

NESTED

EXCHANGES

HOW TO SPOT THEM AND THE CHALLENGES FOR LAW
ENFORCEMENT



WHAT IS A NESTED EXCHANGE

A person or business will create an account with a regulated cryptocurrency exchange in order to become the middle man. Then they will have a third party individual give them crypto to add to their nested account within the regulated exchange. This is also known as an instant exchange and the business can have multiple accounts across many exchanges.

The danger of this type of exchange is there may be little to no requests for identifying documentation; making it the perfect place for fraud and scams to occur.

Nested vs Decentralized

While similar in operation, the main difference is how transactions are done. A nested exchange will take direct custody of your crypto and use an exchange.



DANGERS OF NESTING

1 Few Guarantees

Since the funds are being sent to a party and not the secure, regulated exchange itself, there are no guarantees the person will just run with the funds.

2 Supporting Crime

Due to lack of KYC and other regulations, there is a high likelihood you would be supporting illegal activities. There is even the possibility of accidentally funding terrorism, among other criminal activities.

3 Loss of Funds

A victim could lose funds by the person running with them or the nested exchange shutting down all together. Without the backing or guarantees of a regulated exchange, the funds can disappear at any moment without ever having a change to retrieve them.

4 Legal Consequences

If you knowingly work with a nested exchange which is tied to criminal activity or sanctioned countries, there will be legal consequences with law enforcement.



Identifying a Nested Exchange

Knowing how to identify a Nested Exchange will help ensure you know which exchanges are which, since a nested exchange won't advertise that it is one.

They don't require KYC or have AML requirements in place. An exchange which lets you have instant access is a sign it's a nested exchange.

There is no statement saying they are facilitating the trades.

Follow the transaction using a blockchain explorer. You'll see that it comes from a wallet on a different exchange.

The User Interface doesn't show you where the trades are taking place.

There are different rates displayed which you can choose from. This means the rates are coming from multiple exchanges.



Law Enforcement Actions

CT PRO's analytical tool is now capable of identifying nested exchanges. The example below from our tool shows Binance as the Certainty of Ownership.

The screenshot displays the CT PRO analytical tool interface, which is divided into three main sections: Summary, Transactions Overview, and CEX Associations.

Summary:

- Address Hash: 17b7xzJ3NNk5F5fmsiqYZzvx6QvYRKEsYH
- Balance: 0.0211 BTC / \$1299.0355
- Transactions: 281

Transactions Overview:

Transaction Type	Amount
Received Transaction	156.68780524BTC
Received Amount	\$10542449.1367
Sent Transaction	156.66666321BTC
Sent Amount	\$10526720.0476

CEX Associations:

Exchange	Association Type
Phemex	Evidence of ownership
Bitso	Potential association with the owner
Binance	Certainty of ownership
Nexo	Evidence of ownership
Godex	Evidence of ownership
EasyCrypto	Evidence of ownership

A red arrow points from the text "the Certainty of Ownership" to the "Binance - Certainty of ownership" entry in the CEX Associations table. A red text label "Possible Nested Exchanges" is positioned between the Transactions Overview and CEX Associations sections, with black arrows pointing to the "Binance", "Nexo", "Godex", and "EasyCrypto" entries in the CEX Associations table.

Using this example, a law enforcement officer would send a Letterhead Memo (LHM) to Binance for account identifiers.

Binance will most likely indicate a Nested Exchange is using a Binance API Key and they will provide you with the legal point of contact for the Nested Exchange.

The officer would then send the Letterhead Memo to the legal point of contact for further information.





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