

THE FUTURE OF VIRTUAL CURRENCIES UNDER U.S. DERIVATIVES REGULATION

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By: Clifford C. Histed

The Chicago Board of Trade launched the first formal standardized commodity futures contract in 1865. Today, market participants can trade futures, options, and swaps (called "derivatives" because their value is derived from that of the underlying commodity) on agricultural and financial products, energy, metals, and even the weather.

But where do virtual currencies like Bitcoin fit in? The Commodity Futures Trading Commission ("CFTC") has spoken on the issue in public comments, and in three enforcement actions. In a September 2015 settlement with U.S.-based Coinflip, Inc., the CFTC announced for the first time that "Bitcoin and other virtual currencies are ... properly defined as commodities." Coinflip had operated an online platform for the trading of Bitcoin options but had not registered with the CFTC as either a Swap Execution Facility ("SEF") or as an exchange. Coinflip agreed to cease and desist from its conduct, but was not required to pay a fine—a rare occurrence in a CFTC enforcement action.

Also in September 2015 the CFTC entered into a settlement with U.S.-based TeraExchange, a registered SEF that offered a Bitcoin swap based on the relative value of the U.S. dollar to Bitcoin. According to the CFTC, TeraExchange had facilitated the entry of a single prearranged wash trade between two traders on its platform so that it could issue a press release stating: "TeraExchange announced today the first bitcoin derivative transaction to be executed on a regulated exchange." TeraExchange agreed to cease and desist from such conduct but, like Coinflip, was not required to pay a fine.

Finally, in June 2016 the CFTC entered into a settlement with Hong Kong-based BFXNA, Inc. d/b/a Bitfinex. During the time period covered in the settlement order, Bitfinex operated an online platform for exchanging and trading Bitcoin and other virtual currencies. According to the CFTC, because the trading program resembled futures trading, including the use of leverage, the program constituted unlawful futures trading because it did not occur on a registered exchange. Also, because Bitfinex directly accepted customer funds and trading orders, it should have registered with the CFTC as a Futures Commission Merchant, but had not. Bitfinex agreed to the entry of a cease and desist order and to pay a \$75,000 fine.

The three enforcement orders make clear that the CFTC is policing the trading of virtual currencies, and is willing to assert its authority outside the U.S. But what does the future hold for trading and regulation of virtual currencies in the context of derivatives regulation? Our clearest answer to that question came on January 18, 2017, from statements made by CFTC Commissioner (now Acting Chairman) Christopher Giancarlo in New York at "SEFCON VII 2017." He stated that he wanted to make the CFTC more accessible to Fintech Innovators, and that "regulators must take a 'do no harm' approach" to FinTech. He stated that the CFTC and other regulators should promote distributed ledger technology and other FinTech by allowing "breathing room" including by fostering a regulatory environment where FinTech businesses, working collaboratively with regulators, are able to develop and test innovative solutions without fear of enforcement action and regulatory fines.

On January 27, 2017, Acting Chairman Giancarlo announced that he had appointed Jeffrey Bandman to become an advisor on FinTech matters. According to the press release, "Mr. Bandman will focus on FinTech innovation issues including those arising from distributed ledger technology and virtual currency derivatives. His work will concentrate on key immediate priorities—such as identifying challenges to FinTech innovation in areas within the CFTC's jurisdiction and proposing ways to address them. He will also focus on ways to heighten the CFTC's engagement with the underlying technology."

The CFTC has made it clear that it considers virtual currencies to be "commodities" subject to its authority, but also has recently and repeatedly pledged to work with FinTech businesses to foster a regulatory environment focused more on collaboration and engagement than on enforcement actions and fines. Assuming that Acting Chairman Giancarlo is officially appointed to the position, this should be good news for FinTech.

KEY CONTACTS



CLIFFORD C. HISTED
PARTNER

CHICAGO
+1.312.807.4448
CLIFFORD.HISTED@KLGATES.COM

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