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Groundbreaking and Informative – CFTC’s KuCoin Complaint



By **Peter Y. Malyshev**
Partner | Financial Regulation



By **Mercedes Kelley Tunstall**
Partner | Financial Regulation



By **Nikita B. Cotton**
Associate | Financial Regulation

On March 26, 2024, the U.S. Commodity Futures Trading Commission (“CFTC”) filed a [complaint](#) (the “Complaint”) in the U.S. District Court for the Southern District of New York (“SDNY”) for injunctive and other relief against several non-U.S. entities (collectively, “KuCoin”). The Complaint is noteworthy for several reasons: first, the CFTC clarifies which “digital assets” would qualify as “commodities”; second, it succinctly summarizes the CFTC’s jurisdictional reach in the U.S. and overseas; and third, it provides a comprehensive analysis of KuCoin’s operations and contracts traded, while noting which activities the CFTC deems to be instances of specific violations of the Commodity Exchange Act of 1936 (“CEA”) and the regulations promulgated by the CFTC thereunder (the “CFTC Regulations”) —including the failure to have appropriate customer identification program policies in compliance with anti-money laundering laws, in violation of the CEA’s provision that require FCMs to comply with the Bank Secrecy Act (“BSA”). The CFTC’s requested relief in the case includes that KuCoin would be permanently banned from conducting any regulated business in the U.S., and pay restitution to consumers and investors as well as significant civil monetary penalties. Notably, on the same date, the Department of Justice (by way of the District Attorney’s office of the SDNY) [brought additional criminal claims against KuCoin](#) regarding the BSA and for operating as an unlicensed money transmitter business.

Background:

a. Qualification as a “Commodity”

The CEA's definition of "commodity" found in CEA § 1a(9) as well as 17 C.F.R. § 1.3 of the CFTC regulations provides a list of specific assets (e.g., wheat, cotton, rice, etc.) as well as a catch-all category for "all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt in." However, neither the CEA nor the CFTC Regulations provide a workable definition or a process for determining whether something would qualify as a "commodity" outside of the delineated list, unless it is assumed that everything is a commodity with certain exceptions (the delineated exceptions being onions and motion picture box office receipts). Several courts [have attempted to formulate](#) a test analogous to the "Howey Test" for securities that could be used to determine whether something is a commodity, but no such test has gained prevalence to date. Due to the lack of standard protocol, the CFTC has historically simply made declarations that do not carry the weight of law (e.g., in a Chairman's [speech](#) or a [court filing](#)), putting the market on notice that it considers a certain asset to be a "commodity." This is exactly what the CFTC did in this case, stating in its Complaint that a "digital asset" is anything that: (i) can be stored, (ii) can be transmitted electronically, and (iii) has associated ownership or use rights; and then the CFTC went on to explain that "virtual currencies" qualify as "digital assets" because they (a) are digital representations of value, (b) function as mediums of exchange, (c) are used as units of account, and (d) are stores of value. Having found that Bitcoin ("BTC"), Ether ("ETH"), and Litecoin ("LTC") and stablecoin projects USD Coin ("USDC") and Tether ("USDT") are "digital assets" and "virtual currencies," the CFTC states that these instruments are "commodities" traded in interstate commerce and that there are many contracts for future delivery (i.e., futures contracts) on digital assets traded on commodity exchanges (i.e., designated contract markets ("DCMs")).

Admittedly, when it comes to digital assets and virtual currencies, the U.S. Securities and Exchange Commission (the "SEC") has also been engaged for some time in ["regulation by enforcement"](#) and declared some to be "securities" as defined in U.S. securities laws. Whereas the SEC has undertaken "Howey Test" analyses with respect to individual digital assets in many of its complaints regarding violations of the securities laws, the CFTC has not generally opined specifically and comprehensively on which digital assets are commodities outside of a select few (including [BTC](#), [ETH](#), [LTC](#) and [USDT](#)), potentially because some digital assets are in the "grey area" between a security and a commodity. Rather, the CFTC has previously asserted that digital assets writ large are commodities, referencing CEA § 1a(9) and stating that "commodities, with limited exceptions, includes all manner of 'other goods and articles . . . and all services, rights and interests . . . in which contracts for future delivery are presently or in the future dealt in'", including "non- traditional goods and services".

b. The CFTC's Jurisdictional Reach

The designation of most digital assets as "commodities" is very significant because it provides the CFTC with (1) non-exclusive enforcement jurisdiction (i.e., authority to prosecute for fraud and manipulation involving any "commodity" traded in the interstate commerce under § 6(c)(1) of the CEA and § 180.1(a) of the CFTC

Regulations), and (2) exclusive regulatory jurisdiction (i.e., the authority to regulate how, when, where and by whom any derivative contract on such "commodity" trades under § 2(a)(1)(A) of the CEA). The latter jurisdiction is exclusive, meaning

that no other federal agency—including the SEC—can regulate commodity derivatives (such as futures, options or swaps). The CFTC’s clear assertion of its jurisdiction over specific “digital assets” is significant, as it challenges the SEC’s jurisdictional reach, especially when the SEC [has designated](#) most digital assets as “securities”. In a statement, Commissioner Pham [challenged](#) the jurisdiction of the CFTC over KuCoin’s proprietary leveraged tokens that allow users to mimic leveraged long positions in a number of virtual currencies, which she asserted could be distinguished as “an investment in a fund, which would typically be a security under the jurisdiction of the SEC.” CFTC Chairman Behnam also [urged](#) Congress to act to end the jurisdictional confusion in his recent testimony before the U.S. House Committee on Agriculture.

The Complaint:

a. KuCoin's Specific Violations

After establishing its jurisdiction over KuCoin in the Complaint, the CFTC analyzed the types of contracts KuCoin offered for trading and the manner they were traded in.

The CFTC explained that a “a fungible promise to buy or sell a particular commodity, like BTC, ETH, or LTC, at a fixed date in the future” is a commodity futures contract. All futures must trade on a registered DCM or, if these futures contracts are offered to a U.S. person electronically from overseas, a CFTC-registered foreign board of trade (“FBOT”). Because KuCoin offered trading in futures contracts to U.S. retail participants, KuCoin should therefore have been registered as a FBOT.

Next, the Complaint analyzed “perpetuals” on virtual currencies and concluded that these contracts qualified as “swaps” as defined under [§ 1a\(47\) of the CEA](#), and if offered for trading between multiple participants on a centralized platform, such platform must register as a swap execution facility (“SEF”) or a DCM and must only offer these swaps to eligible contract participants (“ECPs”). Additionally, the CFTC explained that KuCoin’s proprietary leveraged tokens are “leveraged, margined and financed retail commodity transactions” which must either be offered only to ECPs or executed on a regulated exchange pursuant to [§ 2\(c\)\(2\)\(D\) of the CEA](#). KuCoin was not registered in any of these categories.

The CFTC alleged that KuCoin also acted as counterparty to derivative contracts on these virtual currencies, solicited orders and accepted customer assets and margins in some transactions. These activities can only be carried out by registered futures commission merchants (“FCMs”) that have implemented certain customer identification procedures (also known as “know -your -customer” or “KYC” procedures) in accordance with the BSA. As KuCoin did not effectively prevent U.S. customers from participating on its platform, was not registered as an FCM, and did not implement KYC procedures, the CFTC concluded that KuCoin was flagrantly disregarding regulatory requirements with respect to U.S. customers.

b. Requested Relief

The Complaint requests permanent injunction of and an effective ban on KuCoin’s operations in the U.S. as well as a permanent ban on any future business in

commodity transactions and from registering with the CFTC in any regulated category in the future.

The need for this level of sanctions to apply is disheartening because KuCoin could have taken several inexpensive actions to effectively comply with the CEA. First, there is already plenty of authority that some (if not all) digital assets and virtual currencies qualify as “commodities”. Anyone familiar with the CFTC’s enforcement program should have been able to immediately identify compliance gaps with the CEA. Second, the law is clear that FBOTs, SEFs, DCMs, and FCMs must be registered with the CFTC to offer trading to U.S. customers. The Complaint begs the question of whether if KuCoin had registered as a FBOT, most, if not all violations, could have been avoided. Given that KuCoin’s trading volume was \$3.6 trillion and daily trading volume was \$23 billion, the cost of registration as a FBOT would have been insignificant, especially in light of them now facing a total trading ban and potentially criminal sanctions. Third, had KuCoin registered in an appropriate category, it would have been unnecessary to prevent U.S. participants from trading on an FBOT or a DCM, or even a SEF, if such participants qualified as ECPs. KuCoin would still have to implement the KYC program, but any U.S. participant would have been able to trade, as was also explained in the [CFTC’s complaint against Binance](#).

Even though application of the CEA and CFTC Regulations to digital assets is evolving, and the outer reaches of CFTC’s jurisdiction are still being tested in courts (and sometimes challenged by the SEC), KuCoin was on notice and this CFTC Complaint was arguably preventable, and at a comparatively low cost to KuCoin.
