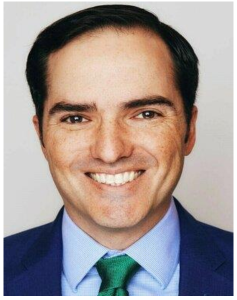
Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

What To Expect From CFPB's Entry Into Cryptocurrency Arena

By **Kyle Tayman, Andrew Kim and Collin Grier** (June 6, 2022, 4:49 PM EDT)



Kyle Tayman

Andrew Kim

Collin Grier

It is no secret that cryptocurrency has attracted the attention of an alphabet soup of state and federal regulators and enforcement agencies — including the U.S. Securities and Exchange Commission, U.S. Commodity Futures Trading Commission, U.S. Department of Justice, Financial Crimes Enforcement Network and IRS.

No longer just the darling of hardcore programmers, crypto is very much in the American mainstream.

While it is now popularized as an investment vehicle by the likes of celebrity endorsers galore, thereby increasing regulatory scrutiny, it holds the potential to play an even bigger and more ubiquitous role in the modern U.S. economy, namely in consumer financial services and transactions.

While digital assets may still be a ways away from having the price stability needed to power everyday transactions in the global economy, as recent market turbulence may suggest, many expect that potential to be realized soon.

With the right development, crypto can provide the backbone for everyday consumer transactions — with stablecoins holding particular promise, the recent **Terra crises** notwithstanding. Indeed, several companies are already at the forefront of such offerings.

The rise of consumer crypto offerings portends a new entrant into the regulatory and enforcement fray: the Consumer Financial Protection Bureau. As the federal government's watchdog for consumer financial products and services, the CFPB has not been shy about using its broad powers to regulate and take enforcement action with respect to emerging financial products and services, such as fintech.

Crypto is no exception: The CFPB first issued consumer warnings on cryptocurrency eight years ago.[1] Late last year, Director Rohit Chopra made clear the agency's vigilance for consumer crypto uses.

And on May 17, the CFPB announced an enforcement policy aimed at stablecoin depository products that potentially mislead consumers to believe they are backed by Federal Deposit Insurance Corp.

insurance.

Although in CFPB parlance, crypto products are not yet used "primarily for personal, family, or household purposes"[2] within the scope of its authority, by all appearances, the CFPB is positioning itself to become the cops of consumer crypto space.

Consumer Crypto: Where Are We Now and Where Are We Going?

Understanding how the CFPB might regulate consumer crypto products requires an understanding of what those products are, or may be. Cryptocurrency is largely perceived as an investment vehicle by regulators — hence the SEC and CFTC's involvement.

But cryptocurrency — and more specifically, the blockchains on which cryptocurrencies are built — is also the engine driving decentralized finance, or DeFi, and even some centralized finance, or CeFi, transactions.[3]

The Ethereum blockchain, for instance, casts itself as "a technology that's home to digital money, global payments, and applications."[4] Cryptocurrency's malleability all but guarantees growing consumer finance uses for crypto.

We focus here on three consumer use cases: (1) crypto-backed lending, (2) crypto-based payments, and (3) crypto deposit accounts. Each of these categories provides the CFPB with a unique path forward for regulation.

Crypto-Backed Lending

Crypto-backed lending is conceptually straightforward: A borrower asks to borrow a certain amount of dollars or crypto-assets — say, stablecoins, bitcoin or ether — and offers his existing crypto-assets as collateral.

In the DeFi context, the transaction is done peer to peer, facilitated by a DeFi platform through a smart contract. In the CeFi context, the platform itself may issue and manage the loan. The borrower pays interest on the loan, often in part with the platform's native digital currency, and their collateral is outside their control while the loan is being repaid. The lender earns interest as the loan is repaid.

While Web3 crypto loan opportunities currently abound, there are few consumer use cases for crypto loans, mainly limited to mortgages.

For instance, Milo Credit LLC allows users to use crypto-assets as collateral to secure a mortgage loan. But crypto loans currently require a considerable amount of collateral due to the volatility of the crypto market — 100% of the value of the loan, in the case of Milo — and carry other restrictions, such as a pledge to maintain a certain loan-to-value ratio if the value of the crypto backing the loan falls.

As cryptocurrencies find surer footing — particularly stablecoins, which are intended to weather market volatility — lending platforms will likely loosen loan requirements, and adopt a lending underwriting process similar to traditional consumer finance.

Indeed, crypto lending could soon become commonplace in auto, personal, mortgage and other loan products, although those products are likely to be first introduced with the high collateral requirements currently seen for crypto-backed loans.

Crypto Payments

Cryptocurrency is used as a payment medium for an increasing number of consumer goods, ranging from electric cars to gym memberships. E-commerce platforms, such as Shopify Inc., are making it increasingly easier for small businesses to accept crypto payments as well, and at least one mortgage servicer briefly tested the waters by temporarily accepting crypto for monthly mortgage payments.

Most transactions are crypto to fiat, where an intermediary converts cryptocurrency to fiat currency received by the payee merchant. But as crypto gains wider acceptance, pure crypto transactions, where a payor pays and a payee receives crypto, are likely to continue to grow in prominence as well.

Crypto Deposit Accounts

Crypto wallets bear some similarities to deposit accounts — wallets hold assets for transactions in and out, much as deposit accounts are used for deposits and withdrawals. Wallets generally do not accrue interest, although some wallets do have interest-earning capabilities.

Several platforms also offer interest-bearing cryptocurrency savings accounts; pooled crypto-assets are used to generate returns by methods such as yield-farming.

Crypto savings accounts sometimes tout interest rates much higher than traditional interest-bearing savings accounts, which has resulted in SEC scrutiny over concerns that crypto savings accounts are vehicles for speculation, including BlockFi Inc.'s recent settlement in which it agreed to cease offering interest-bearing crypto accounts.

The CFPB's Crypto Jurisdiction

The CFPB has a broad mandate to exercise oversight over those "offering or providing … a consumer financial product or service."[5] Crypto products have largely remained outside of the CFPB's regulatory ambit because, right or wrong, they often are viewed as vehicles for speculative profit-making; thus, the regulatory focus has been on whether a product is a security or a commodity, not a consumer financial product or service.

But the agency has made clear that it is actively looking for a way in. In November 2021, in response to a presidential working group's report on stablecoins, Chopra stated that "the CFPB is actively monitoring and preparing for broader consumer adoption of cryptocurrencies," citing the potential use of stablecoins for "consumer deposits, stored value instruments, retail and other consumer payments mechanisms, and in consumer credit arrangements."[6]

President Joe Biden's March executive order on digital assets also named the CFPB as part of an interagency group responsible for the development of a regulatory framework for digital assets. The order mentioned consumer protection — the CFPB's existing mandate and its charge in the executive order — no fewer than a dozen times, and the agency quickly confirmed its intention to protect crypto consumers "against errors, theft, or fraud."[7]

And in April, the CFPB announced its intention to use its dormant authority to regulate "nonbanks whose activities the CFPB has reasonable cause to determine pose risks to consumers," so that the agency may "supervise entities that may be fast-growing or are in markets outside the existing nonbank supervision program."[8]

That announcement has largely been perceived as intention to more closely regulate fintech, but it also sets the stage for the CFPB to regulate crypto entities and offerings.

The CFPB will likely take a methodical approach to regulating consumer crypto uses. It will start by collecting information using its broad investigative powers — such as the Section 1022(c)(4) information collection orders it sent to tech companies regarding their payment systems[9] — and educating itself on the landscape, while simultaneously searching for consumer harm and legal wrongs to resolve.

The Likely Case for Crypto Regulation and Enforcement

What would CFPB regulation look like? The agency's history has demonstrated a clear preference for litigation over rulemaking when addressing novel markets, technologies and legal theories. In other words, the CFPB will likely hold crypto companies accountable through enforcement actions brought under the Dodd-Frank Act.[10]

Given the novelty of crypto-assets, and the legal ambiguities that arise therefrom, the CFPB will most likely borrow from its existing arsenal of regulatory and enforcement powers and laws, rather than engage in new rulemaking to lay out the ground rules for its regulation of digital assets. We explore some of those powers and laws — and their limitations — below.

UDAAP

The most potent weapon in the CFPB's arsenal is its authority to take action against unfair, deceptive, or abusive acts or practices, or UDAAP.[11] Congress gave the CFPB a wide berth in determining what kind of conduct is unfair, deceptive or abusive, and the agency has not hesitated in using its UDAAP-related powers broadly.

With respect to crypto companies, the agency is likely to initially use its UDAAP authority in one of two ways.

First, the CFPB has used its UDAAP authority to go after alleged fraud, unfairness and consumer deception. There is no reason to think the CFPB will treat crypto companies any differently.

For example, promises of pie-in-the-sky returns for crypto deposits may be subject to CFPB scrutiny if the returns do not materialize and were unrealistic from the start. Such deceptive or misleading marketing is an easy target for the CFPB.

As another example, a deposit may be declared unfair if a consumer loses access to funds due to a cybersecurity breach.

Second, to the extent that a crypto product does not fall neatly within the parameters of any other consumer financial services law enforced by the CFPB, the agency may use UDAAP as a workaround.

For example, the CFPB has taken the position that its UDAAP authority may be used to "target discriminatory practices" even where "fair lending laws may not apply."[12] If a consumer crypto offering is not equally accessible to all, or if the marketing of the product targets more vulnerable communities, it could be a UDAAP violation in the CFPB's eyes.

Wallets and Payments

The Congressional Research Service has remarked that crypto wallets and transactions have fallen outside the scope of the Electronic Fund Transfer Act and Regulation E "primarily because these are not bank products and also because cryptocurrencies are not typically used for consumer payments."[13]

But that may soon change: As banks grow more involved in crypto, "certain Regulation E protections could be extended to any bank-based cryptocurrency products that are stored in digital wallets or even potentially other cryptocurrencies stored in a bank-issued digital wallet," according to the CRS.

Under Chopra, payments under Regulation E have been a hotbed source of enforcement activity for the CFPB; Regulation E would therefore be a natural starting point for the CFPB's entry into crypto regulation and enforcement.

For example, if a consumer disputes a transaction paid by crypto and claims it is unauthorized or in error, or if the consumer's account is subject to identity theft, Regulation E dispute procedures could apply, and the CFPB could allege a UDAAP violation if the consumer is denied a process to be made whole.

Federal laws and regulations provide less fertile ground for CFPB action; the FDIC and the Office of the Comptroller of the Currency are the primary regulators for deposit activities, and crypto's lack of status as legal tender hamstrings oversight using existing laws regarding deposits. But here, too, the CFPB has shown its creativity.

For example, on May 17, the agency announced that it would crack down on "misuse [of] the name or logo of the FDIC" and the making of "deceptive representations about deposit insurance," citing "the emergence of financial technologies — such as crypto-assets, including stablecoins" as a reason for the crackdown.[14]

The agency intends to pursue enforcement actions concerning such misrepresentations as a means of enforcing the Federal Deposit Insurance Act through the CFPB's pliable UDAAP powers.[15] Thus, even if another regulator is given jurisdiction over a particular consumer crypto segment, such as the OCC over stablecoins, the CFPB will likely find a way to invoke its own authority.

Fair Lending

The Equal Credit Opportunity Act could provide the CFPB with a powerful oversight and enforcement mechanism to ensure that credit transactions are conducted in a nondiscriminatory way. A crypto credit transaction could conceivably fall within a loose interpretation of credit under the ECOA.[16]

But even then, the ECOA's application is not a given, as the novelty of crypto raises difficult legal questions. A crypto-to-crypto loan, for example, where both disbursements and repayments are made in crypto, is not an arrangement that obviously involves the payment of debt, as conventionally understood, given that crypto is not legal tender in the U.S. yet.

That analysis changes, however, if it is a crypto-to-dollars loan. Again, where such regulatory lines are blurry, the CFPB may use UDAAP as a potential workaround.

Disclosure Regimes

The CFPB is charged with enforcing several statutes that require certain disclosures in consumer finance transactions, such as the Truth in Lending Act.[17] The agency could conceivably try to bring enforcement actions under these statutes. But the CFPB will need to overcome difficult questions presented by the statutory text.

Take TILA, for example. Assume that crypto transactions qualify as extensions of credit, and crypto lenders are creditors. For a crypto-to-crypto transaction, how is the lender to calculate and disclose an annual percentage rate, when crypto-assets and stablecoins may fluctuate in value? Are fees associated with using a network — Ethereum's so-called gas fees, as one example — included in the calculation of a finance charge?

As another example, crypto rewards for credit card offerings are coming to market, which could raise issues under the Credit Card Accountability Responsibility and Disclosure Act. There are difficult questions of how consumers will be informed of the value of those rewards and risks that will likely draw the CFPB's close inspection.

Conclusion

These are only some of the questions presented by the CFPB's forthcoming entry into the crypto world. The versatility of crypto technology and the disruption that crypto can bring to established markets make it difficult to predict all the ways in which consumer crypto products might intersect with the CFPB's regulatory authority.

But one thing is assured: The CFPB's entry into this world is coming. That entry will doubtless generate friction, as Congress did not legislate consumer protection statutes with crypto in mind; and the CFPB will be competing with other agencies on the regulatory field.

It remains to be seen whether the CFPB will proactively attempt to ease that friction by providing guidance and parameters for regulation through the rulemaking process, or whether the agency's first step will be to flex its enforcement muscles to test the boundaries of its authority, leaving it to courts to rein the agency in.

W. Kyle Tayman and Andrew Kim are partners and Collin Grier is an associate at Goodwin Procter LLP.

[1] CFPB, Consumer Advisory: Risks to Consumers Posed by Virtual Currencies (Aug. 2014), https://files.consumerfinance.gov/f/201408_cfpb_consumer-advisory_virtual-currencies.pdf.

[2] 12 U.S.C. §5481(5).

[3] DeFi transactions are conducted over an unregulated technology; CeFi transactions are conducted through a regulated exchange.

[4] Welcome to Ethereum, Ethereum.org, https://ethereum.org/en/ (last updated May 19, 2022).

[5] 12 U.S.C. §5481(6).

[6] Rohit Chopra, CFPB, Statement of CFPB Director Chopra on Stablecoin Report (Nov. 1, 2021), https://www.consumerfinance.gov/about-us/newsroom/statement-cfpb-director-chopra-stablecoin-report/.

[7] CFPB, CFPB Director Chopra Statement on President Biden's Digital Assets Executive Order (Mar. 9, 2022), https://www.consumerfinance.gov/about-us/newsroom/cfpb-director-rohit-chopra-statement-on-president-bidens-digital-assets-executive-order/.

[8] CFPB, CFPB Invokes Dormant Authority to Examine Nonbank Companies Posing Risks to Consumers (Apr. 25, 2022), https://www.consumerfinance.gov/about-us/newsroom/cfpb-invokes-dormant-authority-to-examine-nonbank-companies-posing-risks-to-consumers/.

[9] CFPB, CFPB Orders Tech Giants to Turn Over Information on Their Payment System Plans (Oct. 21, 2021), https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-tech-giants-to-turn-over-information-on-their-payment-system-plans/.

[10] Dodd-Frank Wall Street Reform and Consumer Protection Act, subch. V, 12 U.S.C. §§ 5481-5603.

[11] 12 U.S.C. §5531(a).

[12] CFPB, CFPB Targets Unfair Discrimination in Consumer Finance (Mar. 16, 2022), https://www.consumerfinance.gov/about-us/newsroom/cfpb-targets-unfair-discrimination-in-consumer-finance/.

[13] Paul Tierno & Andrew P. Scott, Cong. Rsch. Serv., Digital Wallets and Selected Policy Issues 2 (Apr. 18, 2022), https://crsreports.congress.gov/product/pdf/IF/IF12079.

[14] CFPB, CFPB Takes Action to Protect Depositors From False Claims About FDIC Insurance (May 17, 2022), https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-to-protect-depositors-from-false-claims-about-fdic-insurance/.

[15] CFPB, Consumer Financial Protection Circular 2022-02 (May 17, 2022), https://www.consumerfinance.gov/compliance/circulars/circular-2022-02-deception-representations-involving-the-fdics-name-or-logo-or-deposit-insurance/.

[16] 15 U.S.C. §1691a(d).

[17] 15 U.S.C. §1601 et seq.