

# TradeStation Crypto's Settlement with the SEC Signals Continued Scrutiny of Interest-Bearing Crypto Lending

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On February 7, 2024, the Securities and Exchange Commission (SEC) announced charges against TradeStation Crypto, Inc. (TradeStation) for “failing to register the offer and sale of a crypto lending product” that it offered to U.S. investors from approximately August 2020 to June 2022.<sup>[1]</sup> According to the SEC, the lending product “allowed U.S. investors to deposit or purchase crypto assets in a TradeStation account in exchange for the company’s promise to pay interest.”<sup>[2]</sup> Without admitting or denying the SEC’s findings, TradeStation agreed to pay a \$1.5 million civil penalty and agreed to a cease-and-desist order, preventing it from violating registration provisions of the Securities Act of 1933 (the Act). TradeStation separately agreed to pay an additional \$1.5 million to resolve investigations by a multistate task force of state securities regulators.<sup>[3]</sup>

The SEC’s action against TradeStation is similar to its enforcement action against BlockFi Lending LLC in early 2022, which we discussed in a [previous post](#).

## TRADESTATION’S “INTEREST FEATURE”

The SEC’s charges concern a product TradeStation offered its customers, which the SEC calls the “Interest Feature.” The Interest Feature allowed customers to lend their crypto assets to TradeStation in exchange for TradeStation’s promise to pay a variable interest rate on the tendered assets. TradeStation informed customers it “would pool their crypto assets into wallets that TradeStation controlled and then lend the crypto assets to third-party institutional borrowers, which generated revenue to pay interest to investors.”<sup>[4]</sup> According to the SEC’s Order, TradeStation screened and selected the interest-bearing opportunities to which investors’ crypto assets were committed.<sup>[5]</sup> As of December 2021, over 8,000 active users and \$195 million in assets participating in the Interest Feature were of U.S. origin—reflecting well over half the global users of, and assets pledged to, the Interest Feature at that time.<sup>[6]</sup>

## SEC FINDS THE INVESTMENT FEATURE IS A SECURITY UNDER HOWEY

The SEC found the Investment Feature qualified as offers and sales of a security because it reflected the offer and sale of investment contracts under *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946)—a now oft-deployed tool in the SEC’s digital assets enforcement toolbox. In *Howey*, the Supreme Court established a four-prong test for determining whether an asset was an “investment contract” within the purview of federal securities laws.<sup>[7]</sup> Under *Howey*, a transaction constitutes an investment contract if it involves: 1) an investment of money, 2) in a common enterprise, 3) with a reasonable expectation of profits that are 4) derived through the efforts of others.<sup>[8]</sup>

Applying *Howey* to the Investment Feature, the SEC found investors tendered money in the form of crypto assets to participate in the Interest Feature; TradeStation pooled participating investors' crypto and used those assets to generate returns to investors; investors had a reasonable expectation they would share in the profits resulting from TradeStation's managerial and entrepreneurial efforts; and TradeStation had sole discretion over the Investment Feature's revenue-generating activities.<sup>[9]</sup> The SEC's legal analysis relied on information and disclosures about the Interest Feature, which TradeStation published in its Customer Account Agreement, a "Crypto Interest" brochure, and an "Investment and Trading Disclosures Booklet."

The SEC found TradeStation violated Sections 5(a) and 5(c) of the Act because it did not file a registration statement with the SEC for the offers and sales of the Interest Feature, a security, and because no exception applied to the Act's registration requirements. The SEC's Order noted TradeStation's remedial efforts, including its cooperation with the SEC and termination of the Interest Feature on June 30, 2022.

## TAKEAWAYS

The TradeStation settlement reaffirms the SEC's position that federal securities laws apply to interest-bearing crypto lending products. It also marks the latest in a series of similar SEC enforcement actions since our coverage of the \$100 million BlockFi settlement:

- In January 2023, the SEC filed charges against Genesis Global Capital, LLC (Genesis) and Gemini Trust Company LLC "for the unregistered offer and sale of crypto asset securities through the Gemini Earn Lending Program."<sup>[10]</sup> Genesis and affiliated companies soon thereafter filed for Chapter 11 bankruptcy. On January 31, 2024, Genesis asked the U.S. Bankruptcy Court for the Southern District of New York to approve a \$21 million settlement with the SEC to resolve the charges against it concerning Gemini Earn.<sup>[11]</sup> If approved, the SEC's claim for a \$21 million penalty would be subordinated behind all allowed administrative expenses, priority, secured, and general unsecured claims.<sup>[12]</sup>
- In January 2023, Nexo Capital Inc. agreed to pay \$45 million in penalties, divided between the SEC and a group of states, for failing to register the offer and sale of its retail crypto asset lending product, "the Earn Interest Product."<sup>[13]</sup>
- In July 2023, the SEC filed charges against Celsius Network Limited alleging it violated federal securities laws by, in part, "offer[ing] to investors the Earn Interest Program, by which investors tendered their crypto assets to Celsius in exchange for interest payments."<sup>[14]</sup>

While the SEC's perspective on interest-bearing crypto lending products appears well cemented, it remains to be seen how the agency would handle registration for interest-bearing crypto lending products. Coming off a record year for crypto-related enforcement actions in 2023, we expect the SEC will continue including interest-bearing crypto-lending products within the scope of its enforcement activity. Businesses that offer or hope to offer such products to U.S. customers should be mindful of the SEC's stance in this area and seek guidance for navigating the associated regulatory landscape.

Winston & Strawn's multijurisdictional Digital Assets & Blockchain Technology Group will continue to monitor developments and provide clients and friends of the firm with updates as they become available.

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<sup>[9]</sup> SEC Charges TradeStation Crypto for Unregistered Offer and Sale of Crypto Asset Lending Product, SEC Press Release (Feb. 7, 2024), available at <https://www.sec.gov/news/press-release/2024-16>.

<sup>[10]</sup> *Id.*

<sup>[11]</sup> NASAA and SEC Announce \$3 Million Settlement with TradeStation over Crypto Interest-Earning Program, NASAA Press Release (Feb. 7, 2024) <https://www.nasaa.org/70993/nasaa-and-sec-announce-3-million-settlement-with-tradestation?qoid=current-headlines>

<sup>[14]</sup> SEC Order, Administrative Proceeding No. 3-21845 at 3 (Feb. 7, 2024), available at <https://www.sec.gov/files/litigation/admin/2024/33-11269.pdf>.

<sup>99</sup> *Id.*

<sup>100</sup> *Id.* at 2.

<sup>101</sup> *Howey*, 328 U.S. at 298-99; see also *Framework for "Investment Contract" Analysis of Digital Assets*, SEC (March 8, 2023), available at <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>.

<sup>102</sup> *Howey*, 328 U.S. at 301.

<sup>103</sup> SEC Order at 2, 5.

<sup>104</sup> *SEC Charges Genesis and Gemini for the Unregistered Offer and Sale of Crypto Asset Securities through the Gemini Earn Lending Program*, SEC Press Release (Jan. 12, 2023) <https://www.sec.gov/news/press-release/2023-7>.

<sup>105</sup> *In re Genesis Global Holdco, LLC, et al.*, Case No. 23-10063-SHL, Doc. 1220 (Bankr. S.D.N.Y., Jan. 31, 2024).

<sup>106</sup> *Id.* at p. 28.

<sup>107</sup> *Nexo Agrees to Pay \$45 Million in Penalties and Cease Unregistered Offering of Crypto Asset Lending Product*, SEC Press Release (Jan. 19, 2023), available at <https://www.sec.gov/news/press-release/2023-11>.

<sup>108</sup> *SEC Charges Celsius Network Limited and Founder Alex Mashinsky with Fraud and Unregistered Offer and Sale of Securities*, SEC Press Release (July 13, 2023), available at <https://www.sec.gov/news/press-release/2023-133>.

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