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# Cryptocurrency Trades Made on Exchanges Don't Always Add Up

Outside the blockchain, transaction data is vulnerable to manipulation.

By Olga Kharif

(Bloomberg Businessweek) -- When Bitcoin hit a 17-month high in late June, the milestone was met with some skepticism. Big jumps in a short period of time can signal that someone is trying to artificially move the market, says John Griffin, a finance professor at University of Texas at Austin. "The extreme volatility suggests that manipulation is rampant."

While many cryptocurrency transactions occur on public digital ledgers known as blockchains, other trades take place on more than 200 global crypto exchanges. Major exchanges that trade traditional assets, such as stocks, are heavily regulated. Crypto exchanges mostly are not, and investors have no way of knowing whether the trading volume and prices they report reflect real activity or market manipulation.

Many exchanges routinely fake their volumes to attract more coins and users, says Hunter Horsley, chief executive officer of Bitwise Asset Management, which runs crypto index funds in San Francisco. One goal is to get listed higher up in the rankings of CoinMarketCap.com, the main site used by investors to keep tabs on global crypto prices. Coin promoters have been known to hire outfits to inflate their trading volumes on exchanges by trading back and forth between two accounts. In a May report, Bitwise said that 95% of Bitcoin exchange trading volume listed on CoinMarketCap.com is fake or noneconomic in nature. "In crypto, the risk is crypto exchanges," says Jeff Dorman, chief investment officer of Arca, an asset manager that invests in cryptocurrencies and other digital tokens.

Regulators are scrambling to get on top of the problem. On July 19, Bloomberg reported that the Commodity Futures Trading Commission is investigating BitMEX, looking at whether the exchange broke rules by letting Americans trade on the platform. Based in the Seychelles, BitMEX is not registered with the CFTC. BitMEX declined to comment for this article. In April, New York Attorney General Letitia James filed court papers alleging that entities related to the Bitfinex exchange had, among other things, lost more than $850 million in commingled client and corporate funds. Bitfinex said the filing "is riddled with false assertions" and has denied the attorney general's claims. In Canada, authorities are investigating the disappearance of client funds at Quadriga.

The U.S. Securities and Exchange Commission is not approving crypto-related exchange-traded funds partly because of concern about exchange integrity. The agency in recent years has rejected a number of applications for bitcoin ETFs, including from Tyler and Cameron Winklevoss, citing failures by applicants to demonstrate how they would prevent fraud and market manipulation. The Winklevoss twins are starting a self-regulatory organization they say will police the industry in the U.S.

In June, the Financial Action Task Force—an intergovernmental organization that establishes anti-money-laundering rules followed by most countries—began requiring exchanges to collect information on senders and recipients of more than $1,000 or €1,000. But because of jurisdictional issues, some crypto exchanges, such as those based in lightly regulated places like the Caribbean, may not follow those rules.

A cottage industry has sprung up selling specialized tools that claim to make the exchanges more transparent. Ex-Goldman Sachs vice president Raakhee Miller launched Bitsian in 2018 and started signing on trial customers this spring, mostly retail investors and funds. The service has devised a way to spot orders placed by bots engaged in so-called spoofing—basically, sending orders and then canceling them at the last minute to create the impression of high demand. Bitsian says it recently discovered 100,000 instances of such spoofing on just one exchange in one month.

As Fidelity, Facebook, and other large companies venture into crypto, oversight and transparency may improve. Fidelity launched a crypto–custody service earlier this year—until recently, such services were offered only by startups. Facebook has promised regular audits of the digital currency it's helping to develop. Earlier this year, Nasdaq disclosed that a handful of crypto exchanges are using its Smarts trade surveillance system to identify customers who may be engaging in pump–and–dump schemes and wash trading, artificial transactions meant to manipulate the price and mislead the market.

Nasdaq is careful about which exchanges it sells Smarts to, says Tony Sio, its head of marketplace regulatory technology. It vets potential buyers to make sure the exchange will actually use Smarts to combat fraud. Not all exchanges pass the test. "That's the thing," Sio says. "We are providing tools for an exchange to weed out bad behavior. If an exchange doesn't want to weed out that behavior, then there's not much we can do."

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