STATE OF VERMONT
DEPARTMENT OF FINANCIAL REGULATION

IN RE: **COINBASE GLOBAL, INC. and** **COINBASE, INC.**	))))))	**DOCKET NO. 23-003-S**

SHOW CAUSE ORDER

The Vermont Department of Financial Regulation (the "Department"), having the authority to administer and provide for the enforcement of all provisions of 9 V.S.A. Chapter 150, the Vermont Uniform Securities Act of 2002 (the "Securities Act"), upon due consideration of the subject matter hereof, has determined as follows:

JURISDICTION

1. The Commissioner of Financial Regulation is responsible for administering and enforcing the securities laws of the State of Vermont and is authorized to investigate companies to determine compliance with Vermont law and issue orders imposing remedial actions and civil administrative penalties, pursuant to 9 V.S.A. §§ 5601-5605.
2. Pursuant to 9 V.S.A. § 5604(a)(1), the Commissioner may issue orders or directives to any person to cease and desist from specific conduct if the Commissioner finds that the person has engaged, is engaging or is about to engage in an act, practice or course of business which constitutes a violation of the Securities Act.
3. Pursuant to 9 V.S.A. § 5604(b) and Section 1.04(O) of Department Regulation No. 2022-01, the Commissioner may issue such orders without prior notice or an opportunity to be heard.

4. Pursuant to 9 V.S.A. § 5604, the Commissioner may: (1) impose a civil administrative penalty for each violation of the Securities Act, an administrative rule of the Department, or an order of the Commissioner relating to securities, of up to $15,000 per violation; and (2) require a company to make restitution or provide disgorgement of any sums shown to have been obtained in violation of the Securities Act, plus interest at the legal rate.

RESPONDENTS

5. Coinbase Global, Inc. ("Coinbase Global") is a Delaware corporation that conducts business in the State of Vermont. Coinbase Global is a remote-first company with no physical headquarters.

6. Coinbase, Inc., a wholly owned subsidiary of Coinbase Global, is a Delaware corporation that conducts business in the State of Vermont. Coinbase, Inc. is a remote-first company with no physical headquarters.

7. Coinbase Global and Coinbase, Inc. are referred to herein collectively as "Coinbase" or the "Respondents."

BACKGROUND AND FINDINGS OF FACT

8. Respondents operate a crypto platform that offers a staking rewards program, crypto borrowing, and crypto exchange services, among others, to retail and institutional customers.

9. Respondents conduct their business on the internet, through a website accessible to the general public at https://www.coinbase.com (the "Coinbase Website"), as well as through Respondents' proprietary smartphone applications, which are also accessible to the general public.

10. From as early as November 6, 2019, Respondents have offered and sold unregistered securities, in the form of crypto asset staking rewards offerings (together the "Coinbase

Staking Offerings," each a "Coinbase Staking Offering"), made to the United States public at large and to Vermont residents.[1]

11. Respondents have promoted the Coinbase Staking Offerings on their blog at https://www.coinbase.com/blog, as well as on social media through various platforms, including Twitter, Facebook, and Instagram.

12. In marketing the Coinbase Staking Offerings, Respondents have touted them as secure and accessible to the retail investor, as compared to those investors staking on their own. For example, Coinbase has stated:

    a. "It's easy. Start earning with a couple of clicks. You can earn on as little as $1."
    b. "It's secure. We take measures to mitigate risks and allow you to opt-out anytime."
    c. "You shouldn't have to be an expert crypto trader to grow your crypto wealth. Offering an easy way for our customers to earn rewards from staking is an important step in building an open financial system."
    d. "With today's launch, Coinbase is offering an easy, secure way for anyone to actively participate in the Tezos network. While it's possible to stake Tezos on your own or via a delegated staking service, it can be confusing, complicated, and even risky with regard to the security of your staked Tezos. We're changing that with staking rewards on Coinbase."

13. Respondents permit Vermont residents and other investors who are at least eighteen years old to invest in the Coinbase Staking Offerings through the Coinbase Website and smartphone applications.[2]

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[1] The Coinbase Staking Offerings are described here: https://www.coinbase.com/earn (last accessed June 1, 2023).

[2] When opening a Coinbase account, an investor will go through several user identity-verification protocols, including, at a minimum, the provision of an investor's legal name, date of birth, and address.

Crypto Assets and Proof-of-Stake

14. The Coinbase Website describes crypto assets as "decentralized digital money designed to be used over the internet."

15. According to the Coinbase Website, "crypto makes it possible to transfer value online without the need for a middleman like a bank or payment processor." Rather, crypto assets rely on blockchains, which are ongoing, constantly re-verified records of every single publicly-recorded transaction ever made using that crypto asset. The blockchain is distributed across participants of the crypto asset's network.

16. For crypto assets that use a proof-of-stake blockchain, transactions are added to the blockchain by "validators." The Coinbase Website defines a validator as "a node on a proof of stake blockchain that is responsible for securing the network, storing the history of transactions and confirming the validity of new transactions added to the next block in the chain."

17. Coinbase has explained staking as follows in its March 20, 2023 comment letter to the Securities and Exchange Commission:

> The protocol rules of a blockchain are often referred to as its "consensus mechanism" and they dictate how the computers in the network reach agreement on what transactions and blocks to add to the blockchain… The most commonly-known consensus mechanisms are based on what are called "proof-of-work" and "proof-of-stake" protocols…
>
> Proof-of-stake is generally considered to be faster and less resource-intensive [than proof-of-work]. In proof-of-stake, participants must lock up, or "stake," their cryptocurrency in order to validate transactions and add new blocks to the blockchain. These "validators" receive rewards from the protocol for their contribution to securing the blockchain…

18. The chance of a validator being chosen to validate a transaction on a proof-of-stake blockchain is typically proportional to the amount of crypto assets being staked. If a chosen validator successfully validates a block, it is awarded a staking reward.

19. According to the Coinbase Website, participating as a validator in a proof-of-stake blockchain requires "a minimum number of tokens, technical knowledge, and a dedicated computer that can perform validations day or night without downtime."

20. Participating as a validator comes with security considerations and risk of loss, because downtime or failure to comply with blockchain rules can cause a validator's stake to be "slashed," meaning its staked crypto assets are not returned. According to the Coinbase Website, "[s]lashing is a penalty enforced at the protocol level associated with a network or validator failure."

21. In its 2022 Annual Report on Form 10-K for its publicly traded stock, filed with the U.S. Securities and Exchange Commission on February 21, 2023, Coinbase Global states:

> Today, staking crypto assets is a technical challenge for most consumers. Staking independently requires a participant to run their own hardware, software, and maintain close to 100% up-time.

22. Coinbase advertises that a simpler way to participate in staking is through a crypto exchange like Coinbase and encourages customers to participate in staking through its Coinbase Staking Offerings.

The Coinbase Staking Offerings

23. The Coinbase Staking Offerings are offered exclusively by Coinbase through Coinbase's smartphone applications and the Coinbase Website; prospective investors can open accounts on either.

24. As of June 1, 2023, the Coinbase Website represents as follows:

a. “Earn up to 10.00% APY on your crypto. Put your crypto to work and earn rewards.”

b. “We’ll help you put your assets to work in the cryptoeconomy so you can grow your crypto holdings with little effort.”

c. “We take measures to mitigate risks and allow you to opt-out anytime.”

25. To invest in the Coinbase Staking Offerings, Coinbase directs users to buy new earning assets through Coinbase’s cryptocurrency exchange service. Coinbase typically receives commissions from the buyer and/or seller in connection with each such purchase.

26. Users also have the option to deposit eligible crypto assets into their Coinbase accounts from outside digital wallets by transferring custody of such crypto assets to Coinbase and enrolling such crypto assets in the applicable Coinbase Staking Offering.

27. Prior to March 21, 2023, for non-Ethereum assets, Coinbase automatically enrolled Coinbase account holders in a Coinbase Staking Offering once the account holder had a required minimum balance of an eligible crypto asset. Beginning on March 21, 2023, Coinbase discontinued its prior practice of automatically enrolling customers holding eligible crypto assets in Coinbase Staking Offerings. As of March 21, 2023, Coinbase account holders must affirmatively opt into the Coinbase Staking Offerings for their eligible crypto assets.

28. The minimum amounts Coinbase requires to participate in the Coinbase Staking Offerings are generally lower than the amounts that would be required for an individual to operate a validator node on his or her own.

29. Coinbase then, in its sole and absolute discretion, facilitates the staking of investors’ crypto assets by:

a. Aggregating investors’ deposits of crypto assets in an omnibus wallet.

b. Performing on-chain operations to configure validator nodes on the relevant blockchain network.

c. Bonding investors' crypto assets to validator nodes for any period of time. These operations may be conducted for multiple investors in a single batch and typically incur on-chain fees borne by Coinbase and not passed on to investors.

d. Operating or engaging third parties to operate validator nodes that use the staked crypto assets to validate transactions on the underlying protocol.

e. Maintaining rewards received from investors' staked crypto assets in a Coinbase omnibus wallet and re-staking any rewards earned in un-staked form.

f. Periodically crediting investors' Coinbase accounts with rewards, after taking a percentage of the rewards.

g. In certain cases, voting on investors' behalf on matters related to the governance of the underlying crypto protocol.

h. Drawing down or exiting validator nodes when an investor requests to un-stake an asset, which may be done in conjunction with multiple investors in a single batch.

30. The Coinbase User Agreement (the "User Agreement") sets forth that, in the event of a slashing event, Coinbase may, in some circumstances, replace investors' staked assets at no additional cost.

31. On the Coinbase Website, Respondents note that there are risks associated with the Coinbase Staking Offerings, including: "the possible slashing of staked assets or rewards. Although it's unlikely, there is a possibility you could lose your staked assets or rewards in case of a network or validator failure. We've taken measures to reduce these risks, but some events are outside our control."

32. Investors assume other risks related to the Coinbase Staking Offerings. For instance, investors take the risk of market events affecting the value of their staked assets for the designated lock-up period. On the Coinbase Website, Respondents state: "Staking requires assets to be locked on the protocol in order to earn rewards. During this time you won't be able to trade or transfer your assets."

33. In return, investors earn interest on their staked crypto assets in the form of like-kind crypto assets. Under the User Agreement, investor earnings are based on the type and

amount of crypto assets they have staked through each Coinbase Staking Offering, net of Coinbase's commissions.

34. Coinbase takes 25 to 35 percent of a Coinbase Staking Offering's rewards as a commission. Participants in a Coinbase subscription program known as Coinbase One may have the opportunity to opt-in to lower commissions. Coinbase may also offer lower commissions for certain Coinbase Staking Offerings on a promotional basis, and these promotions may differ among Coinbase users.

35. On the Coinbase Website and smartphone applications, Respondents publish a list of crypto assets that they transact in for the Coinbase Staking Offerings. Those lists state each of the crypto asset's annual percentage yield.

36. In exchange for consideration (*i.e.* deposits and the attendant rights to use them as described above) received in the present, Coinbase has at all relevant times promised to pay lucrative interest rates in the future. Coinbase has at all relevant times promoted the interest rates through the Coinbase Website and applications, which advertise annualized returns on Coinbase Staking Offerings for retail investors.

37. The annual percentage yield for deposited crypto assets in the Coinbase Staking Offerings have been upward of 16.39%, depending on which crypto assets were deposited.

38. Coinbase finances its payments to Coinbase Staking Offering investors through revenue from its business activities, including operating validator nodes, which verify transactions on proof-of-stake blockchains. Investors neither provide nor facilitate these activities or services.

39. As of mid-January 2023, Coinbase employed 64 engineers to support the Coinbase Staking Offerings.

40. Whether investors in the Coinbase Staking Offerings receive interest payments depends entirely on the success of Coinbase as a business and its managerial and entrepreneurial efforts. These investors do not engage in any substantive program activities beyond buying or depositing crypto assets into the Coinbase Staking Offerings.

41. Accordingly, any profit earned by investors in the Coinbase Staking Offering is earned solely through the efforts of Respondents with means determined solely by Respondents.

42. Coinbase's interest payments to investors in the Coinbase Staking Offerings function like those for pooled investment vehicles. But Coinbase is not protected by investor- and consumer-protection organizations, such as the Securities Investor Protection Corporation or the Federal Deposit Insurance Corporation.

43. As of March 29, 2023, more than 3,499,500 U.S. residents had invested over $4,800,702,550 in Coinbase Staking Offerings, nationally.

44. As of March 29, 2023, 5,449 Vermont residents were active investors in the Coinbase Staking Offerings with investments totaling $5,482,303.65. Respondents offered these Coinbase Staking Offerings to Vermonters without complying with the securities registration requirements in Vermont law.

The Lack of Registration and Public Protections

45. Respondents are not registered with the Vermont Department of Financial Regulation to offer or sell securities in Vermont in connection with the Coinbase Staking Offerings.[3]

46. The Coinbase Staking Offerings are not and have never been registered or permitted for sale in Vermont, nor do they qualify for any exemption from registration pursuant to the Securities Act.

47. Respondents are not registered with the United States Securities and Exchange Commission (the "SEC") in connection with the Coinbase Staking Offerings.

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[3] Coinbase, Inc. is licensed as a money transmitter under the Vermont Money Services Act, 8 V.S.A. § 2500, *et seq*. but that does not authorize Respondents to offer or sell securities in Vermont.

48. Respondents did not file or cause to be filed a registration statement with the SEC in connection with the offer and sale of the Coinbase Staking Offerings.

49. Respondents are not disclosing material information to investors in the Coinbase Staking Offering that issuers of registered securities must include in a registration statement and provide to prospective investors in the form of a prospectus pursuant to the Subchapter 3 of the Securities Act and Section 6-1 of the Vermont Securities Regulation.

50. The Coinbase Staking Offerings are not protected by Securities Investor Protection Corporation, otherwise known as the SIPC, a federally mandated, non-profit, member-funded United States corporation created under the Securities Investor Protection Act of 1970 that mandates membership of most US-registered broker-dealers.

51. The Coinbase Staking Offerings are also not insured by the Federal Deposit Insurance Corporation, otherwise known as the FDIC, an agency that provides deposit insurance to depositors in the United States, or the National Credit Union Administration, otherwise known as the NCUA, an agency that regulates and insures credit unions.

52. Respondents have continued to offer the Coinbase Staking Offerings to Vermonters without complying with the registration requirements set forth in this Show Cause Order.

<u>CONCLUSIONS OF LAW</u>

53. Pursuant to 9 V.S.A. § 5301, "[i]t is unlawful for a person to offer or sell a security in this State unless: (1) the security is a federal covered security; (2) the security, transaction, or offer is exempted from registration under sections 5201 through 5203 of this chapter; or (3) the security is registered under this chapter."

54. Pursuant to 9 V.S.A § 5102(28), the term "security" includes notes, investment contracts, evidence of indebtedness, and related types of participation in profit-sharing agreements.

Section 5102(28)(D) specifies that the Securities Act's definition of security includes "an investment in a common enterprise with the expectation of profits to be derived primarily from the efforts of a person other than the investor and a 'common enterprise' means an enterprise in which the fortunes of the investor are interwoven with those of either the person offering the investment, a third party, or other investors." *Id.*

55. The Coinbase Staking Offerings offered by Respondents are securities within the meaning of 9 V.S.A. § 5102(28).

56. The Coinbase Staking Offerings were neither federal covered securities nor registered with the Department nor exempted from registration when Respondents offered or sold them to Vermont investors.

57. Accordingly, Respondents are in violation of 9 V.S.A. § 5301.

ORDER

ACCORDINGLY, IT IS HEREBY ORDERED that Respondents show cause to the Commissioner, within thirty (30) days of the date of this Order, why an order should not be entered by the Commissioner directing Respondents to cease and desist offering Coinbase Staking Offerings in Vermont, and further, as a condition of such order, to pay restitution and meet such other terms and conditions as the Commissioner deems appropriate under 9 V.S.A. § 5604, including, but not limited to a civil penalty of not more than $15,000.00 for each violation.

Dated at Montpelier, Vermont this 6th day of June, 2023.

Kevin J. Gaffney
Commissioner
Vermont Department of Financial Regulation