

SEC crypto crackdown: US regulator sues Binance and Coinbase

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On Monday, after months of discussions, threats and warnings, the US Securities and Exchange Commission (SEC) took aim at the most powerful force in the world of cryptocurrencies. The US financial watchdog accused the crypto exchange Binance and its founder Changpeng Zhao of operating a “web of deception,” charging him and his exchange with 13 offences. Binance handles billions in investments for many everyday investors, but the effects are likely to stretch far beyond the cloistered, online world of crypto. The company sponsors the Italian football team Lazio and the Argentina national team. It also sponsored the 2021 Africa Cup of Nations tournament. It has also extended its interests with venture capital investments as well as a \$500m stake in Elon Musk’s Twitter. The SEC appears bent on a wider crypto crackdown, prompted by the collapse last year of the Bahamas-based FTX, whose founder, the US national Sam Bankman-Fried, has now been charged with securities fraud, money laundering and other offences. On Tuesday, the SEC accused another crypto platform, Coinbase, of putting customers at risk by operating as an “unregistered broker, exchange and clearing agency”. What is Binance? Binance is the world’s largest cryptocurrency exchange. Through its online platform, the company offers simplified avenues for buying and selling cryptocurrencies and other digital assets, in exchange for small fees. Binance dominates crypto trading. Last year its trades accounted for up to 70% of the market, with billions of dollars pumped through the exchange every day. As the company has faced a tougher regulatory environment, its share of the market has fallen – but it still accounts for around 50% of the monthly crypto exchange volume. In 2019, Binance was facing a regulatory crackdown in the US over a number of potential violations. In response, it restricted access to its main exchange –Binance.com – in the US and launched a new business: Binance.US. Binance.US offered fewer crypto and digital assets than its parent company – but crucially, it was billed as an entirely separate exchange that was run independent of Binance.com. Binance.US would be subject to US regulations and therefore be able to operate legally within the country. What is Binance and its founder accused of? Among the central allegations from the SEC is that Binance and Zhao failed to truly split the US company from the US exchange that it was spun off from. Binance.US says that, from 2019, its customers were restricted from transacting on Binance.com. However, the SEC alleges that in reality, Binance and Zhao “subverted their own controls to secretly allow high-value US customers to continue trading on the Binance.com platform”. The SEC alleges that, while Binance publicly claimed that Binance.US was a separate, independent trading platform for US investors, Zhao secretly controlled the US company behind the scenes. Among the products that Binance.US is alleged to have illegally offered its US customers are commodity derivatives – which effectively place a bet on the price of a cryptocurrency rather than buying it directly.

Another US regulator filed a lawsuit in March claiming that Binance had been offering these services since July 2019, despite not being registered with the derivatives markets regulator. The SEC complaint includes evidence that the Binance leadership were aware that they were contravening US regulations. A message from the Binance chief compliance officer to a colleague, included in the evidence in the lawsuit, reads: "We are operating as a fking unlicensed securities exchange in the USA bro." The SEC alleges that assets were diverted to a separate entity, owned and controlled by Zhao, called Sigma Chain. This was used for so-called "wash-trading", in which a trader buys and sells the same asset between their own accounts, in order to give the "artificial appearance of" increased trading volume. Through this practice, the SEC alleges that Zhao was able to inflate the Binance.US trading volume. What does Binance say? Binance says that it has actively cooperated with the SEC since the start of its investigation and and "respectfully disagrees" with the allegations. "We intend to defend our platform vigorously," the company said in a blogpost, but added that "because Binance is not a US exchange, the SEC's actions are limited in reach". "As with other crypto projects facing similar suits, the Commission has determined to regulate with the blunt weapons of enforcement and litigation rather than the thoughtful, nuanced approach demanded by this dynamic and complex technology," Binance said. The company added that "any allegations that user assets on the Binance.US platform have ever been at risk are simply wrong." How significant is this? News of the SEC charges sent the price of bitcoin – the largest and most commonly traded crypto asset – to its lowest point in almost three months. When rival exchange FTX collapsed last year, the price of bitcoin fell by close to 25% in a matter of days. There is no sign that Binance is close to any sort of collapse – and the company has sought to calm its customer and curb a sudden withdrawal of deposits by saying that "all user assets on Binance and Binance affiliate platforms, including Binance.US, are safe and secure".. Known as "CZ", Zhao is one of the most prominent leaders in the crypto sector – particularly after the fall of his rival, Bankman-Fried. Is it part of a broader crackdown? On Tuesday, the SEC announced a new set of charges, this time targeting Coinbase, the US-domiciled crypto exchange that has long marketed itself as the most respectable crypto exchange. Not so, argued the regulator, which has accused Coinbase of operating an unlicensed securities exchange, brokerage and clearing agency, putting customers at risk in the process. The pair of enforcement actions suggest the SEC has decided to take broad aim at cryptocurrency firms it sees as bypassing regulation, either by blurring the distinction between on- and offshore services, as with its allegations against Binance, or by trading unregulated securities, as it alleges Coinbase has done. At the heart of the issue is a more fundamental question: are cryptocurrencies something truly new, which needs a unique regulatory regime, or are they simply digital versions of pre-existing financial instruments which the SEC already regulates? The agency believes that a good portion of the industry is the latter, and is seeking to ensure that crypto companies either comply, or stop operating in the US. What now for crypto? The sector, already bruised by the collapse of FTX, is firmly in the midst of a "crypto winter", with investment drying up and regulators preparing to pounce. The SEC's interpretation of US law is potentially damaging for a broad swathe of the industry, and could prompt companies to move elsewhere, but regulatory havens are increasingly few and far between. In the UK, the prime minister, Rishi Sunak, has historically been a supporter of the sector, using his time at the Treasury to command the Royal Mint to make and sell a collectible "NFT" and pushing the Bank of England to issue guidance on stablecoins and "central bank digital currencies". But in recent months, the UK has discussed introducing stricter rules itself, as Sunak's attention has turned to AI: a May report from MPs called on cryptocurrencies to be regulated as a form of gambling.