The Crisis at Celsius Is Rocking DeFi and Crypto

The company froze withdrawals in what looks like an effort to stop a virtual bank run. Now boosters are wondering where the bottom is.

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From Crypto
Celsius Network amassed more than $20 billion in assets with a pitch that seemed to defy the basic physics of finance. Deposit crypto coins and earn interest rates as high as 18%, tens or hundreds of times the rates on traditional savings accounts. “When you look at what the banks pay, you say to yourself, ‘Somebody is lying. Either the bank is lying or Celsius is lying,’” co-founder Alex Mashinsky said in an interview last year.

More than a million people entrusted their savings to Celsius, according to the company. Even as skepticism mounted over whether its interest rates were sustainable, and customers started withdrawing hundreds of millions of dollars amid a deepening crypto rout, Mashinsky maintained that his company was safe. Then, on the night of June 12, Celsius announced it was halting withdrawals because of “extreme market conditions.” It was like a bank locking depositors out of its branches to preserve cash in the midst of a panic. “We are working with a singular focus: to protect and preserve assets to meet our obligations to customers,” Celsius said in a post on Medium.

Celsius’s apparent effort to ward off the digital equivalent of a bank run comes just a month after the $60 billion collapse of TerraUSD and Luna, two cryptocurrencies that were part of a complex system that lured investors with 20% interest rates. The back-to-back flops have spooked investors already anxious about the value of crypto assets. The price of Bitcoin fell to as low as $20,102 on June 15—it’s lowest since December 2020 and about 70% off its peak last year. Ether, the second-most-popular coin, has dropped 75% from its 2021 high, and many lesser-known cryptocurrencies and nonfungible tokens (NFTs) have suffered bigger declines. The total market value of all cryptocurrencies, which topped $3 trillion in November, fell below $1 trillion.

Crypto boosters are wondering where the bottom is, and just how systemically important Celsius and other projects may be to the digital asset market. “A run on Celsius could end up having a bigger impact on the market as a whole than the collapse of the Terra ecosystem—that hurt a lot, but was relatively isolated,” Noelle Acheson, head of market insights at Genesis Global Trading, tweeted on June 13. “This implosion could impact many ecosystems, as Celsius has a range of assets leveraged on several platforms.” Celsius didn’t respond to questions for this story.

The idea that investors can earn high returns without taking correspondingly high risks may sound foolish now. But Celsius and Terra were associated with what’s called decentralized finance, or DeFi—a constellation of companies, developers, and apps that are supposed to be building a new financial system around crypto and blockchain technology. While Celsius was organized like a traditional company, many DeFi projects are run by software protocols governed by users. Some claim near-magical abilities to pay big returns as a reward for allowing the platform to lend or temporarily use their tokens.

For more than a year, it seemed to be working. By November more than $100 billion was borrowed, lent, or deposited with DeFi protocols, according to DeFi Pulse. The activity powered the massive increases in the prices of all cryptocurrencies. “The financial revolution is DeFi and really just taking
all the middlemen out of the financial ecosystem,” Cathie Wood, founder and chief executive officer of asset manager ARK Invest, said in March.

Celsius’s Mashinsky, 56, is an indefatigable pitchman. In speeches at conferences and weekly hourslong appearances on YouTube, he told his fans, whom he called Celsians, that Celsius was the way to financial freedom. Last year, in testimonials posted on Twitter as part of a contest, many said they’d trusted the company with their life savings. Celsius’s slogan was “Unbank Yourself,” and Mashinsky sold the company as a better alternative to traditional banks, which he argued were colluding to rip off savers. “We give the vast majority of the income to the community,” he said in an April podcast interview. “That is a new paradigm. It’s a new business model, never existed before. No one was crazy enough.”

Runs on traditional banks by depositors have been uncommon in the US since the creation of the Federal Deposit Insurance Corp. in 1933. But Celsius isn’t regulated as a bank, and its deposits aren’t covered by FDIC insurance. The lack of regulation also meant Celsius could invest customers’ funds as it saw fit, without restrictions, reserve requirements, or stress tests.

Mashinsky’s pitch focused on the high interest rates and was more vague about what Celsius was doing to earn the money to pay them. He said that the company lent money to hedge funds and other major entities in the crypto market, and that it sent users’ funds to DeFi protocols itself. In effect, Celsius was a more user-friendly gateway to the intimidatingly hard-to-understand DeFi world.

Last year, Celsius took advantage of its growth to raise $750 million from investors including Canadian pension fund Caisse de Dépôt et Placement du Québec. The valuation of the funding round, about $3 billion, made Mashinsky a billionaire on paper. He told Cointelegraph at the time that he expected the value to double or triple this year, to as much as $10.5 billion.

Skeptics had started raising questions online about Celsius’s investments. One influential anonymous poster, who went by “Dirty Bubble Media,” used publicly available data from the blockchain to illustrate examples of where exactly Celsius was investing. His account gained 14,000 followers on Twitter and inspired others to start questioning Celsius, too. In an interview, he says his real name is C.J. Block and he’s a 30-year-old recent medical school graduate who started the project in his spare time. “What surprised me was how much risk they were taking on,” he says.

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One place Celsius invested users’ funds was Terra, where it could earn more than enough to pay the rates it promised. Celsius said it pulled out just before the collapse last month, but that hardly inspired confidence. Mashinsky maintained there was no problem and suggested Celsius’s critics might be getting paid by unnamed enemies. “Celsius has billions in liquidity, right, and we provide immediate access to everybody,” he said in a livestream on June 10, two days before Celsius halted withdrawals.

“This is a failure of risk management,” says Campbell Harvey, a professor of finance at Duke University and author of the book *DeFi and the Future of Finance*. “Come on, given the volatility of this space, you need to do some basic stress-testing.”

Now crypto investors are wondering who else might be at risk. On June 14, with rumors flying about issues at Three Arrows Capital, one of the largest crypto hedge funds, one of its founders tweeted cryptically that he was “communicating with relevant parties and fully committed to working this out.” (The fund didn’t respond to questions.)

Among the companies that have invested in Celsius is Tether, the issuer of a stablecoin that’s supposed to be always worth $1 and one of the biggest players in crypto markets. Tether says it has $71.5 billion in assets backing its tokens, but it’s been fined by regulators over allegations it lied about its reserves in the past. Tether was an early investor in Celsius and lent the company about 1 billion of its tokens, Mashinsky said in the interview last year. Tether said in a June 15 statement that it had closed the Celsius loan without taking a loss and that its investment in the company was small.

Celsius has hired restructuring lawyers from Akin Gump Strauss Hauer & Feld to advise on a path forward, whether that's raising funds from new investors or a financial restructuring, according to Dow Jones. Even if Celsius has enough money to repay all depositors in full—something it didn’t address one way or another in its statement—it seems unlikely it will regain users’ trust anytime soon. The US Securities and Exchange Commission has been investigating Celsius since at least the beginning of the year over whether its products should’ve been registered with the agency.

On June 14, SEC chief Gary Gensler said crypto companies should be required to disclose the risks they’re taking. “You have companies out there saying, ‘Come hither, give us your hard-earned money and we’ll get you 17% returns,’” he said in remarks delivered virtually at the RFK Compass Summer Investors Conference. “One has to wonder where those returns are coming from.”