Enforcement Approach to Virtual Assets

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Enforcement approach to Virtual Assets

- Guiding principles
  - Market integrity
  - Customer protection
- Key powers
  - Economic manipulation
    - Have to prove artificial price
    - Difficult and mainly involved a battle of the experts
  - Post Dodd-Frank we now have fraud based manipulation powers

Jurisdiction Overview

- Split into two buckets –
  - Regulatory oversight
  - Enforcement jurisdiction
- Regulatory oversight
  - In general, oversight over the commodity derivatives markets
  - Regulatory oversight over commodity futures, options, and swaps – and their respective markets and intermediaries

Jurisdiction Overview

- What does that mean in the virtual asset space
  - If you have future, option or swap contract,
  - Involving a virtual asset that is a 'commodity',
  - Not otherwise a security or product involving narrow-based security index, then
  - CFTC has the authority to regulate transactions
- Intermediaries and exchanges must be registered and follow the appropriate rules regarding disclosures, capital requirements, core principles
- For futures and options, you cannot trade the product other than on a registered designated contract market

Jurisdiction Overview

- For example
  - Products designated as futures, options or swaps sold in the US
    - CME and CBOE bitcoin futures
    - NADEX binary option bitcoin spreads
  - Then there are other products that may fit into these definitions
  - This is where the debate has centered…

Jurisdiction Overview

- First question—is it a commodity?
  - The definition is quite broad – "commodity" means
    - Wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions and motion picture box office receipts
    - And all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in

- Is it otherwise a security or a product involving a narrow-based security index?

Jurisdiction Overview

- What is the nature of the transaction ?
  - Transactions involving the sale of bitcoin to retail customers on a margined, leveraged or financed basis
    - These are considered futures for most purposes – meaning – they must be traded on a registered DCM and the intermediaries must also be registered
  - Specific to virtual currencies CFTC issued guidance for comment last year on this topic specifically related to actual delivery --- we have not released the final guidance

Jurisdiction Overview

- What is the nature of the transaction?
  - Smart contracts — depending on the nature of that smart contract, it could be considered a swap,
    - Meaning that the average retail customer cannot enter into that contract in the US and
    - Exchanges must be registered and dealers must also be registered
  - A product that shifts risk provides of fixed or contingent payments between the parties based on a flux in price or the occurrence of certain events—it's a swap
  - So that may include smart event contracts —
    - A contract that transfers Ethereum between parties based on the occurrence or non occurrence of an event
    - The CFTC may have regulatory oversight depending on
      - The parties involved
      - How the contract is structured – including whether there is some form of delivery of the event object

Jurisdiction Overview

- Very generalized overview of the CFTC's regulatory oversight
  - Facts and circumstances of each case or transaction dictate the outcome and it can be dangerous to overgeneralize here

Enforcement Jurisdiction

- CFTC has jurisdiction to enforce any of the statutes and regulations, such as registration requirements relating to the products
- Who should be held responsible?
- For example—in the case of decentralized smart contracts that are properly considered swaps
  ◦ Is there an exchange or intermediary involved?
  ◦ A developer could be held responsible and these developers should reach out to legal counsel
- "Generally that offering or facilitating a product or activity by way of releasing code onto a blockchain does not absolve any entity or individual from complying with pertinent laws or CFTC regulations"

Enforcement Jurisdiction

- The CFTC's door is open for inquiries and discussion.
- CFTC's LABCFTC initiative was designed to allow for a productive dialogue on these issues
- Simple to get in touch with us, send an email to labcftc@cftc.gov

Fraud and Manipulation

- Connection with a swap, future, or contract of sale of any commodity in interstate commerce in contravention of CFTC rules
  - Shall be unlawful for any person, directly or indirectly, in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity, to intentionally or recklessly:
    - Use or employ, or attempt to use or employ, any manipulative device, scheme, or artifice to defraud;
    - Make, or attempt to make, any untrue or misleading statement of a material fact or to omit to state a material fact necessary in order to make the statements made not untrue or misleading;
    - Engage, or attempt to engage, in any act, practice, or course of business, which operates or would operate as a fraud or deceit upon any person
- We believe that the statute and regulation is pretty clear that it would cover fraud and or manipulation of a virtual asset that is commodity and not a security

Fraud and Manipulation

▸ *CFTC V. mybigcoin pay*– 2018 WL 4621727-- *My Big Coin* court ruled that CFTC had jurisdiction over fraud relating to mybigcoin because the CEA "only requires the existence of futures trading within a certain class" of items "in order for all items within that class . . . to be considered commodities." *My Big Coin Pay, Inc.*, 2018 WL 4621727, at *4.