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BITCOIN PRICE INDEX (24H)

USD -1.11%

\$240.68

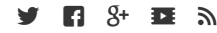
CNY -1.43%

¥1,489.92

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Huobi's BitVC Uses Trader Profits to Cover Futures Loss

Jon Southurst (@southtopia) | Published on November 20, 2014 at 14:43 BST



UPDATE (November 20th 16:01 GMT): Alongside its plan to pool 20% of all trading fees into a 'system reserve fund', Huobi informed CoinDesk it has now reimbursed all users who suffered from its "system loss allocation policy" in the form of credit for future trading fees.

"BitVC will continue working toward our goal of providing a fair, transparent and stable trading platform, and we always welcome user feedback and suggestions," the platform added.

BitVC, the digital currency futures trading platform owned by exchange Huobi, found itself on the receiving end of customer anger last week when it took 46.1% of traders' profits from the week to cover a "system loss" of over 3,000 BTC.



The loss raises questions about whether cryptocurrency exchange platforms have the liquidity to support sophisticated trading features such as margin lending and derivatives, and whether they are using the correct mechanisms to deal with unusual events.

It also highlights how bitcoin's price volatility can bring surprises in a world of highly leveraged trading and the 'socialized' sharing of losses between trading winners.

Huobi's/BitVC's solution, to take the total loss (worth over \$1.17m today) out of its users' profits for that week and reimburse the funds in the form of trading fees, prompted instant outrage on various social media forums such as weibo, QQ and Reddit.

Single trader brought losses

According to an official statement by Huobi, an initial loss of 2,500 BTC was the result of an individual trader who on 14th November opened a highly leveraged long position of 40m CNY at a BTC price of 3,000 CNY, only to be forced into liquidation at a lower price (2817.76) when the market took a sharp dive.

Even the forced liquidation price was unattainable, however, since the price at the time was falling fast. The trader's position could only be fully closed at a price averaging 2378.72 CNY, resulting in the system loss. In total, BitVC's futures contract system lost 3032.3848 BTC over the week.

Hong Kong-registered BitVC launched in June with margin trading and interest-bearing accounts for CNY holders. Its futures platform has been operating since September.

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On its futures exchange BitVC offers 5x and 20x leverage. On its regular margin trading platform the firm allows a maximum leverage of twice a user's total assets (in BTC/LTC/CNY) up to a maximum limit of 5m CNY, 500 BTC or 10,000 LTC.

Proposing future solutions

"We understand that this level of loss allocation is unacceptable," Huobi posted on Reddit, as it promised to reimburse users' lost profits with exchange fee credits.

Huobi/BitVC proposed a new system to protect traders from similar events in future, which would see 20% of all trading fees collected pooled into a 'system reserve fund' that would cover any system losses first, before they are passed proportionally onto users.

The company also promised to "improve the futures exchange rules, liquidation process, and transparency, including publishing forced liquidation orders and other relevant data in real time".

Not all trader reactions were negative, however, with one Reddit user responding:

"It's called counterparty risk ... If you take 46% of the list you posted, you only have 1700 BTC. People are trading futures without having a clue what it is."

Indeed, unexpected losses on leveraged currency trading are not unique to bitcoin or digital currencies, and are even the norm in the traditional ForEx world, as Bloomberg recently pointed out.

High leverages bring risk

Representatives from other derivatives exchanges in and outside China have stepped forward with opinions on leverage and system losses. Should traders just expect incidents like last week's, or are there other ways to manage them?

Arthur Hayes, CEO of soon-to-launch platform BitMEX, told CoinDesk the recent price volatility exposed how big the 'tax' on winners profits could be on some exchanges.

He said:

"I think some traders (at BitVC) read the terms and traded in full knowledge, and some were quite surprised when they got a big hefty tax."

Hayes pointed out that similar exchanges such as 796.com and OKCoin took 25.01% and 5.15% out of their own winning traders' profits respectively in the same week ending 14th November, to deal with 'System Assumed Counterparty Loss'.

OKCoin offers up to 20x leverage to margin traders, saying "with this increased leverage, we urge investors to manage their risk carefully".

796's settlement history page details exactly what the loss and 'profit socialized' amounts have been over time and indicates that, on at least two other occasions, they have been percentages in double figures.

Comparing these kinds of settlements to a casino that tries to tax its winners' payouts, Hayes said the products turned spread trading into a dangerous game unsuitable for businesses hedging real-world currency risks.

Counterparty risk is a big issue, he continued, and many exchanges use part of the trading fees to cover this risk, not a tax on winnings. Much of the risk lay with the high leverages being offered, which are up to 20x.

"With 20x leverage, bankruptcy is only a 5% move away. This is incredibly risky on contracts that can move as much as 20% in a day. These exchanges then enjoy the increased fees gained by their increased leverage and offload the risk onto their

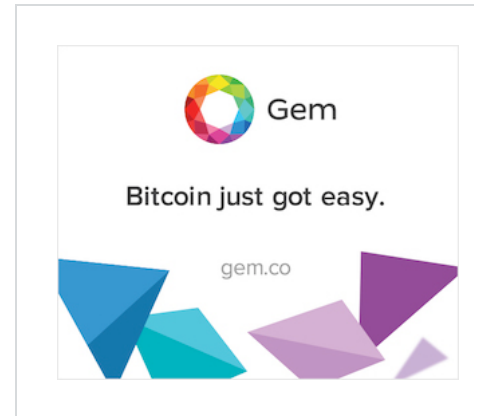
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users. It may seem that fees are low, but at 20x leverage, 0.2% becomes a 4% fee. Many in the bitcoin community have not noticed."

Design can be an issue

Jeremy Glaros is the co-founder of [Coinarch](#), a derivatives platform which offers leveraged products such as 'Booster' and allows users to lend bitcoin to traders in return for interest.

Noting that he was speaking about exchanges in general and not any company or incident in particular, he said problems with leveraged trading in bitcoin are the result of fundamental product design flaws rather than a "rampant market" issue.

Different providers in the bitcoin space employed different mechanisms for dealing with these situations, he said.

While limited market depth does result in sharp price moves and quick position close-outs, the design of some markets means that if markets move a long way, and winners win big on paper, profits are going to be significantly pared back.

"The problem exists because traders can take very high leverage and nominate that their losses be capped at their initial margin (as little as 5% in some cases). This means that losers' losses are almost never going to be sufficiently covered by the margin they post unless the market moves by only a small amount (eg: less than 5%), in which case the wins would not be that big anyway, so a pare-back is not of great concern."

No major asset class over which futures are available, Glaros continued, includes anything like this feature in its contracts. Usually, if a futures trader is losing and does not put up the additional margin required to keep a position open, the exchange itself will take over that position as principal to ensure its other futures contracts are made good.

Whatever risks it takes from doing so are offloaded onto another market participant who assumes the position, with any losses absorbed by the exchange.

Cautionary tale for traders

While no one has suggested any wrongdoing or illegal behavior on any exchange's part, these incidents and issues serve as a warning for bitcoin holders new to the world of trading to study hard before jumping in with the professionals.

Leveraged trading experience with a decent track record, plus an understanding of sensible losing techniques, is a minimum requirement.

Even for those with years of financial world experience, bitcoin may provide new quirks and they need to understand completely the kind of margin policies their chosen platforms are offering.

Thanks to Eric Mu for assisting with this article

Trader image via Shutterstock

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Huobi · 4 months ago

This article title is very misleading. Huobi/BitVC did not suffer any loss and did not take any profits. BitVC is a platform for users to trade with each other, BitVC is not a counterparty to trades. What happened was an automatic, proportional reallocation of UNREALIZED profits and losses at SETTLEMENT according to the predetermined rules of the futures exchange. There was no net loss of bitcoin. There was no reversal of trades. There was no technical malfunction.

The full explanation of what happened and BitVC's response was given in an earlier statement (<http://redd.it/2mieok>).

If anyone has any questions we will be happy to answer.

15 ^ | v · Share



NickTheGreek → Huobi · 4 months ago

Sorry, but you are not telling the truth. I trade quite actively in the Chinese market and i know for a fact you have a trader who works inside huobi and is often the counterparty to many trades.... up to 35% at one point i heard from my sources inside Huobi. Please be careful with what you are doing, i dont think you understand the risk you are putting yourselves in.

10 ^ | v · Share



DebtLadenEbolaZombie → NickTheGreek · 4 months ago

They aren't putting themselves in risk, they're putting their "customers" at risk. Maybe fools is a better word than customers.

3 ^ | v · Share



Orchideric → Huobi · 4 months ago

Thank you for clarifying.... I have a suspicion this article was meant to scare away customers to other exchanges.

Makes me wonder if Jon Southurst has a reading comprehension problem while spreading FUD about China Exchanges.

... also note that this was posted just a day after the article headline which reads "New Research Links Bitcoin Price Spikes to Media Hype".... any coincidence there?

Coindesk should remove this article... IMMEDIATELY!

3 ^ | v · Share



cohagen → Huobi · 4 months ago

Bullsh*&! You dipsticks can't cover the operating expense of your own bs biz.

^ | v · Share



skies2006 · 4 months ago

This exchange will slowly die. Any exchange that takes money out of the accounts of winners have no future.

If your technical risk control system failed to supervise risk levels and autoclose positions as seam to be the case. Then the exchange has to pay the winners out of its own pocket. And make the losing trader pay back the debt to the exchange.


Taking winning traders money to offset a loss is totally unacceptable.


3 ^ | v · Share





cohagen → skies2006 · 4 months ago


 100% Correct!!!!!!!
1 ^ | v · Share >


 **Alphi** · 4 months ago
This is outright theft. Who is going to trust a trading platform which takes money from its users? just look at what happened to vircorex. it has never recovered from freezing customer funds to pay for coins that were "lost" by their system.
3 ^ | v · Share >


 Guest → **Alphi** · 4 months ago
welcome to the wild west of bitcoins, no rules, no responsibility.
2 ^ | v · Share >

 **ArtyD** → Guest · 4 months ago
Technically there still are rules and responsibility. It merely requires someone to file a lawsuit
2 ^ | v · Share >

 Guest → **ArtyD** · 4 months ago
.. and they would claim losses on what exactly?
1 ^ | v · Share >


 **ArtyD** → Guest · 4 months ago
Hell if I know. Only the users who are losing something would know. I'm not claiming there is or is not an issue. I'm only pointing out there are things they can do if they felt they needed to.
^ | v · Share >


 Guest → **ArtyD** · 4 months ago
if that were so, it would not have happened in the first place, but it did !!
As soon as lawyers get into it, you all lose.
1 ^ | v · Share >


 **ArtyD** → Guest · 4 months ago
Repercussions do not guarantee actions do not happen. But I guess you need a quote from the Huobi website:


"15.1 Any disputes between Huobi and users should be resolved through friendly negotiation and dialogue, either party has right to submit a claim form to the Beijing Arbitration Commission for arbitration according to the rules when no settlement can be reached."

^ | v · Share >

 **Orchideric** → **ArtyD** · 4 months ago
Omg, there is no dispute, and no customer funds were used. Not a single dime. The author is spreading FALSE rumors.
1 ^ | v · Share >

 Guest → **ArtyD** · 4 months ago
and actions do not guarantee repercussion do not happen!
^ | v · Share >

 **Orchideric** → Guest · 4 months ago
They already reimbursed the pool from its "system loss allocation policy".... In a single week!
That shows me I can trust them, and they only borrowed profit which is part of the risking leverage in the first place!.
It could have been much worse!
Nobody lost a dime except the person who made the dumb trade in the first place.
2 ^ | v · Share >

 **Jaime Moksha** → **Orchideric** · 4 months ago
Your comment sums up my assessment of the whole situation. Huge leverage will come with certain risks. Huobi seems to be up front about everything, even when things go a bit wrong. It actually makes me trust Huobi more than some exchange that might be losing large sums and pretending nothing has gone wrong. You are just asking to

get goxxed by these other secretive places.

2 ^ | v · Share >

bob → Orchideric · 4 months ago

>Nobody lost a dime except the person who made the dumb trade in the first place

and all the people who 46% of their profits taken from them. If I had 1btc profit but was only given .46btc in profit, that means a lost a lot more than a dime.

>They already reimbursed the pool from its "system loss allocation policy".... In a single week!

They didn't reimburse anything. They gave users credit on trade fees. That's a far cry from a reimbursement. What if I don't want to trade there anymore, then I didn't receive any reimbursement.

1 ^ | v · Share >

cohagen → bob · 4 months ago

Exactly no future trades no satisfaction.

^ | v · Share >

cohagen → Orchideric · 4 months ago

With trading credit, nah that's hogwash! Real reimbursement would have to be cash or btc.

^ | v · Share >

Guest → Guest · 4 months ago

WTF? They already reimbursed the pool from its "system loss allocation policy".... In a single week!

That shows me I can trust them, and they only borrowed profit which is part of the risking leverage in the first place!.

It could have been much worse!

Nobody lost a dime except the person who made the dumb trade in the first place.

1 ^ | v · Share >

cohagen → Guest · 4 months ago

Trade credit isn't a proper reimbursement.

^ | v · Share >

Guest → Alphi · 4 months ago

Err, the author outright lied or simply can't comprehend the situation. There was absolutely NO NET LOSS OF BITCOIN, no reversal of trades, there was no technical malfunction. Trades were perfectly executed according to the rules as written. Someone (a user) simply made a bad leverage decision and lost.

1 ^ | v · Share >

Jon Mod → Guest · 4 months ago

Please point to the sentence where I refer to a net loss and not a system loss.

2 ^ | v · Share >

DebtLadenEbolaZombie → Guest · 4 months ago

You are such a weasel.

"Net" loss?

Robbing this week's winners is the same as robbing this month's losers.

1 ^ | v · Share >

Guest · 4 months ago

TOTAL FUD No user funds were touched. There was NO NET LOSS OF BITCOIN, no reversal of trades, there was no technical malfunction. Move along folks

3 ^ | v · Share >

Guest → Guest · 4 months ago

you told us what did not happen,, SO what did happen then ?

2 ^ | v · Share >



Guest · 4 months ago

"High leverages bring risk"
who would have ever thought that !!!!

4 ^ | v · Share ›



DebtLadenEbolaZombie → Guest · 4 months ago

You clearly do not understand the difference between leverage risk and counterparty risk.

High leverage at a properly-run exchange does NOT bring any counterparty risk whatsoever.

Or you can just keep being a stupid simpleton.

^ | v · Share ›



skies2006 → DebtLadenEbolaZombie · 4 months ago

Of cause there is counter party risk if the losing trader goes under water on his account.

If the account is +100 btc and a losing trade of 200 btc makes it -100 btc, someone has to pony up 100 btc. Either the losing trader or the exchange company.

1 ^ | v · Share ›



cohagen · 4 months ago

This isn't exactly news, all cryptoexchanges,BITCOIN, ALTCOIN, ECT IS A FRAUD!!!!!!!!!!!!!!

^ | v · Share ›



Rogue Wave · 4 months ago

Damn, kids, again: stay away from futures, heck any derivatives, Do not copy fiat flaws.

^ | v · Share ›



DebtLadenEbolaZombie · 4 months ago

How many times do I have to scream "counterparty risk" before you listen?

^ | v · Share ›



Tim · 4 months ago

Hedgy.co offers derivative products where the reserve capital is always locked in the blockchain. There is no possibility for default with their product.

^ | v · Share ›



DebtLadenEbolaZombie → Tim · 4 months ago

Zero technical details, no whitepaper, expensive-flashy-web3.0-website.

SCAM SCAM SCAM.

If you were for real, you'd have a whitepaper with full technical details. Otherwise how is anybody going to independently verify? Isn't that the whole point? Multisig is just one ingredient.

^ | v · Share ›



Tim → DebtLadenEbolaZombie · 4 months ago

You are right to call us out. We are working on documentation, an API, and an open-source client.

^ | v · Share ›



cohagen → DebtLadenEbolaZombie · 4 months ago

PREACH IT BROTHER!!!!!!!!!!!!!!

^ | v · Share ›



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