

March 19, 2018

Christopher J. Kirkpatrick, Esq.
Secretary, Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street NW
Washington, DC 20581

PUBLIC COMMENT REGARDING 82 FR 60335

Dear Secretary Kirkpatrick:

Cable Car Capital LLC (“Cable Car”) is an investment adviser registered with the Commission as a Commodity Trading Advisor in connection with the accounts of qualified eligible persons. Although Cable Car does not currently direct trading in commodity interests, registration was required in order for Cable Car to main custodial accounts with the ability to direct commodity interest trading in the future. In 2013 and 2014, prior to engaging in any activity that would require registration, Cable Car sought no-action and rulemaking relief in order to clarify the application of the exemption contained in Section 4m(3) to its proposed activities. Upon learning that such exemption would not be applied to state-registered investment advisers, Cable Car duly registered as required. Despite the associated costs, registration has not been unreasonably burdensome.

It is with that experience in mind, along with extensive study, that Cable Car appreciates the opportunity to comment on the Commission’s proposed rulemaking regarding Retail Commodity Transactions Involving Virtual Currency. The proposed rulemaking follows a 2016 petitionⁱ and no-action requestⁱⁱ by Poloniex, a self-described “cryptocurrency exchange.” Broadly, the purpose of its submissions appears to be to identify potential loopholes by which entities acting as *de facto* futures commission merchants and designated contract markets, or otherwise facilitating retail trade and speculation in commodity interests, might not be required to register with the Commission. Cable Car respectfully submits that the requirement to register with the Commission prior to engaging in covered commodity interest activity is a basic matter of fairness.

As noted in the proposed rulemaking, and notwithstanding the purported “lack of regulatory clarity” regarding the definition of “actual delivery” in the context of blockchain-based transactions articulated in petitioner’s requests, the Commission’s 2013 Guidance already described the requirements for “actual delivery” in the context of CEA section 2(c)(2)(D). As the subsequent *Biffinex* enforcement order made clear, the facial technological complexity of intermediating blockchain-based commodity interest transactions does not absolve intermediaries from their registration obligations.

This rulemaking, while entirely unobjectionable as proposed, is partly an exercise in reiterating previous guidance that could perhaps have been avoided if market participants had abided by their statutory responsibilities rather than sought to evade regulation. At bottom, any debate over the contours of the delivery exemption in CEA section 2(c)(2)(D)(ii)(III) is a debate over which entities involved in the emerging virtual currency markets should be required to register with the Commission and in what capacity. There should be very little such controversy. A “cryptocurrency exchange” is no more exempt from registration and its associated requirements than a “[fiat] currency exchange” would be. The technological implementation of



virtual currencies should not obscure the fact that the practices of many digital asset trading venues very closely resemble those of certain retail forex providers, binary options dealers, and contract-for-difference brokers, which have been the subject of significant oversight and enforcement activity. As practiced, the trading of digital assets is not distinguishable from leveraged speculation in other commodities regulated by the Commission, which necessitates close supervision. Any brokerage, exchange, or adviser soliciting the general public to trade cryptocurrencies on margin should be prepared to register with the Commission and abide by the requirements of the CEA.

As the Commission regularly recites in its enforcement orders, “[r]egistration is the kingpin in this statutory machinery, giving the Commission the information about participants in commodity trading which it so vitally requires to carry out its other statutory functions of monitoring and enforcing the Act.”ⁱⁱⁱ Therefore, Cable Car encourages the Commission to construe its jurisdiction broadly, in order to provide much-needed oversight and investor protection to an area of burgeoning retail interest. Entities that have failed to register as facially required, even after *Bitfinex* and throughout the pendency of this rulemaking proposal, are clearly in need of additional supervision.

The remainder of this letter addresses specific questions contained in the proposed rulemaking, which are paraphrased in the headings.

Q1. WOULD A 2-DAY ACTUAL DELIVERY PERIOD BE MORE APPROPRIATE?

While a preference for broader registration requirements supports the shortest possible reading of the actual delivery requirement, the one- or two-day settlement cycle of fiat currencies is not perfectly analogous to virtual currency delivery. Although two days is more than sufficient time for most blockchain-based settlement practices, some of which are theoretically instantaneous, the actual practice of transaction verification in the Bitcoin network, for example, can be significantly longer. Although there are proposed technical fixes, media reports indicate that unconfirmed transactions can linger for more than two weeks before settlement during times of high network congestion.^{iv} Insofar as the Commission does not intend to regulate “spot” commodity transactions that may be unpredictably delayed by network congestion, any delivery timeframe used to establish regulatory requirements should take into account the limitations of transaction verification.

One solution to network congestion involves “batching” of transactions by trusted intermediaries, such as exchanges. Batching entails the aggregation for blockchain-based settlement of multiple transactions, but there is not yet an industry-standardized delivery timetable. A batch of transactions could be aggregated over a period of minutes, hours, or longer. The ability of an intermediary to effect a unilateral delay in settlement suggests the need for close regulatory oversight, including through registration. Furthermore, Example 1 in the proposed rulemaking may need to be clarified to address whether the public ledger must reflect each and every transaction between exchange wallet counterparties or if netting is permissible.

To the extent that the proposed rulemaking already clarifies that financed retail commodity transactions secured by a lien on a margin account do not result in “actual delivery” on *any* timeframe, there is no need to engage Congress to differentiate among transactions that settle on variable timetables. That said, establishing a uniform maximum settlement cycle length for exempt spot virtual currency transactions might be beneficial for future oversight efforts.



Q2. WHAT OTHER EXAMPLE TRANSACTIONS SHOULD THE COMMISSION CONSIDER?

One additional example may be illustrative. The Commission should consider the uncertain status of credit card transactions, particularly in light of the delivery timetables discussed above. Several exchanges, including Coinbase and Bitstamp, along with payment processors such as PayPal, currently allow or have previously allowed the purchase of virtual currencies using a credit card. (Card issuers are increasingly processing such transactions as a cash advance, which entails higher fees and discourages the practice). The Commission should evaluate a situation in which an individual, non-eligible contract participant financed the purchase of a commodity virtual currency with a credit card, an apparent financed retail transaction within the meaning of section 2(c)(2)(D). The question of whether “actual delivery” of the commodity occurred hinges on whether the full amount of the purchase became available for use in commerce, but the analysis is complicated by any rights retained by the card issuer prior to satisfaction of the short-term debt. There appears to be a risk that “actual delivery” may not occur in certain circumstances, such as when and if: (1) the card issuer maintains a chargeback right that extends beyond 28 days; (2) platforms seek to limit the transfer of credit card-financed virtual currency positions due to chargeback concerns; or (3) network settlement delays of credit card-financed purchases limit the availability of a credit card-financed purchase beyond a 2- or 28-day timeframe.

Q3. WHAT ABOUT BUCKET SHOPS?

Consistent with previous correspondence, Cable Car submits that any interpretation is clearly erroneous if it would exempt from regulatory oversight an entity acting as principal in the trade of regulated product markets. The Commission has oversight responsibility for the commodities underlying regulated products, which could be easily manipulated by the establishment of parallel notional, bilateral markets between a bucket shop as counterparty and its customers. Moreover, any such transaction is more properly viewed as a swap, not a spot transaction in the underlying commodity, placing it squarely within the Commission’s jurisdiction. Otherwise, such conduct is likely covered by state bucket shop laws or the superseding authority granted to the Securities and Exchange Commission under Section 767 of the Dodd-Frank Act.^v

Q4. SHOULD THE COMMISSION PROVIDE EXEMPTIVE RELIEF OR AN ALTERNATIVE REGIME?

As previously cited, “[r]egistration is the kingpin in this statutory machinery, giving the Commission the information about participants in commodity trading which it so vitally requires to carry out its other statutory functions of monitoring and enforcing the Act.”^{vi} Without registration, the Commission will struggle to protect retail investors from abusive behavior by larger, unregulated counterparties, and it would lack the data with which to assess and prevent market manipulation within the products it regulates. Unless the Commission determines that its jurisdiction does not extend to virtual currencies or that they are not commodities, there is no reason to consider exempting from registration entities that trade them.

At this time, there is no apparent need for a distinct regulatory pathway, and exemptive relief from registration is not justified. The existing regulatory framework remains perfectly serviceable, and it should be tried before being discarded. Cable Car agrees with the proposed rulemaking comment that “entities offering virtual currency retail commodity transactions operate in a similar manner to any other entity offering retail

commodity transactions online.” If experience suggests that a separate category of registration would be useful, a future rulemaking could address the costs and benefits in more detail. In the meantime, accepting the self-serving arguments of firms that have historically ignored their registration obligations would serve only to prejudice those entities that have already properly registered under the existing regime.

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Cable Car does not have sufficient basis to form an opinion on Questions 5 and 6.

Q7. SHOULD CERTAIN LIEN TERMINATION EVENTS BE CONSIDERED “ACTUAL DELIVERY”?

Absolutely not. As previously emphasized, registration is the crux of the Commission’s ability to protect investors. The proposed rulemaking states that “[w]ithout the application of CEA section 2(c)(2)(D), retail market participants that transact on platforms offering speculative transactions in virtual currency (involving margin, leverage, or other financing) will not be afforded many of the protections that flow from registration under the CEA.”^{vii} Those investor protections are precisely why the registration requirements of section 2(c)(2)(D) are so very important.

The Commission would be making an extremely grave error if it interpreted any particular technical definition of lien termination *on a margin trading platform* to be grounds for exemption from registration. As the Commission is well aware from long experience with other commodity interests, forced liquidation of a trading position, typically due to insufficient margin after a market movement, is often the mechanism by which leverage results in permanent customer losses. Using the timing of a margin loan termination as the basis for exempting a margin trading platform from registration would also potentially undermine the Commission’s oversight of retail forex firms.

As to hypothetical alternative characterizations of a broker’s or exchange’s security interest in a margin account, it is difficult to imagine any entity extending credit to retail customers for the purchase of commodity interests without a satisfactory claim on the customer’s collateral. The Commission should be on guard against proposed “lien scenarios” that lack economic purpose or serve only to circumvent registration requirements. As Example 4 already makes clear, the Commission should not consider, *e.g.*, an automatic liquidation of a margin-financed position at 27 days and 23 hours to be “actual delivery” of a financed retail transaction, since the full amount of the purchase (including the financed portion) was never delivered.

Q8. WHAT OTHER EXAMPLES ADDRESS THE STATUS OF “TITLE”?

With respect to both bucket shops and “batching” discussed earlier, a transfer to one customer’s “exchange wallet” from a counterparty principal or another customer’s “exchange wallet” may represent a book-entry at the intermediary exchange that is not immediately reflected on the blockchain for the commodity in question. The Commission should consider whether a customer holds actual title to the commodity prior to the memorialization of the transaction on the relevant public ledger.

Q9. HOW DOES THE RULEMAKING INTERSECT WITH SEC JURISDICTION?

As recently observed by the Honorable Jack B. Weinstein in *CabbageTech*, “[t]he jurisdictional authority of CFTC to regulate virtual currencies as commodities does not preclude other agencies from exercising their regulatory power when virtual currencies function differently than derivative commodities.”^{viii} For many entities engaged in the trade of virtual currencies, registration with both the Commission and the Securities and Exchange Commission is necessary, but that is not an unreasonable outcome. It is already standard practice for many broker-dealers, investment managers like Cable Car, and other financial intermediaries to register with the Commission as well as a state or national securities authority. Furthermore, as Skadden observed in a primer last year, “[i]t is well established that some instruments can be both commodities and securities. The CEA and federal securities laws have provisions that effectuate CFTC and SEC agreements on how jurisdiction is to be allocated when a security is the subject of a futures contract, option or swap.”^{ix}

It may, therefore, become necessary for the Commission and the SEC to reach agreements determining the nature, and governing the treatment of, certain digital assets, whose status as a commodity or security may currently be subject to uncertainty. That the determination of which digital assets fall into which category continues to evolve, as well as the fact that the SEC has jurisdiction over securities, should not preclude the Commission from developing a robust framework for financed retail commodity transactions. Whether the products of coin offerings are securities is determined not only “depending on their use” as posited in the proposed rulemaking, but also based on what investors were “led to expect” and other factors indicative of an investment contract. Cable Car respectfully submits that the default presumption for the new issuance of a financing instrument by a business, following long-established market practice, should be that it is a security. That this would result in many digital assets falling outside the Commission’s jurisdiction would present a concern only if the SEC were unable to provide the requisite investor protection.

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Thank you again for the opportunity to comment.

Sincerely,

Jacob Ma-Weaver
Managing Member
Cable Car Capital LLC

ⁱ See Steptoe & Johnson LLP, “Petition for Rulemaking Concerning the Requirements of “Actual Delivery” and the Transfer of Ownership under the Commodity Exchange Act in the Context of Cryptocurrency Markets Utilizing Blockchain for Executing Transactions” (July 1, 2016) available at [https://poloniex.com/press-releases/2016.10.18-Our-request-for-no-action-relief/Steptoe-Petition-for-CFTC-Rulemaking-\(07-01-2016\).pdf](https://poloniex.com/press-releases/2016.10.18-Our-request-for-no-action-relief/Steptoe-Petition-for-CFTC-Rulemaking-(07-01-2016).pdf).

ⁱⁱ See Poloniex, “Request for No-Action Relief from the Commodity Exchange Act Section 2(c)(2)(D)” (October 18, 2016), available at [https://poloniex.com/press-releases/2016.10.18-Our-request-for-no-action-relief/Poloniex-No-Action-Relief-Request-\(10-18-2016\).pdf](https://poloniex.com/press-releases/2016.10.18-Our-request-for-no-action-relief/Poloniex-No-Action-Relief-Request-(10-18-2016).pdf).

ⁱⁱⁱ *Flaxman v. Commodity Futures Trading Comm’n*, 697 F.2d 782, 787 (7th Cir. 1983) (quoting *Commodity Futures Trading Comm’n v. British Am.*, 560 F.2d 135, 139-40 (2d Cir. 1977)).

^{iv} See Izabella Kaminska, FT Alphaville, “The currency of the future has a settlement problem” (May 17, 2017), available at <https://ftalphaville.ft.com/2017/05/17/2188961/the-currency-of-the-future-has-a-settlement-problem/>.

^v See 15 U.S.C. Section § 78bb(a)(3).



^{vi} *Flaxman v. Commodity Futures Trading Comm'n*, 697 F.2d 782, 787 (7th Cir. 1983) (quoting *Commodity Futures Trading Comm'n v. British Am.*, 560 F.2d 135, 139-40 (2d Cir. 1977)).

^{vii} 82 FR 60335.

^{viii} Memorandum & Order, *Commodity Futures Trading Comm'n v. Patrick K. McDonnell and CabbageTech Corp., d/b/a Coin Drop Markets*, 18-cv-361 (March 6, 2018), available at

<http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoindroporder030618.pdf>.

^{ix} See Adrian J. S. Deitz, *et al.*, Skadden, Arps, Slate, Meagher & Flom LLP, “Frequently Asked Questions on Virtual Currency and CFTC Jurisdiction” (November 15, 2017) available at

https://www.skadden.com/insights/publications/2017/11/faqs_on_virtual_currency_and_cftc_jurisdiction.

