

Why CFTC Whistleblowers Are Crucial To Crypto Regulation

By **Stephen Kohn** (January 16, 2024)

The U.S. authorities' landmark \$4.3 billion settlement with Binance Holdings Ltd.[1] in November 2023 was a major development in the enforcement of crypto fraud regulation.

A key player in the case was the U.S. Commodity Futures Trading Commission, a little-known regulatory agency.

Alongside charges by the U.S. Department of Justice,[2] the Financial Crimes Enforcement Network[3] and the Office of Foreign Assets Control,[4] the historic settlement resolved charges filed by the CFTC against Binance and its CEO Changpeng Zhao back in March 2023.



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As part of the settlement, Binance and Zhao agreed to pay the CFTC \$2.85 billion to settle charges that they, among other violations, willfully violated the Commodity Exchange Act and operated an illegal digital asset derivatives exchange.

Among the charges filed by the CFTC and other agencies were allegations that Binance and Zhao accepted funds from customers without requiring them to provide any identity-verifying information before trading on the platform.

The U.S. government found that in doing so, Binance and Zhao violated the Commodity Exchange Act and Bank Secrecy Act and facilitated money laundering by sanctioned individuals and terrorist organizations.

Since the Dodd-Frank Wall Street Reform and Consumer Protection Act[5] established the CFTC's whistleblower program and enhanced its regulatory authorities in 2010, the commission has emerged as a leading regulator over a variety of white collar crimes, including, most recently, those involving cryptocurrencies and digital assets.

While debates remain over the jurisdiction of the CFTC versus the U.S. Securities and Exchange Commission, there is no doubt that the CFTC is taking the enforcement of crypto fraud very seriously.

In its enforcement results for the 2023 fiscal year, released in November,[6] the CFTC revealed that it "brought 47 actions involving conduct related to digital asset commodities, representing more than 49% of all actions filed during that period."

These actions included high-profile charges against FTX and co-founder Sam Bankman-Fried.[7]

Central to all the CFTC's enforcement efforts is its whistleblower award program. According to the agency, roughly 30% of its enforcement investigations stem from whistleblowers.[8]

But the CFTC whistleblower program[9] is particularly positioned to play a critical role in the agency's crypto enforcement efforts, given the fast-paced rise of cryptocurrencies and the lack of traditional oversight in the area.

And crypto insiders are already flocking to the program; for the second straight fiscal year,

a majority of the whistleblower tips received by the program related to crypto- and digital assets.[10]

The CFTC whistleblower program, a little-known program for a little-known regulatory agency, is thus primed to be a key tool in the United States' efforts to police cryptocurrency's role in the financial markets, an area already proven to be rife with fraud.

CFTC Whistleblower Program

The CFTC whistleblower program was established alongside the SEC whistleblower program in 2010 with the passage of the Dodd-Frank Act.

Both programs were established partially in response to the Bernie Madoff Ponzi scheme, in recognition that incentivizing insiders was key to preventing future large-scale financial frauds.

Through the CFTC whistleblower program, qualified whistleblowers,[11] individuals who voluntarily report original information that leads to a successful enforcement action where the CFTC collects at least \$1 million, are entitled to monetary awards of 10-30% of the funds collected in an action connected to their whistleblowing.

In addition to monetary awards, the program offers anti-retaliation protection, as well as anonymous and confidential reporting channels.[12]

When a whistleblower files their disclosure through an attorney, they can do so anonymously.

The CFTC will also not reveal any identifying information about whistleblowers, including which specific enforcement actions were aided by whistleblowers.

While the CFTC whistleblower program had a slow start — it did not issue its first whistleblower award until 2014 — it has blossomed in recent years.

Overall, the CFTC has issued almost \$350 million in whistleblower awards.

In fiscal year 2023, the agency received a record 1,530 whistleblower tips,[13] a gigantic increase from the 58 tips received in the first 18 months of the program.

"Whistleblowers play a vital role in supporting CFTC investigations related to fraud and other illegality," said CFTC Commissioner Christy Goldsmith Romero in a statement on the whistleblower program's fiscal year 2023 results.[14] "The CFTC could not fully protect customers and markets without whistleblowers. Whistleblowers help identify fraud and other illegality, interpret key evidence, and save considerable Commission resources and time. The faster we can stop fraud, the more we can protect customers from harm."

Crypto and the CFTC

In December 2022, CFTC Chair Rostin Behnam testified before the Senate about crypto fraud enforcement.[15]

While advocating for new legislation, Behnam supported a regulatory system "where the SEC would utilize its existing authority and reporting regime requirements for all security tokens, while the CFTC would apply its market-based rules for the more limited subset of

commodity tokens, which do not have the same characteristics as security tokens."

This split outlined by Behnam reflects the agencies' current approach to digital assets, despite the lack of clear legislation.

A year after his 2022 Senate testimony, Behnam highlighted that he is "proud of the Division of Enforcement's groundbreaking work in the digital asset space." [16]

As of September 2023, the agency had brought approximately 115 enforcement matters relating to digital assets. These actions resulted in over \$4.3 billion in penalties, restitution and disgorgement.

Since the CFTC reported these statistics, it brought the landmark enforcement action against Binance and Zhao, which included \$2.85 billion in disgorgement and penalties.

Crypto Whistleblower Tips

Back in 2019, the CFTC posted a whistleblower alert to "inform members of the public about how they may make themselves eligible for both financial awards and certain protections while helping stop fraud and manipulation relating to virtual currencies." [17]

Since then, crypto whistleblower tips to the agency have grown tremendously.

While the CFTC whistleblower program's annual reports for the 2020 and 2021 fiscal years made no mention of crypto whistleblower tips, the report for 2022 [18] states that "the majority of tips received during the Period involved fraudulent misappropriation and fraudulent solicitation involving crypto/digital assets," and the 2023 report [19] says much the same.

"The majority of the tips received this year involved crypto — an area that continues to have pervasive fraud and other illegality," said Commissioner Goldsmith Romero about the 2023 report. "With the rise of crypto, more retail customers have come under the CFTC's jurisdiction, making even more critical the efforts of the CFTC's Whistleblower Program."

In keeping with its confidentiality protections, the CFTC does not reveal the specifics of any whistleblower tips, nor does it say when whistleblower information was used in specific enforcement actions. However, the whistleblower program's report does offer insights into what types of crypto misconduct whistleblowers are reporting.

The 2023 report specifically mentions "pump-and-dump schemes, fraudulent representations of moneymaking opportunities, or refusals to honor withdrawal requests" as examples of crypto- and digital asset fraud. [20]

Conclusion

The CFTC has positioned itself as a leading regulator of cryptocurrency fraud, a position that might be further solidified by future legislation.

Given the central role the agency's whistleblower program plays in its enforcement efforts, it seems safe to say that the CFTC whistleblower program is and will continue to be a major factor in the United States' regulation of cryptocurrency and digital assets.

It is thus critical that the program receives the support it needs.

Unfortunately, the program's recent growth has led to a financial crisis in which the fund used to pay awards and finance the program faces a risk of depletion.

The issue stems from a congressionally set cap on the program's Consumer Protection Fund. The amount of money that can be placed in the fund, which is entirely financed by sanctions collected thanks to whistleblowers — not by taxpayers — is capped at \$100 million.

The size of this cap has proven incommensurate with the recent growth of the program.

CFTC officials have informed members of Congress^[21] that the financial crisis has caused the program to delay the issuance of whistleblower awards and has raised the possibility of needing to furlough staff.

The bipartisan CFTC Whistleblower Fund Improvement Act, which is currently pending in Congress,^[22] would provide a simple fix to this issue at no cost to taxpayers. It raises the cap to \$300 million. The passage of this bill is essential to ensure the program remains funded.^[23]

Funding the CFTC whistleblower program would go a long way toward protecting the American public from crypto fraudsters.

As Commissioner Goldsmith Romero highlighted, crypto is "an area that continues to have pervasive fraud and other illegality" and "the CFTC could not fully protect customers and markets without whistleblowers."

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