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June 5, 2023 - SEC Sues Binance

Micro Summary:

The pages contain allegations against Binance, BAM Trading, and Changpeng Zhao (CZ) regarding their violation of federal securities laws and investor protection. The allegations include:

- Soliciting U.S. investors to buy, sell, and trade crypto asset securities through unregistered platforms.
- Engaging in unregistered offers and sales of securities, failing to provide material information to investors, and making misrepresentations about surveillance and controls on their platforms.
- Intentionally evading U.S. laws and regulatory oversight.
- Commingling and diverting investors' funds, engaging in wash trading, and operating without proper surveillance and controls.
- Securities and Exchange Commission (SEC) filing a complaint seeking permanent injunctions, disgorgement of ill-gotten gains, civil money penalties, and other equitable relief to protect investors.

Binance SEC Summary

<https://www.sec.gov/news/press-release/2023-101>

The Securities and Exchange Commission (SEC) has charged Binance Holdings Ltd., the operator of the largest cryptocurrency trading platform in the world, Binance.com, along with its U.S.-based affiliate BAM Trading Services Inc., and their founder, Changpeng Zhao, with various violations of securities laws.

According to the SEC, Binance and Zhao claimed that U.S. customers were restricted from trading on Binance.com, but in reality, they secretly allowed high-value U.S. customers to continue trading on the platform. They also alleged that Binance.US, which was presented as a

separate platform for U.S. investors, was actually controlled by Zhao and Binance behind the scenes.

The SEC further accused Zhao and Binance of exercising control over customer assets, allowing them to commingle or divert assets as they pleased, including sending them to an entity owned by Zhao called Sigma Chain. The SEC claimed that BAM Trading and BAM Management misled investors about non-existent trading controls on the Binance.US platform, and Sigma Chain engaged in manipulative trading to inflate trading volume.

Additionally, the SEC charged Binance and BAM Trading with operating unregistered national securities exchanges, broker-dealers, and clearing agencies. They also alleged that Binance conducted unregistered offerings and sales of its own crypto assets, including BNB and BUSD, as well as certain crypto-lending products. Zhao was charged as a control person for the operation of these unregistered entities.

SEC Chair Gary Gensler stated that Zhao and Binance engaged in deception, conflicts of interest, and lack of disclosure, while actively concealing important information from investors. Gurbir S. Grewal, Director of the SEC's Division of Enforcement, accused Zhao and Binance of deliberately evading rules and putting customers and investors at risk to maximize their own profits.

The SEC's complaint, filed in the U.S. District Court for the District of Columbia, asserts that Binance.com and Binance.US operated as exchanges, brokers, dealers, and clearing agencies without proper registration. The SEC also charged Binance and BAM Trading with the unregistered offer and sale of various crypto assets. The complaint further highlights that Binance controlled assets staked by U.S. customers in BAM's staking program.

The SEC's investigation into the violations involving the Binance.US platform was conducted by Kathleen Hitchins, Ann Rosenfield, and Colby Steele, while the investigation into the violations related to the Binance.com platform was conducted by Michael Baker, Donna K. Norman, and Martin Zerwitz. The litigation is being led by Matthew Scarlato, Jennifer Farer, and J. Emmett Murphy.

Exchange act Summary

The Exchange Act, or the Securities Exchange Act of 1934, is a United States federal law that regulates securities transactions on the secondary market. It was enacted to provide transparency and investor protection in the trading of securities, including stocks, bonds, and other financial instruments. Here's a summary of key points related to the Exchange Act:

1. **Regulation of Securities Exchanges:** The Exchange Act establishes the framework for the regulation and oversight of securities exchanges, such as the New York Stock Exchange and NASDAQ. It sets rules and requirements for the operation, governance, and self-regulatory functions of these exchanges.
2. **Registration and Disclosure Requirements:** The Act requires companies that offer and sell securities to the public to register with the Securities and Exchange Commission (SEC). It mandates regular reporting by public companies, including financial statements, to provide transparency and enable investors to make informed investment decisions.
3. **Prohibition of Insider Trading:** The Act prohibits insider trading, which involves the buying or selling of securities based on non-public information. It requires individuals who possess material, non-public information to either disclose the information or abstain from trading until the information becomes public.
4. **Regulation of Securities Professionals:** The Exchange Act regulates various securities professionals, such as brokers, dealers, and investment advisers. It establishes requirements for their registration, conduct, and disclosure of information to clients, aiming to ensure fair dealing and protect investors.
5. **Proxy Solicitation and Shareholder Rights:** The Act regulates the solicitation of proxies from shareholders, ensuring that shareholders have the right to vote on important matters affecting the company. It also mandates disclosure of information regarding corporate governance, executive compensation, and other matters relevant to shareholders' decision-making.
6. **Enforcement and Remedies:** The Exchange Act grants the SEC enforcement powers to investigate and take legal action against violations of securities laws. It provides remedies for harmed investors, including civil penalties, disgorgement of profits, and injunctive relief.

The Exchange Act plays a crucial role in maintaining the integrity of the securities markets, protecting investors, and promoting fair and transparent trading practices.

Securities Act summary:

The Securities Act, also known as the Securities Act of 1933, is a United States federal law that regulates the initial issuance and sale of securities. It was enacted to ensure transparency, accuracy, and investor protection in the primary market for securities. Here's a summary of key points related to the Securities Act:

1. **Registration of Securities:** The Act requires companies to register securities offerings with the Securities and Exchange Commission (SEC) before they can be sold to the public. This registration process involves providing detailed information about the company, its financials, and the securities being offered to enable investors to make informed investment decisions.
2. **Prospectus Requirement:** The Act mandates the disclosure of essential information to potential investors through a prospectus. A prospectus is a document that provides details about the offering, including the company's business, financials, risks, and how the proceeds from the offering will be used.
3. **Anti-Fraud Provisions:** The Act contains anti-fraud provisions, which prohibit misleading statements or omissions of material facts in connection with the offer and sale of securities. It aims to prevent fraudulent activities and ensure that investors have accurate and reliable information.
4. **Exemptions from Registration:** The Act provides certain exemptions from the registration requirement for specific types of securities offerings. For example, private offerings to a limited number of sophisticated investors, known as private placements, may be exempt from registration under certain conditions.
5. **Civil Liability:** The Act establishes civil liability provisions, allowing investors who suffer financial losses due to material misstatements or omissions to take legal action against issuers, underwriters, and other parties involved in the offering.
6. **Enforcement and Penalties:** The Securities Act grants the SEC enforcement powers to investigate and take legal action against violations of securities laws. Violators may face civil and criminal penalties, including fines, disgorgement of profits, and even imprisonment.

The Securities Act aims to promote transparency, accuracy, and fairness in the issuance and sale of securities, protecting investors from fraudulent practices. It complements the Securities Exchange Act of 1934, which regulates securities trading on the secondary market. Together, these acts form the foundation of U.S. securities laws and help maintain the integrity of the capital markets.

SEC Case Document Summary -

<https://www.sec.gov/files/litigation/complaints/2023/comp-pr2023-101.pdf>

Pages 1-13:

This case involves allegations of Defendants' violation of federal securities laws and their disregard for investor protection. Defendants, including Binance and BAM Trading, are accused of soliciting U.S. investors to buy, sell, and trade crypto asset securities through unregistered platforms. They have engaged in unregistered offers and sales of securities, failed to provide material information to investors, and made misrepresentations about surveillance and controls on their platforms. The Defendants, under the leadership of Zhao, intentionally evaded U.S. laws and regulatory oversight. They commingled and diverted investors' funds, engaged in wash trading, and operated without proper surveillance and controls. The Securities and Exchange Commission (SEC) has filed a complaint seeking permanent injunctions, disgorgement of ill-gotten gains, civil money penalties, and other equitable relief to protect investors. The jurisdiction and venue for this case are established, and the SEC alleges violations of the Securities Act and the Exchange Act.

Pages 12-23:

The first section discusses the statutory and legal framework of securities laws in the United States. It emphasizes the Securities Act and the Exchange Act as the backbone of American securities laws. These acts define securities broadly, including "investment contracts" and provide registration and disclosure requirements for securities offerings. The second section provides background information on crypto assets and crypto trading platforms. It explains that crypto assets are digital assets issued and transferred using blockchain or distributed ledger technology. It also mentions the storage and trading of crypto assets and the role of intermediaries such as exchanges, broker-dealers, and clearing agencies in the crypto market.

Pages 23 -35

In summary, the facts presented indicate that under the control of Changpeng Zhao (commonly known as CZ), the cryptocurrency exchange Binance provided exchange, broker-dealer, and clearing agency services to investors in the United States through its platform, Binance.com. Binance launched the platform in 2017 and conducted an initial coin offering (ICO) of its own cryptocurrency called Binance Coin (BNB), raising approximately \$15 million, including funds from US investors. BNB was promoted as a security investment, tied to Binance's efforts to create a successful crypto asset trading platform centered around BNB.

The Binance.com platform functions as a marketplace for trading crypto asset securities. It offers spot market trading and utilizes an order-matching system to execute trades. Binance also operates an over-the-counter (OTC) trading feature, allowing customers to transact directly with Binance as the counterparty. Binance holds and controls customers' funds and crypto assets, providing wallets for storage and facilitating deposits and withdrawals. Binance clears and settles all trades on its platform and generates revenue primarily from transaction fees. Despite knowing the legal violations, Binance actively solicited investors worldwide, including the United States, to trade crypto assets on its platform and developed a plan to evade US legal scrutiny while continuing to profit from US investors.

Pages 35-47

Describes various actions and statements made by Binance and its CEO, Changpeng Zhao (CZ), regarding the onboarding of large U.S. customers and the establishment of the Binance.US platform. Here are the key points:

1. Binance's CCO suggested onboarding large U.S. customers by asking them to join a U.S. exchange but allowing them to trade on Binance.com through a special arrangement, emphasizing the support for business and finding ways to accommodate whales (large-volume investors).
2. Binance did not require all customers to submit Know Your Customer (KYC) documents until after August 2021, even though they had millions of worldwide customers. This raised concerns about compliance and customer identification.
3. Binance successfully retained U.S. investors, including VIP customers, despite appearing to restrict them. Internal presentations showed a significant percentage of VIP trading volume on Binance.com came from U.S. customers.

4. Binance and CZ planned the launch of the Binance.US platform while maintaining control and involvement in its operations. They created U.S. entities, BAM Management and BAM Trading, to launch the platform, with Zhao being the beneficial owner of BAM Management.
5. Binance provided funding for the Binance.US platform, and Zhao played a crucial role in its development and operation. Binance employees operated the platform under Zhao's direction, and he had final signoff on various decisions.
6. Binance announced the launch of the Binance.US platform in partnership with BAM Trading, emphasizing regulatory compliance. The press release coincided with updates to Binance.com's terms of use to restrict U.S. investors, although the connection was not explicitly stated.
7. Zhao and Binance exerted control over the Binance.US platform and its trading services. Binance personnel managed trading functions, made decisions on investment opportunities, and controlled trading data.
8. Zhao overruled objections to offering BNB for trading on the Binance.US platform, despite potential legal risks. Zhao and Binance controlled BAM Trading's bank accounts, which raised concerns about regulatory scrutiny and separation between Binance and BAM Trading.

Pages 47-60

This section describes the relationship between BAM Trading, Binance, and Zhao in the operation of the Binance.US Platform. It highlights the lack of independence of BAM Trading, which is controlled by Zhao and Binance. The following key points are summarized:

- Merit Peak, a purportedly independent entity, received over \$20 billion, including customer funds from both Binance Platforms, and transferred the majority of those funds to Trust Company A without customer notice.
- BAM Trading employees expressed dissatisfaction with the lack of independence and control over the company's operations, compiling a list of "shackles" that demonstrated their lack of knowledge and transparency.
- BAM CEO A's efforts to give BAM Trading more independence were rejected by Zhao, causing her team to lose trust and feel like puppets.

- BAM CEO B, who succeeded BAM CEO A, also realized that Binance exerted substantial control over BAM Trading and the Binance.US Platform.
- Binance and BAM Trading, under Zhao's control, operate the Binance.US Platform as an exchange, clearing agency, and brokerage service without registering.
- BAM Trading and Binance actively solicit investors and market the Binance.US Platform's services, products, and incentives in the United States.
- BAM Trading and Binance, under Zhao's control, maintain and provide a marketplace and facilities for trading crypto asset securities on the Binance.US Platform.
- Binance's matching engine technology is used for order matching, and BAM Trading licenses Binance's proprietary software.
- BAM Trading offers additional services such as the OTC Desk, OCBS, and Convert trading services on the Binance.US Platform.

Overall, this section highlights the close control and coordination between Zhao, BAM Trading, and Binance in the operation and marketing of the Binance.US Platform.

Pages 60-73

In summary, the provided excerpt is part of a legal document that accuses BAM Trading and BAM Management, affiliated with Binance.US Platform, of making false and misleading statements to investors. The allegations include:

1. Falsely describing active surveillance of the Binance.US Platform using a trade surveillance software and claiming to prevent market manipulation and identify abusive trading practices.
2. Misleadingly touting the trading volume of the Binance.US Platform without disclosing the extensive nature of wash trading (a manipulative trading practice) that they knew existed.
3. Providing trading volume data through various public resources and social media, creating the impression of robust and reliable trading volumes.
4. The lack of trade surveillance mechanisms and controls to prevent manipulative trading on the Binance.US Platform, despite claiming otherwise.
5. Sigma Chain, an entity owned and controlled by Zhao (founder of Binance), engaging in wash trading on the Binance.US Platform, inflating trading volumes.

6. BAM Trading and BAM Management being aware of Sigma Chain's wash trading but not taking any steps to address or prevent it.
7. The false and misleading statements made by BAM Trading and BAM Management being material to investors and having an impact on their trading decisions and assessments of BAM Management's profitability.

It's important to note that this is only a summary of the allegations made in the legal document and does not imply any factual verification or judgement of guilt.

Pages 74-87

Here is a summary of the key points:

1. Binance has promoted the investment potential of its native token BNB, claiming that efforts to make the Binance.com Platform more profitable will increase BNB's value.
2. Binance has conducted interviews and internal town halls where its representatives have expressed bullish sentiments about BNB's future performance.
3. Binance has a BNB price prediction blog that tracks customers' consensus rating and price target for BNB over a three-year period.
4. Binance has sought to increase demand for BNB by creating additional use cases for the token and investing in projects related to the Binance blockchain.
5. BNB has been made available for trading on various platforms, and Binance has encouraged other exchanges to list the token.
6. Binance has offered BNB as part of employee compensation packages and incentivized employees to hold BNB tokens.
7. BNB has been traded on the Binance.com Platform since its launch, and the price of all BNB tokens moves together.
8. Binance has marketed BUSD (Binance USD) as a stablecoin that allows investors to participate in profit-generating schemes within the Binance ecosystem.
9. BUSD has been offered and sold as an investment contract and has been promoted for its profit-earning potential.
10. Binance has offered programs like BNB Vault and Simple Earn, which provide interest payments to investors who lend their crypto assets to Binance for fixed or flexible periods.

It's important to note that this is a summary of the provided text and may not include all the details or context.

Pages 87 - 100

Summary:

A. SOL:

- SOL is the native token of the Solana blockchain created by Solana Labs.
- Solana aims to improve scalability and achieve high transaction speeds using a combination of consensus mechanisms.
- SOL can be staked to earn rewards and burned to propose transactions on the Solana blockchain.
- Solana Labs conducted multiple sales of SOL, raising over \$23 million in the past.
- SOL has been available for trading on various platforms, including Binance.US and Binance.com.

B. ADA:

- ADA is the native token of the Cardano blockchain created by Charles Hoskinson and Jeremy Wood.
- Cardano is built on its own proof-of-stake consensus protocol called Ouroboros.
- ADA was sold in a token sale conducted by IOHK, raising approximately \$62 million for Cardano.
- Cardano is managed by the Cardano Foundation, IOHK, and Emurgo, with proceeds from ADA sales used for development and growth.
- ADA has been available for trading on platforms like Binance.com and Binance.US.

C. MATIC:

- MATIC is the native token of the Polygon blockchain (formerly known as Matic Network).
- Polygon was created in 2017 by Jaynti Kanani, Sandeep Nailwal, and Anurag Arjun.
- The founders have remained actively involved with Polygon.
- Details about the sales or availability of MATIC on specific platforms are not mentioned in the provided information.

Pages 100 - 113

The passage discusses the development and promotion of two cryptocurrencies, FIL (Filecoin) and ATOM (Cosmos). It mentions that Protocol Labs, the company behind Filecoin, used funds from the sale of FIL to develop and expand the Filecoin network. The public dissemination of information by Protocol Labs led FIL holders to view FIL as an investment and expect to profit from the growth of the protocol.

Protocol Labs and the Filecoin team released documents and made public statements emphasizing the value and potential of FIL. They stated that the success of Filecoin would increase the value of FIL tokens and reward the investment of supporters. The allocation of FIL tokens was described, with percentages allocated to Filecoin miners, Protocol Labs, investors, and the Filecoin Foundation.

The documents and statements highlighted the need for funding to develop and grow the Filecoin network and create value for FIL holders. The economic structure of FIL distribution and the burning of FIL tokens were presented as features that could potentially increase the token's value. Protocol Labs continued to be involved in the development and promotion of the Filecoin network, releasing roadmaps and updates on future plans.

Similarly, the passage mentions that ATOM is the native cryptocurrency of the Cosmos Hub. The Cosmos project aims to create an ecosystem of interoperable blockchains. The Interchain Foundation conducted a fundraiser in 2017, selling ATOM tokens to raise funds for the development of the Cosmos network. The information publicly disseminated by the Interchain Foundation, Jae Kwon, and Ethan Buchman led ATOM holders to view ATOM as an investment and expect to profit from the growth of the Cosmos protocol.

The passage also mentions the entities involved in the development of Cosmos, including the Interchain Foundation, Interchain GmbH, Tendermint (now Ignite, Inc.), and NewTendermint. ATOM has been available for buying, selling, and trading on cryptocurrency platforms such as Binance.

Overall, the passage highlights the fundraising efforts, development plans, and the expectations of investors regarding the value and growth of FIL and ATOM.

Pages 114 - 125

The document contains information about three different tokens: ALGO, AXS, and COTI.

1. ALGO:

- ALGO is the native token of the Algorand blockchain.

- The Algorand blockchain was founded by Silvio Micali and uses a consensus algorithm called "pure proof-of-stake."
- The maximum supply of ALGO is 10 billion tokens.
- The Algorand Foundation conducted an initial token sale in 2019, raising approximately \$60 million.
- The foundation promoted the token sale with a refund policy to support the value of ALGO.
- The foundation and Algorand, Inc. collaborate on projects for the Algorand community.
- The Algorand Foundation owns 500 million ALGO tokens and controls over 3 billion ALGO tokens for various purposes.
- ALGO has been available for buying, selling, and trading on Binance platforms since 2019.

2. AXS:

- AXS is the native token of the Axie Infinity game.
- The game was created by Sky Mavis PTE LTD in 2018.
- Players can earn and use AXS for in-game purchases.
- Sky Mavis conducted private and public sales of AXS tokens in 2020, raising funds for the development of the Axie platform.
- AXS has been available for buying, selling, and trading on Binance platforms since 2020.
- AXS holders expect to profit from the growth of the Axie protocol and increased demand for AXS.

3. COTI:

- COTI is the native token of the Coti blockchain and ecosystem.
- Coti provides a digital infrastructure for payments.
- Coti conducted an initial exchange offering (IEO) in 2019, raising approximately \$3 million.
- COTI has been available for buying, selling, and trading on Binance platforms since 2020.
- COTI holders expect to profit from the growth of the Coti protocol and increased demand for COTI.

These summaries provide an overview of the key information about each token mentioned in the document.

Pages 125-136

The following paragraphs outline claims made against Binance, BAM Trading, and Zhao for alleged violations of securities laws:

1. First Claim for Relief: Binance is accused of violating Sections 5(a) and 5(c) of the Securities Act by offering and selling BNB without a registration statement, thereby using interstate commerce or mails for the purpose of selling securities.
2. Second Claim for Relief: Similar to the first claim, Binance is alleged to have violated Sections 5(a) and 5(c) of the Securities Act by offering and selling BUSD without a registration statement, using interstate commerce or mails for selling securities.
3. Third Claim for Relief: Binance is accused of violating Sections 5(a) and 5(c) of the Securities Act by offering and selling the Simple Earn and BNB Vault programs without a registration statement, using interstate commerce or mails for selling securities.
4. Fourth Claim for Relief: BAM Trading is accused of violating Sections 5(a) and 5(c) of the Securities Act by offering and selling its Staking program without a registration statement, using interstate commerce or mails for selling securities.
5. Fifth Claim for Relief: Binance is accused of violating Exchange Act Section 5 by failing to register as an exchange for the Binance.com platform and using facilities of an exchange within the jurisdiction of the United States.
6. Sixth Claim for Relief: Binance is accused of violating Exchange Act Section 15(a) by failing to register as a broker-dealer for the Binance.com platform.
7. Seventh Claim for Relief: Binance is accused of violating Exchange Act Section 17A(b) by failing to register as a clearing agency for the Binance.com platform.
8. Eighth Claim for Relief: Binance and BAM Trading are accused of violating Exchange Act Section 5 by failing to register as an exchange for the Binance.US platform.
9. Ninth Claim for Relief: BAM Trading is accused of violating Exchange Act Section 15(a) by failing to register as a broker for the Binance.US platform.
10. Tenth Claim for Relief: Binance and BAM Trading are accused of violating Exchange Act Section 17A(b) by failing to register as a clearing agency for the Binance.US platform.

11. Eleventh Claim for Relief: Zhao is alleged to be a control person of Binance and is accused of being liable for Binance's violations of Exchange Act Sections 5, 15(a), and 17A(b).