

CLIENT ALERT

# CFTC Pushes Enforcement on Overseas Crypto Platform

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On August 10, 2021, the U.S. District Court for the Southern District of New York entered a consent order (“Consent Order”) for a permanent injunction and \$100 million fine against five companies running “BitMEX” in connection with charges brought by the Commodity Futures Trading Commission. The Consent Order settled charges for operating a cryptocurrency derivatives trading platform that failed to register as a swap execution facility (“SEF”), designated contract market (“DCM”), or futures commission merchant (“FCM”), and for failure to comply with the Bank Secrecy Act, including a failure to implement a customer identification program (“CIP”) and know-your-customer (“KYC”) procedures, among others.<sup>1</sup> Although the Consent Order names specific individuals connected with the alleged misconduct such as the BitMEX co-founders, the Consent Order applies only to the legal entities identified in the Order and the individuals remain under investigation.

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<sup>1</sup> Consent Order for Permanent Injunction, Civil Monetary Penalty and Other Equitable Relief Against Defendants HDR Global Trading Limited, 100x Holdings Limited, Shine Effort Inc. Limited, and HDR Global Services (Bermuda) Limited, Case No. 1:20-cv-08132 (2021).

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The Consent Order highlights risks for trading platforms located outside the United States that are not registered with the CFTC because they do not offer derivative products to U.S. customers. The CFTC made clear that if an overseas derivatives trading platform is not registered with the CFTC, the platform needs to implement controls to prevent U.S. customers from accessing its platform. Furthermore, the Consent Order calls into question the ability for overseas platforms to simply rely upon a customer's IP address to determine whether the customer is a U.S. person. Rather, overseas platforms that do not intend to register with the CFTC should contemplate additional KYC procedures and other controls to identify U.S. customers and prevent them from trading on their platforms. The Consent Order also highlights continued exposure for individual liability for potential violations of the Commodity Exchange Act.

### Background

BitMEX is a peer-to-peer trading platform that offers the trading of cryptocurrency derivatives, including derivatives on bitcoin, ether, and litecoin, among other products. In October 2020, the CFTC brought charges against a number of entities doing business as BitMEX, along with BitMEX's co-founders Arthur Hayes, Benjamin Delo, and Samuel Reed (collectively "BitMEX") for their involvement in offering cryptocurrency derivatives to U.S. customers without complying with various provisions of the Commodity Exchange Act, as amended, and corresponding CFTC regulations.

According to the Consent Order, BitMEX offered leveraged trading of cryptocurrency derivatives to retail and institutional customers globally through its website and mobile application, and by direct connection to its trading engine servers through the BitMEX application programming interface.<sup>2</sup> In 2016, BitMEX also launched a "perpetual swap contract," described as "a product similar to a traditional Futures Contract in how it trades."<sup>3</sup>

### Alleged Misconduct

The Consent Order explained that BitMEX failed to implement appropriate CIP and KYC procedures. As a result, from approximately November 2014 to October 2020 (the "Relevant Period"), BitMEX failed to implement any procedures to allow it to identify U.S. persons using its platform or to determine the true identity of a majority of its customers either in the United States or elsewhere. This deficiency led to U.S. customers gaining access to trade cryptocurrency derivatives on BitMEX, and during the Relevant Period, BitMEX had some degree of awareness that U.S. persons could access its platform using a virtual private network ("VPN"). By virtue of allowing U.S. persons to trade cryptocurrency derivatives on its platform, BitMEX violated the Commodity Exchange Act and CFTC regulations for failure to register with the CFTC in some capacity, such as an SEF, DCM, and/or FCM. The Consent Order also found that BitMEX's lack of CIP and KYC procedures violated CFTC Rule 42.2, which requires that an FCM comply with the applicable provisions of the Bank Secrecy Act and the regulations of the Department of Treasury.

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<sup>2</sup> *Id.* at 6-7.

<sup>3</sup> *Id.* at 7 (quoting the BitMEX website).

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Lastly, the Consent Order found that the conduct described above meant that BitMEX failed to supervise its officers, employees and agents in violation of CFTC Rule 166.3, which requires that each CFTC registrant “diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.” Notwithstanding the violation of Rule 166.3, the Consent Order acknowledged that BitMEX instituted certain remedial measures in response to the CFTC staff’s investigation, including developing an AML program and user verification program, appointing a Chief Compliance Officer, and engaging an outside consultant to review such programs, policies and procedures.<sup>4</sup>

### Settlement

The aforementioned charges were brought against (i) the co-founders of BitMEX, Arthur Hayes, Benjamin Delo, and Samuel Reed, (ii) HDR, as the entity owning and operating BitMEX, (iii) 100x, as the holding group for HDR, (iv) ABS, as the U.S.-based entity for which BitMEX conducted activity in the United States, (v) Shine, which was the corporate entity in which BitMEX conducted proprietary trading on its platform, and (vi) HDR Services, which employs personnel working for BitMEX.<sup>5</sup>

BitMEX and the CFTC settled for a \$100 million civil monetary penalty for BitMEX’s failure to register as a DCM, SEF and/or FCM, and for failing to implement CIP or KYC policies and procedures, anti-money laundering programs, or to screen customers for their inclusion on the OFAC list.<sup>6</sup> As part of the settlement, BitMEX neither admitted nor denied the findings concerning their alleged conduct.<sup>7</sup> This Consent Order only applied to the legal entities in whose name BitMEX operated during the Relevant Period. The natural persons that developed and controlled BitMEX during the Relevant Period remain under investigation.

Apart from the settlement with the CFTC, the U.S. Attorney’s Office for the Southern District of New York indicted the three co-founders named in the Consent Order (Hayes, Delo, and Reed), along with Greg Dwyer, a senior employee at BitMEX, on charges of willfully causing a financial institution to violate the Bank Secrecy Act, and conspiracy to commit the same offense.

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<sup>4</sup> *Id.* at 9.

<sup>5</sup> *Id.* at 5-6.

<sup>6</sup> *Id.* at 13.

<sup>7</sup> *Id.* at 4.

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### Implications

This Consent Order highlights the CFTC's enforcement reach when U.S. customers trade derivatives on an overseas platform. Cryptocurrency platforms that offer derivatives, but are not registered with the CFTC, should take note of the CFTC's discussion in the Consent Order, particularly as it relates to BitMEX's failure to implement appropriate policies and procedures to identify U.S. customers trading on its platform. The Consent Order suggests that the CFTC expects an overseas platform to have a robust KYC program if it offers futures contracts, but does not intend to register with the CFTC because it does not make its products available to U.S. persons. The Consent Order also suggests that overseas platforms that offer derivatives, but do not intend to register with the CFTC, should consider additional steps to prevent U.S. customers from accessing their market beyond identifying the customers' IP addresses in light of a customer's ability to use VPN or other technology to appear outside of the U.S. Notably, although the Consent Order references that BitMEX offered swaps products on its platform, the Consent Order did not address the CFTC's extraterritorial jurisdiction over swap activity pursuant to Section 2(i) of the Commodity Exchange Act that extends CFTC jurisdiction over swaps to include activities that "have a direct and significant connection with activities in, or effect on, commerce of the United States."

This Consent Order also demonstrates the CFTC's continued focus on the regulation of cryptocurrency derivatives. As CFTC Commissioner Dan Berkovitz explained in his statement concerning this Consent Order, "[t]he [Commodity Exchange Act] does not carve out cryptocurrency products or markets . . . . Blockchains, smart contracts, and other new technologies have the potential to improve the transparency and efficiency of our derivatives markets. However, for innovation to be responsible and competition to be fair, it must comply with the CEA and our regulations."<sup>8</sup>

Finally, the Consent Order highlights the potential liability for individuals who violate the Commodity Exchange Act, and the continued cooperation between the CFTC and criminal authorities. The three co-founders named in the Consent Order remain under investigation by the CFTC, and the three co-founders and Greg Dwyer were indicted by the U.S. Attorney's Office for the Southern District of New York.

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<sup>8</sup> Statement of Commissioner Dan M. Berkovitz on the \$100 Million BitMEX Crypto Trading Fine, August 10, 2021, [available here](#).

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If you have any questions regarding this client alert, please contact one of the authors, any member of our CFTC team listed below, or the Willkie attorney with whom you regularly work.<sup>9</sup>

Willkie has a dedicated team of attorneys with extensive knowledge and experience in all aspects of the Commodity Exchange Act and the CFTC regulatory regime. We would be pleased to assist on your matters.

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<sup>9</sup> For more information on additional CFTC and NFA regulatory reminders, see our client memorandum entitled "CFTC and NFA Regulatory Reminders" (January 6, 2021), [available here](#).