that company’s credit coupon system was not deposit banking operation because the company was not holding money which needed to be repayed); *State Tax Comm’n v. Yavapai County Sav. Bank*, 81 P.2d 86, 88 (Ariz. 1938).

¹²⁵ Although a deposit must be repaid when it is demanded, it does not have to be repaid immediately. See N.Y. BANKING LAW § 2 (McKinney 2022) (“12. Time deposits. The term, ‘time deposits,’ when used in this chapter, and except as provided otherwise by regulation of the superintendent of financial services, means all deposits the payment of which cannot legally be required within fourteen days”).

2. Application to a “yield product”

Regulators could reasonably consider yield products to be considered deposits and thus must be registered with a Banking Authority because they hold a customer’s stablecoins with a promise to repay them upon demand.

The first requirement to find a deposit account is a contractual agreement between the parties. Absent a contract, there is no basis to enforce the company or bank’s reciprocal promise to pay back the deposit.¹²⁶ Most companies currently offering yield products provide a terms of service agreement the customers sign on to when they sign up for the product.¹²⁷ Yield products run on a smart contract. The creation and opening of this smart contract should be considered an offer as the conditions to make a reasonable person would assume that the contract is being offered. The terms, which are contained in the code, are publicly available for anyone to read at any time. From the code, a party would be able to determine the identity of the parties involved and what the smart contract does. The expression of these terms would lead a reasonable person to believe that the smart contract is an offer. If someone deposits stablecoins into the smart contract, that is acceptance by complete performance, and there is a contract.

The depositor satisfies the second requirement by providing money, funds, or things to the company. Here, the depositor is providing stablecoins to the company. Stablecoins are not a traditional deposit accepted by banks, but they should still satisfy this requirement. Recently, as cryptocurrency gains more acceptance in mainstream finance, regulators have made it clear that banks and other deposit institutions can accept crypto products.¹²⁸ Further, the Office of the Comptroller of the Currency recently issued guidance stating banks can use stablecoins in payments.¹²⁹ Given the acceptance of certain national regulators of these types of assets, it is reasonable to assume that states and courts would accept stablecoins can be considered as monetary equivalents to satisfy this requirement of deposits.

The third requirement for deposits is that the company will repay the debt upon demand from the depositor. Coinbase’s Lend, FTX’s Earn, and

¹²⁶ JP Morgan Chase Bank, N.A. v. Freyberg, 171 F.Supp.3d 179, 191 (S.D.N.Y. 2016) (“[T]he relationship between a bank and its depositor is that of debtor and creditor, which, without more, is not a fiduciary or special relationship”).

¹²⁷ *Interest Account Terms (Non-US)*, BLOCKFI (last modified Jan. 20, 2022) <https://blockfi.com/interest-account-terms/>.

¹²⁸ Letter from Todd M. Harper, Chairman of the NCUA, on Relationships with Third Parties that Provide Services Related to Digital Assets, to Federally Insured Credit Unions (Dec. 2021) (<https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/relationships-third-parties-provide-services-related-digital-assets>).

¹²⁹ Jonathan V. Gould, *OCC Chief Counsel’s Interpretation on National Bank and Federal Savings Association Authority to Use Independent Node Verification Networks and Stablecoins for Payment Activities*, Interpretive Letter 1174 (Jan. 4, 2021).

BlockFi's Crypto Interest Account all represent that a depositor's assets are freely withdrawable.¹³⁰ The ability to be repaid on demand is central to the functionality of yield product.

As with the *Howey Test* and *Reves Test* for securities, yield products fit within the requirements commonly found in definitions of "deposits." This makes sense, as Coinbase advertised itself as an alternative to traditional savings accounts.¹³¹ Yield products are created with an agreement between users and the company offering the product, where the user provides the company with cryptocurrency, and the company allows the user to withdraw cryptocurrency whenever. Based on this analysis, unregistered yield products are failing to comply with both securities laws and banking regulations.

III. CONCLUSION

As cryptocurrencies have grown in popularity and proliferated, they have evolved and mutated into new products. Some of these new products closely mimic traditional financial instruments. This mixture of familiarity and innovation has led to confusion for regulators as to how they should treat these products. This is the case for yield products. Yield products operate by having a company take stablecoins from customers. These stablecoins are pooled together and then a smart contract matches the stablecoin assets with borrowers. The company then takes the earnings from these loans and returns them to depositors in the form of interest. The customer is free to demand the assets in their account whenever they want.

This particular financial product has the issue of falling under the jurisdiction of both securities laws and banking laws. Yield products pass both the *Howey* and *Reves* test for being a security and function as deposit accounts. Right now, these accounts subject crypto companies to both liability for offering an unregistered security and for illegally operating as a bank.

There are options for these crypto companies can take to register these products in order to comply with existing regulations. BlockFi has announced its intention to register its product as a new investment product by filing a form T-1 under the Trust Indenture Act of 1939 in addition to its registration statement.¹³² Registering with the SEC imposes requirements of regular filings of reports in order to give investors an idea of the risks that they face. Registering as a security would not cure the fact that a company

¹³⁰ COINBASE, *supra* note 1; FTX Earn, FTX, *supra* note 44; BLOCKFI, *supra* note 44.

¹³¹ COINBASE, *supra* note 1. Courts have used the guarantees made by a party as evidence of a deposit account. *See Jenkins*, 943 F.2d 167 at 174.

¹³² BlockFi Lending LLC., No. 3-20758 (Feb. 14, 2022).

is illegally operating as a bank, but it might deter banking regulators from bringing action against companies that take this option.

Alternatively, a crypto company could seek to organize as a bank and offer these products as deposit accounts. Banking regulations impose a requirement to be open to inspections and to maintain deposit insurance. Given the outcome in *Marine Bank*, a bank subject to banking laws would be exempt from having to register its products as a security because banking regulation would already reduce the risk that securities regulation seeks to protect against.¹³³ Moreover, registering as a bank would provide the most certainty to crypto companies that they are complying with regulations.

While the idea of a crypto bank is new, it is not unprecedented. Kraken has taken advantage of Wyoming's new rules regarding Special Purpose Depository Institutions ("SPDIs") to set up Kraken Bank.¹³⁴ Kraken Bank and other SPDIs will operate similar to custody banks meaning that they focus more on holding and administrating assets deposited by customers.¹³⁵ Kraken Bank is looking to offer customers the ability to have deposit accounts, as well as pay and receive payment from others in crypto.¹³⁶ However, there are limitations to how they can operate. At this time, Kraken Bank must maintain 100% reserves of deposits in fiat currency and cannot participate in lending activities.¹³⁷

The overall trend in the banking regulatory world is to be more accepting of cryptocurrency and other digital assets. Still, there does not yet seem to be a regulatory infrastructure in place to cover yield accounts. Until such a scheme is in place, the SEC will likely keep requiring these products to be securities as they meet the definition of a security under both the *Howey* and *Reeves* tests.

¹³³ *Marine Bank v. Weaver*, 455 U.S. 551, 558 (1982).

¹³⁴ KrakenFX, *Kraken Wins Bank Charter Approval*, KRAKEN (Sept. 16, 2020), <https://blog.kraken.com/post/6241/kraken-wyoming-first-digital-asset-bank/>.

¹³⁵ *Special Purpose Depository Institutions*, WYOMING DIVISION OF BANKING (last visited Apr. 10, 2022), <https://wyomingbankingdivision.wyo.gov/banks-and-trust-companies/special-purpose-depository-institutions>; THE CLEARING HOUSE, THE CUSTODY SERVICE OF BANKS 3-8 (2016), https://www.theclearinghouse.org/-/media/tch/documents/research/articles/2016/07/20160728_tch_white_paper_the_custody_services_of_banks.pdf; CUSTODY SERVICES, COMPTROLLER OF THE CURRENCY ADMINISTRATOR OF NATIONAL BANKS 1 (2002), <https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/custody-services/pub-ch-custody-services.pdf>.

¹³⁶ KrakenFX, *supra* note 134.

¹³⁷ *Id.*