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BEFORE THE DEPARTMENT OF FINANCIAL PROTECTION AND INNOVATION
OF THE STATE OF CALIFORNIA

In the Matter of:

THE COMMISSIONER OF FINANCIAL PROTECTION AND INNOVATION,

Complainant,

v.

COINBASE GLOBAL, INC. and COINBASE, INC.

Respondents.

The Commissioner of Financial Protection and Innovation (Commissioner) is informed and believes, and based upon such information and believe, alleges and charges as follows:

FACTUAL BACKGROUND

1. From as early as November 6, 2019, Coinbase Global, Inc. and Coinbase, Inc. (collectively “Coinbase”) have offered and sold unqualified 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 California residents.

2. As of March 29, 2023, at least 644,470 California residents were active investors in the Coinbase Staking Offerings with investments totaling at least $1,283,785,772.

A. Crypto Assets and Proof-of-Stake

3. Coinbase describes crypto assets, sometimes referred to as cryptocurrency, as “decentralized digital money designed to be used over the internet.”

4. Crypto assets do not rely on middlemen like banks or payment processors to execute transactions. Rather, crypto assets rely on blockchains, which are ongoing, constantly re-verified records of every single transaction ever made using that crypto asset. The blockchain is distributed across participants of the crypto asset’s network.

5. For crypto assets that use a proof-of-stake blockchain, transactions are added to the blockchain by “validators.” Coinbase 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.”

6. 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…

7. 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 the staking reward.
8. To participate 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.”

9. 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 their staked crypto assets are not returned. According to Coinbase, “[s]lashing is a penalty enforced at the protocol level associated with a network or validator failure.”

10. 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.

B. The Respondent

11. Coinbase, Inc. was founded in 2012. In April 2014, Coinbase, Inc. became a wholly-owned subsidiary of Coinbase Global, Inc. as part of a corporate reorganization.

12. Coinbase is a remote-first company with no physical headquarters. Prior to May 2020, Coinbase was headquartered at 548 Market Street, Suite 23008 San Francisco, California 94104.

13. Coinbase operates a crypto platform that offers a staking rewards program, crypto borrowing, and crypto exchange services, among others, to retail and institutional customers.

14. Coinbase conducts business in the United States through Coinbase’s mobile application and public website at https://www.coinbase.com/. The Coinbase website is accessible to the general public, including residents of California.

C. The Coinbase Staking Offerings

15. The Coinbase Staking Offerings are offered exclusively by Coinbase through Coinbase’s smartphone application and public website; prospective investors can open accounts on either. The Coinbase Staking Offerings public website is https://www.coinbase.com/earn.

16. The Coinbase Staking Offerings website represents as follows:
   a. “Earn up to 6.00% 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.”

17. To participate in the Coinbase Staking Offerings, investors deposit designated crypto assets into their accounts or purchase the designated crypto assets from Coinbase’s platform and maintain a minimum amount of those designated crypto assets in Coinbase’s custody. 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 their own.

18. 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 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.

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

20. Coinbase has promoted its services and products, including the Coinbase Staking Offerings, in the United States through its smartphone application, website, blog, and Twitter
account, among other media networks. In its marketing of its staking rewards program, Coinbase has touted the program 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.”

21. On its public website, Coinbase notes 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.” In the event that crypto assets invested by Coinbase Staking Offerings investors are lost or reduced as the result of “slashing,” Coinbase may, in some circumstances, replace investors’ slashed assets staked in the Coinbase Staking Offering at no additional cost.

22. Coinbase has no contractual obligation to retain a like amount of investors’ crypto assets or comparable ones in its possession or control to fully cover investors’ staked assets in the event of loss.

23. 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 its public website, Coinbase states: “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.”
24. In return, investors earn interest on their staked crypto assets in the form of like-kind crypto assets. 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.

25. On its public website, Coinbase publishes a list of crypto assets that it transacts in for the Coinbase Staking Offerings. That list states each of these assets’ annual percentage yield.

26. The annual percentage yield for deposited crypto assets in the Coinbase Staking Offerings have been upward of at least 6%, depending on which crypto assets were deposited.

27. 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.

28. 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 depositing crypto assets into a Coinbase Staking Offering.

29. 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 and the Federal Deposit Insurance Corporation.

30. The Commissioner has issued no permit or other form of qualification authorizing Coinbase to offer or sell securities, including the Coinbase Staking Offerings, in California. Nor are the offers and sales of these securities excepted, exempt, or otherwise not subject to qualification.
DESIST AND REFRAIN ORDER

The Commissioner is authorized to administer and enforce the provisions of the Corporate Securities Law of 1968, Corporations Code sections 25000 et seq. (CSL) and the regulations thereunder at Title 10, California Code of Regulations (CCR).

Based on the foregoing findings, the Commissioner is of the opinion that the Coinbase Staking Offerings offered and sold by Coinbase (1) are securities, in the form of investment contracts, under California Corporations Code section 25019; (2) are being offered and sold in this state in issuer transactions; (3) are subject to qualification under the Corporate Securities Law of 1968; and (4) have been offered and sold without prior qualification, in violation of California Corporations Code section 25110.

Pursuant to California Corporations Code section 25532, Coinbase is HEREBY ORDERED to desist and refrain from the further offer and sale of securities in California, including, but not limited to, the Coinbase Staking Offerings, unless such sale has been qualified under the law, or unless such securities or transactions are excepted, exempt, or otherwise not subject to qualification.

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NOTICE OF INTENT TO ISSUE ORDER LEVYING ADMINISTRATIVE PENALTIES

Corporations Code section 25252(a) authorizes the Commissioner to levy administrative penalties against any person subject to the Corporate Securities Law of 1968 for willful violations of any provisions of the CSL, including section 25110.

The Department finds that Coinbase willfully violated the CSL by offering and selling securities without prior qualification, in violation of section 25110. Over 644,470 California investors participated in the Coinbase Staking Offerings.

Pursuant to Corporations Code section 25252(a), the Commissioner hereby provides notice of intent to levy administrative penalties against Coinbase for the statutory amount of not more than one thousand dollars ($1,000) for the first violation, and not more than two thousand five hundred dollars ($2,500) for each subsequent violation, or according to proof, for Coinbase’s repeated willful violations of section 25110.

This Order is necessary, in the public interest, for the protection of investors, and consistent with the purposes, policies, and provisions of the CSL.

DATED: June 6, 2023
Sacramento, California

CLOTHILDE V. HEWLETT
Commissioner of Financial Protection and Innovation

By:
MARY ANN SMITH
Deputy Commissioner
Enforcement Division