

Investing in Cryptocurrency: *Ribbis* Concerns

Investing, in any Jewish owned business, raises a concern that perhaps the deal is structured in a manner that involves *ribbis*. Recently, we received numerous inquiries about investing with cryptocurrency. This gives us an opportunity to explore some of the fundamental issues related to investments and *ribbis*.

Although interest bearing loans are prohibited for both the lender and the borrower¹, an investment that pays returns on the investment is permitted. The question is, what is the difference between a loan and an investment? The answer to that question, in a word, is, risk. An investment, by definition, involves a risk that the business will fail, and the investor may lose some or even all of his investment. On the other hand, a loan does not carry risk. However, the precise meaning of risk, in this context, must be explained. Any businessman will tell you that every deal carries risk, even a loan. After all, if a borrower declares bankruptcy the lender will not be repaid.

The distinction between the risk of an investment and the risk of a loan relates to the obligation to repay the money. If an investment fails and there are no funds to repay the investor, he has no recourse. The recipient of those funds does not have an obligation to repay the investor. Hypothetically, if someone invests \$100,000 in a business that fails, the recipient does not have an obligation to repay those funds to the investor. Even if the next day the recipient wins \$100,000,000 in the lottery, he has no obligation to repay the investor. The obligation to repay an investor for a foiled business venture simply does not exist. In contrast, a borrower's obligation to repay a loan remains in force until the loan is repaid. Even if it turns out that borrower loses everything and has no assets with which to repay the loan, the obligation to repay the loan remains in place. In the hypothetical scenario where the borrower wins \$100,000,000 in the lottery, he must now repay the loan. The obligation remained in force; he just did not have the means to repay the loan. Therefore, when he acquires the means to repay the loan, the obligation remains in force.

Therefore, when we talk about risk as the difference between a loan and an investment, the risk revolves around the obligation to repay. If an investment that fails, the recipient has no obligation to repay the invested money, but a borrower remains obligated to repay his loan, even though he currently does not have the means to repay the loan.

This point is essential to bear in mind when considering an investment of any kind. Many times a deal between two people is characterized as an investment and one can

¹ The *mishnah* (Bava Metzia 75b) includes in the prohibition anyone who facilitates an interest-bearing loan between Jews, including the scribe (e.g., lawyer who drafts the loan document) and witnesses. Entering into an interest-bearing loan violates the prohibition of *ribbis*, even if interest is never paid.

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even point to the use of the word risk associated with that deal. However, upon reading the nature of the risk involved, one can see that it is the risk associated with loans rather than the risk associated with investments. For example, one cryptocurrency investing platform has a section called, “Risk Disclosure” in their posted Terms and Conditions. If one skims the terms and conditions of an investment opportunity and notices a section called “Risk Disclosure” one may assume that this means that the deal is an investment, free of any *ribbis* concerns. However, if one reads what is actually written, one would see that it is not the risk associated with investments, it is the risk associated with loans. Consider, as an example, the following wording, “You are, exposed to the possibility that Celsius becoming unable to repay its obligations in part or in full, in which case your Digital Assets may be at risk.” Although the term risk is found, it is the risk of, “Celsius becoming unable to repay its obligations...” In other words, Celsius has an obligation to repay the “invested amount” but due to possible market conditions, Celsius may be unable to repay its obligation and thus the investor may not receive back his investment. The company does not say that they will not be obligated to repay the investment. The obligation to repay the investor remains, the risk is that they will not have the resources to repay the money. Since the company does not produce anything, they do not have the assets needed to repay their “investors” if cryptocurrency loses value and thus they will be unable to repay their obligation. That language, halachically, is indicative of a loan and before “investing” one must research further to determine whether it is indeed an investment or a loan.

There is another issue that separates interest bearing loans from investment returns. We will use a *heter iska* to address this point. Everyone knows that a method commonly used to avoid violating the prohibition of *ribbis* is for the parties to sign a *heter iska*. What is a *heter iska* and how does it successfully sidestep the prohibition of *ribbis*?

As mentioned, paying dividends on an investment is permitted. The mechanics of a *heter iska* is that rather than creating a lender/borrower relationship, the lender “invests” money in the “borrower’s” business or assets² and earns a return on his investment. Essentially, the investor becomes a partner in the recipient’s business and

² A *heter iska* is more reliable when the recipient has a business that can generate returns to justify repaying the investor more than the amount the investor gave the recipient. When the “borrower” does not have profit generating assets, or the profit generating assets cannot produce the type of return the investor expects to earn, the validity of the *heter iska* becomes highly questionable.

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rather than receiving interest payments on a loan, he is paid dividends that reflect the earnings from his share of the business³.

Earning profit is fundamentally different from interest payments on a loan. As mentioned, when an interest-bearing loan is issued, the borrower is obligated to repay the loan, with the accrued interest, regardless of what happens to the borrowed money. If the money was borrowed to start a business that flopped, the borrower remains obligated to repay the principal and interest. He is not relieved of that obligation because the business failed. In contrast, an investor who becomes a partner in the recipient's business earns a share of profits. If the business does not earn a profit, the investor does not receive dividends. The nature of an investment is that one earns profits or suffers a loss commensurate with his share of the company. When an investor is guaranteed dividends on his investment, it cannot be characterized as an investment. It must be a loan because dividends that are guaranteed are essentially interest payments.

This is another area of the terms and conditions that must be carefully scrutinized. If the rewards reflect a share of the earned profits, it is likely that the deal is an investment. If, however, the rewards are not tied at all to the profits, it is likely that it is an interest-bearing loan rather than an investment. Take, for example, the following statement from the Terms and Conditions of a cryptocurrency investing platform.

“We calculate the Rewards on Loaned Digital Assets based on market demand for each Eligible Digital Asset. Reward rates are not determined based on Celsius' income or profit, generated directly or indirectly as a result of the use by Celsius of a particular Digital Asset, a type of Digital Assets, or otherwise.”

The company states clearly that the dividends that they pay are not calculated according to the profits earned from one's investment. The dividends are paid according to market demand for each Eligible Digital Asset. It is clear that when dividends are not paid according to one's share of the profits, commensurate with their share in the company, but rather according to another metric, the relationship is not that of an investment. Once it is clear that the money given to the company does not meet

³ In most instances, the *heter iska* states that the recipient has the option to pay the investor a fixed amount of money or a fixed percentage annually as his share of the profits rather than having to produce witnesses or take an oath regarding the precise amount of profits and losses. Theoretically, though, there is a risk that the recipient will choose to demonstrate that the business suffered a loss and if that happens the investor will not be able to recover some or even all of his principal.

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the criteria to be an investment, the alarm bells ring that it is an interest-bearing loan and the parties may be violating the prohibition against *ribbis*.

There is, however, another model to consider which could also avoid violating the prohibition of *ribbis*, namely a rental. Although the Torah prohibits loaning a Jew money and collecting interest, perhaps it is permitted to rent someone one's money and the owner may charge a rental fee for the time they have possession of your money. After all, it is permitted to rent real estate, cars, tools and clothing without violating the prohibition of *ribbis*, so perhaps it is also permitted to rent one's money and charge a rental fee from the renter without violating any prohibitions.

The *gemara* in *Bava Metzia* (69b), in fact, relates that Rav Chama did exactly that. Rather than loan people money and charge interest, he rented them his money and charged a rental fee. This approach, however, did not work out and Rav Chama went bankrupt. What was Rav Chama's mistake? Why isn't it permitted to rent money and charge a rental fee?

The *gemara* points out two differences between a rental of, for example, a car and renting money. One difference is that when I rent your car, the same car that I rented is what I return to you. I may not rent one vehicle and return to you another vehicle. In contrast, when I rent you money, the expectation is that you will spend the bills that I give you and at the end of the rental term, you will repay me with other bills. The second difference is that when I rent to you my car, it will depreciate from wear and tear from your use of the car. Money, however, does not depreciate with use. It was worth a dollar when you gave me the money and is worth a dollar after I use it and return it to you. Since renting money has these two fundamental differences distinguishing it from the rental of objects, it is not permitted to rent money because it is essentially a loan in different packaging.

Rishonim debate whether both features must be present to be categorized as a rental or even one feature is sufficient to categorize it as a rental. Rashi⁴ maintains that rentals must contain both elements to be categorized, halachically, as a rental. The object that is rented must be the same object that is returned and there must be depreciation from wear and tear of the rented object. If only one of these elements is present, it is considered a loan and could potentially violate the prohibition of *ribbis*.

⁴ ד"ה וידיע פחתיה

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Tosafos⁵ rejects Rashi's position on this and one of his arguments is that according to Rashi it is not permitted to rent jewelry or precious stones because they do not depreciate from wear and tear. This is untenable according to Tosafos. Therefore, Tosafos, rules that the presence of either element is sufficient to be categorized as a rental. In other words, if the object that is rented is the one that is returned, it is categorized as a rental, even if there is no depreciation. Similarly, if the object depreciates from use, it is categorized as a loan even if the renter does not return the exact object that he rented and replaces it with a similar object.

Shulchan Aruch⁶ follows Tosafos' view that either characteristic is sufficient to categorize the agreement as a rental rather than a loan. When neither characteristic is present, the agreement is a loan and subject to *ribbis* prohibitions. Therefore, it is prohibited to rent money for the renter to spend since the renter will not return the same monies that he rented and money is not subject to depreciation from wear and tear. On the other hand, if one rents money and will return the exact same monies that he rented, it is permitted for the owner to charge the renter a fee for renting his money. This is permitted because the same monies will be returned, even though there is no wear and tear depreciation. On the other hand, it is permitted to rent utensils, even if the renter has the right to return other utensils, since the utensil that is rented undergoes wear and tear depreciation. Allowing the renter to return other utensils is prohibited only when the rented utensils do not suffer wear and tear depreciation.

With this background, we can consider whether two Jews are permitted to enter into a rental agreement of cryptocurrency. Obviously, every platform could be structured differently and those differences could have a major impact on the *halacha*, but we will use language from one such company as a learning device.

It is imperative to bear in mind that as a Digital Asset, cryptocurrency does not suffer from wear and tear depreciation. Cryptocurrency does not exist in the physical world. This means that of the two criteria to categorize an agreement as a rental rather than a loan, one of them cannot apply. Therefore, to be considered a rental agreement, it is essential that the same object that is rented is returned. Examining the language of the Terms and Conditions leads us to the conclusion that this is not the nature of the agreement. The Terms and Conditions state:

We may lend, sell, pledge, hypothecate, assign, invest, use, comingle or otherwise dispose of assets and Eligible Digital Assets to counterparties or

⁵ ד"ה מרא הדרא

⁶ Y.D. 176:1-2

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hold the Eligible Digital Assets with counterparties, and we will use our best commercial and operational effort to prevent losses.

This language is what *halachically* is called *milvah l'hotza'ah nitnah* – Monies given as a loan are intended to be spent. In the context of this discussion the company has the right to lend, sell, use or dispose of your asset with the understanding that if they do so, they will repay you with another Digital Asset of that kind. The potential exists that they will not return to you the one you gave them but will replace it with another. This means that they are not obligated to return to you the cryptocurrency that you gave them. This indicates that neither factors are present to consider this agreement a rental of the cryptocurrency and it defaults into an interest bearing loan.

In conclusion, when considering investing in cryptocurrency, or any investment for that matter, one must research these issues. Is there an element of risk for the investor and if so, what is the nature of that risk? How is the investor paid? Does it come from his share of the profits or is it a predetermined amount regardless of the profits earned? Is it possible that the agreement could be categorized as a loan or not? There are also potential *Shabbos* issues that apply to investing in cryptocurrency that are beyond the scope of this article.