



Regulatory Update May 6, 2019

In this update, we look at the NYAG's proceedings against Bitfinex and Tether as well as recent regulatory actions involving money laundering in the crypto space.

NYAG Strikes at Bitfinex and Tether Alleging "Ongoing Fraud"

On April 24, the New York Attorney General's office (OAG) obtained a [court order](#) for the production of documents related to its investigation of cryptocurrency exchange Bitfinex and its affiliate stablecoin issuer Tether (USDT), alleging that the entities coordinated efforts in an "ongoing fraud" resulting in the loss of \$850 million in customer funds. The proceedings stem from the state's Martin Act, a blue sky law which gives the OAG broad authority to prosecute fraud in connection with the sale of securities and commodities.¹ While Bitfinex announced in August 2017 that it would no longer support New York residents, the OAG expressed that it "has

reason to believe" New York residents continue to transact on the platform.

"Troubled" Banking Past

The OAG described Bitfinex and Tether's "troubled banking relationships," which caused them to look to third-party payment processors, such as Crypto Capital Corp., to handle client withdrawals. According to the OAG, Bitfinex sent over \$1 billion in co-mingled client and corporate funds, including \$23 million that "appears" to be from one New York client to Crypto Capital without ever having a contract in place or disclosing the relationship to clients.

After which, counsel for Bitfinex stated that Crypto Capital told them \$850 million of the funds were seized by government authorities. This "loss or theft" caused Bitfinex to experience difficulty in fulfilling withdraw requests by mid-2018.

The "Line of Credit"

To make up for this deficit, the OAG alleges that Bitfinex and Tether executed "undisclosed, conflicted transactions... transferring money out of tether reserve funds" as a "line of credit." While they allege that the transaction was completed at an "arm's length," the OAG forwarded concerns that it would leave USDT reserves "dissipated and unrecoverable" while

¹ [New York General Business Law \(GBL\) § 354.](#)

misleading Bitfinex clients, Tether holders, and the OAG by failing to provide information regarding the transaction prior to its execution despite such requests. In addition to documents related to the transaction, the order included an injunction freezing any further borrowing.

Motion to Vacate the Injunction

Bitfinex [responded](#) stating that the OAG filings were made in “bad faith and are riddled with false assertions.” On April 30, it filed a [motion to vacate](#) the order, arguing that the OAG failed to show that USDT is a security or commodity within purview of the Martin Act and that an injunction would be “proper and expedient” given the circumstances. Rather, they argued it harms its clients, USDT holders, as well as the cryptocurrency markets in general.

Bitfinex’s General Counsel also submitted an [affirmation](#) stating that tether is backed by 74% of its reserves and that “holders are not at risk.” He described the transaction as “the companies’ good faith solution,” stating that the OAG’s action “serves no useful purpose.”

Responding to the motion to vacate, the OAG filed a [memorandum of law](#) on May 3. The memorandum reiterates the claims in

the order. It also mentions the SDNY’s [indictment](#) of Reginald Fowler and Ravid Yosef on April 30, alleging they operated a “shadow bank” in connection with processing millions of dollars worth of transactions for cryptocurrency exchanges.² According to the OAG, this underscores the need to prevent depletion of the USDT reserves.

The Order Stands, Modification Requested

On May 6, the court denied the respondents motion to vacate while asking the OAG to narrow the scope of the injunction. On the subject of fractional reserve banking, the judge responded: “I recognize the point that banks don’t have all of the dollars available at a moment’s notice. I also recognize that you’re not banks, you’re not heavily regulated.” The judge requested that the parties meet to discuss the proper scope and submit a proposed amended injunction within a week, on which the judge will rule.

Authorities Take on Crypto Money Laundering: Update on Recent Actions

Regulators have stepped up enforcement

² A bank account listed in court documents is held by Global Trading Solutions LLC, which is purportedly related to a parent company of Crypto Capital.

actions for money laundering involving virtual currencies. In April alone, FinCEN [announced](#) its first penalty against a peer-to-peer virtual currency exchanger. New York State obtained its first conviction for bitcoin money laundering, while also indicting another two individuals on similar charges. The NYDFS also [denied](#) cryptocurrency exchange Bittrex's BitLicense application citing AML concerns.

FinCEN Fines Peer-to-Peer Exchanger

FinCEN [fined](#) Eric Powers \$35,000 for facilitating virtual currency transactions without registering as a money services business (MSB), implementing an AML program, or filing reports required by the Bank Secrecy Act (BSA), specifically Suspicious Activity Reports (SARs) and Currency Transaction Reports (CTRs).

FinCEN described how Powers advertised his services online and facilitated more than 200 transactions of over \$10,000 without ever filing a CTR. FinCEN alleged he conducted more than 160 in-person bitcoin sales for approximately \$5 million and directed over 100 transactions on Silk Road without ever filing a SAR.

FinCEN Director Kenneth A. Blanco said the enforcement should not come as a surprise given the agency's [2013 guidance](#). "Obligations under the BSA apply to money transmitters regardless of their size," he said. He alleged Powers was aware of the BSA obligations but "willfully failed to honor them" as evidenced by his participation in online AML compliance forums. Blanco described the violations as a threat to national security, our financial system, and "the safety and well-being of our people."

FinCEN barred Powers from the money services industry, though stating he cooperated with the investigation and noting the forfeitures imposed on him by other state and federal regulators in the amount of \$100,000 and 237.53575 bitcoin.

New York Convicts Two in Crypto Money Laundering Scheme, Indicts Three More

On April 23, the Manhattan District Attorney's Office [announced](#) its first conviction for virtual currency money laundering in its action against Defendants Callaway Crain and Mark Sanchez. Crain and Sanchez sold over 10,000 packages of steroids and other controlled substances to residents of all 50 states through their website "NextDayGear," using crypto to

launder close to \$3 million in payments from 2013 to 2018.

District Attorney Cyrus R. Vance, Jr. cautioned: "Online drug sellers who do business in New York should take note: whether you're operating in plain sight or in hidden corners of the dark web, my Office has the skills and resources to follow the money, shut down your business, and hold you accountable."

Both defendants pled guilty to felony charges of Money Laundering in the 2nd Degree and Criminal Sale of a Controlled Substance in the 5th Degree, which could bring prison sentences of 2 ½ - 7 ½ years. Sentencing is set for July 12, 2019.

A few days prior, state attorneys [reported](#) the indictment of three others on similar money laundering charges, alleging that Chester Anderson, Jarrette Codd, and Ronald MacCarty sold hundreds of thousands of counterfeit and illegal drugs on the dark web, laundering about \$2.3 million in crypto "by using preloaded debit cards and withdrawing cash at ATMs in Manhattan and New Jersey."

After receiving reports of suspicious activity from the ATMs, an undercover investigation of the defendants' enterprise led to the seizure of "the largest quantity of pills in

New Jersey State history," which included alprazolam tablets, fentanyl-laced heroin, methamphetamine, ketamine, and gamma hydroxybutyric acid (GHB) among others.

In addition to the Manhattan DA's office, the investigation team included members of the U.S. Secret Service, the U.S. Postal Inspection Service, and the U.S. Homeland Security Investigations.

NYDFS Denies Bittrex's BitLicense Application Citing AML Failures

An unprecedented media war ensued between Bittrex and the NYDFS after the NYDFS published a [5-page letter](#) on April 10 detailing the exchange's compliance shortcomings that led to the denial of its application for a BitLicense.

In the letter, the NYDFS called Bittrex's AML policies "nonexistent or inadequate," allegedly resulting in transactions being processed for customers based in sanctioned countries like Iran and North Korea. It asserted that deficiency in customer due diligence led to missing or inaccurate client information, as well as accounts using "clearly false names" (like "Elvis Presley," "Donald Duck," and "Give me the money"). The NYDFS stated, in reviewing the exchange's token listings, it was "unable to assess compliance" with

Bittrex's own listing policies. The NYDFS also noted deficiencies in employee training, effectiveness of their head compliance officer, and lack of adequate independent testing of their AML program.

Bittrex responded through social media and a [press release](#) in which it expressed disappointment with the NYDFS's decision, stating that it believes the decision "harms rather than protects New York customers." It refuted many of the claims in the letter, [alleging](#) that the North Korean accounts mentioned were actually "South Korean residents [who] mistakenly selected North Korea in [the] company drop-down menu." Bittrex CEO Bill Shihara further purported that the NYDFS wanted to control which tokens Bittrex listed.

On April 18, the NYDFS Executive Deputy Superintendent for Banking, Shirin Emami, published an [opinion piece](#) on CoinDesk. The article aimed "to get the facts straight," repeating many of the allegations of the April 10 letter and denying Bittrex's claim that their application sat on a desk at the NYDFS "for years." Bittrex again responded saying that the Department is "overstepping its regulatory authority and changing rules and guidelines on the fly."

Bittrex said it has no current plans to reapply for a BitLicense. Pursuant to the decision, it must immediately abandon its New York operations and wind down resident accounts within 60 days.

[Read more on our website](#)

Something to Watch

- FrenchWeb: [Le Decode de la semaine avec Frédéric Montagnon \(LGO\) et Maxence Fabron \(Decode Media\)](#)

The information provided is for informational purposes only. It does not constitute legal or investment advice.

© LGO Markets LLC