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A Peek Behind the Curtain at the Largest Crypto Trading Platforms

New York Attorney General's Office publishes a detailed report on policies and practices at virtual asset trading platforms, citing multiple common deficiencies

The New York Attorney General's Office ("NYAG") issued a report on September 18 summarizing its assessment of the responses to information-seeking letters it sent to more than a dozen major virtual currency trading platforms this past April. The report cited a number of perceived deficiencies in the industry and noted that the NYAG had referred three platforms—Binance, Gate.io, and Kraken—to the New York State Department of Financial Services for potentially operating unlawfully in New York.

The NYAG stated that its effort aimed to "provide customers with easily-accessible information about virtual asset trading platforms, and to arm customers with the basic questions they should expect every platform to answer." For industry participants, however, the details from this report also provide a window into the policies and practices in place at several of the largest cryptocurrency trading platforms, as well as one state's regulatory perspective on this developing industry.

BASICS OF THE REPORT

The report is posted online,¹ along with an interactive web site² detailing the findings.

The NYAG stated that it sought to include platforms that are widely used in New York, the United States, and internationally, to provide an overview of the industry. The findings were based on firms' voluntary submissions.

Ultimately, ten platforms participated in the NYAG's initiative: Bitfinex, bitFlyer USA, Bitstamp, Bittrex, Coinbase, Gemini, itBit, Poloniex, Tidex, and HBUS. Four platforms declined to participate: Binance, Gate.io, Huobi, and Kraken. (When news of the NYAG's information requests became public in April, Kraken's CEO posted a statement on Twitter indicating that Kraken would not comply with the information request.) While those firms



took the position that they do not allow trading from New York, the NYAG stated that it investigated and ultimately contacted the state's Department of Financial Services to determine if three platforms had violated New York's virtual currency regulations.

The resulting 42-page report is organized into five sections, summarizing the platforms' responses to question in each area: (I) Jurisdiction, Acceptance of Currencies, and Fees; (II) Trading Policies and Market Fairness; (III) Managing Conflicts of Interest; (IV) Security, Insurance, and Protecting Consumer Funds; and (V) Access to Customer Funds, Suspensions, and Outages. It contains a fair amount of detail from the platforms' responses, and the interactive web page includes a number of graphics comparing the firms' responses on particular topics.

KEY FINDINGS

Overall, the NYAG's report flagged three "key findings":

- "The various business lines and operational roles of trading platforms create potential conflicts of interest." The report noted that virtual asset trading platforms typically play multiple roles akin to exchanges, broker-dealers, money-transmitters, proprietary traders, owners of large virtual currency holdings, and (in some cases) issuers of virtual currencies. With the varied incentives created by these multiple roles, the NYAG stated that there is "substantial potential for conflicts between the interests of the platform, platform insiders, and platform customers."
- "Trading platforms have yet to implement serious efforts to impede abusive trading activity." The NYAG stated that some platforms "lack robust real-time and historical market surveillance capabilities." The report also flagged a lack of any mechanism for analyzing suspicious trades across multiple platforms, the operation of unmonitored "bot" trading, and the view of some platforms that they have no responsibility to prevent traders from artificially affecting prices.
- "Protections for customer funds are often limited or illusory." The report noted the lack of accepted methods for auditing virtual assets, and pointed out that some platforms do no independent auditing of their virtual currency holdings. That makes it difficult to confirm that the platforms are in fact holding assets appropriately. Additionally, while foreign deposit insurance may cover losses of stolen or misappropriated fiat currency, there is no comparable coverage for losses on virtual currencies, exposing investors to losses that may stem from theft or misappropriation.

CONCLUSION AND TAKEAWAYS

After an in-depth recap of the platforms' answers to the NYAG's list of questions, the report concluded that "customers would do well to avoid platforms that cannot satisfactorily answer the questions posed in this Report." The NYAG offered eight "basic questions" that investors should expect every platform to answer:

1. What security measures are in place to stop hackers from unlawfully accessing the platform or particular customer accounts?
2. What insurance or other policies are in place to make customers whole in event of a theft of virtual or fiat currency?
3. What guardrails or other policies does the platform maintain to ensure fairness for retail investors in trading against professionals?
4. What controls does the platform maintain to keep unauthorized or abusive traders off the venue?
5. What policies are in place to prevent the company and its employees from exploiting non-public information to benefit themselves at the expense of customers?
6. How does the platform notify customers of a site outage or suspension, the terms under which trading will resume, and how customers can access funds during an outage?



7. What steps does the platform take to promote transparency and to subject its security, its virtual and fiat accounts, and its controls to independent auditing or verification?
8. Is the platform subject to, and registered under, banking regulations or a similar regime – for instance, the New York BitLicense regulations?

While the NYAG was focused on flagging issues for potential retail investors, the report also provides an opportunity for trading platforms and other firms involved in the cryptocurrency industry to identify best practices and to assess where improvements can be made. Those already involved in the marketplace or considering an expansion into this relatively new asset class would do well to evaluate the policies described in the report and to note the regulatory feedback on each.

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¹ https://ag.ny.gov/sites/default/files/vmii_report.pdf

² <https://virtualmarkets.ag.ny.gov/>