

Consumer Advocacy and Financial Regulation Organization

March 20, 2018

Via Electronic Submission

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

Re: Proposed interpretation of “actual delivery” and the Commission's treatment of virtual currency transactions (RIN 3038-AE62)

Dear Mr. Kirkpatrick,

The Consumer Advocacy and Financial Regulation Organization (CAFRO), a group of students at the University of Michigan Law School, appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (CFTC) regarding the proposed interpretation of “actual delivery” and the CFTC's treatment of virtual currency transactions.

CAFRO urges a forward-looking approach for promulgating regulations on virtual currency. Given the rapidly evolving and unpredictable nature of the fintech space, definitions of “commodity,” “actual delivery,” and “control” could result in unintended restriction of the CFTC’s authority over virtual currency if these terms are construed too narrowly. However, regulators should also be wary about constraining invaluable fintech innovation. If definitions do not provide adequate guidance for compliance, developers may be overly cautious and the CFTC regulations might hinder growth. While finding this balance is challenging, CFTC regulators may benefit from considering potential future paths of virtual currency.

CAFRO offers two questions regarding foreseeable forms of virtual currency and CFTC oversight. The first relates to the possible development of government-backed cryptocurrencies. The second relates to a potential hybrid commodity-security virtual currency.

1. How will the CFTC regulate virtual currency that is adopted by foreign countries and traded off the exchange on a leveraged or margined basis?

An important factor the CFTC has used to distinguish virtual currency from real currency is that virtual currency “does not have legal tender status in any jurisdiction.”¹ However, some countries are considering instituting national cryptocurrencies that would satisfy this factor. For example, Sweden’s central bank is contemplating a blockchain based “e-Krona.”²

¹ Complaint at 3, CFTC v. McDonnell, No. 18-CV-361, 2018 WL 1175156 (E.D.N.Y. 2018); *See also* In re Coinflip Inc., CFTC No. 15-29, 2015 WL 5535736 (Sept. 17, 2015); *See also* I.R.S. Notice 2014-21 (Mar. 25, 2014) (“Virtual currency is a digital representation of value but it does not have legal tender status in any jurisdiction”).

² Lee Roden, *Sweden Predicted to Become the First Country with Own Cryptocurrency*, THE LOCAL (Jan. 15, 2018), <https://www.thelocal.se/20180115/sweden-predicted-to-become-first-country-with-own-cryptocurrency>.

Low transaction costs, the ability to overcome geographical barriers to bank access, and other benefits³ are likely to encourage more countries to consider adopting a virtual currency. Similar perks have already incentivized countries, including Ecuador and Senegal, to experiment with digital currencies.⁴

We have already seen examples of virtual currency being used in a manner similar to FOREX trading. Trading in foreign currency is sometimes used to safeguard against volatility in one's domestic currency. In 2017, hyperinflation caused some Venezuelans to turn to bitcoin.⁵ Though Ecuador and others have banned the use of bitcoin, some countries may embrace trades where their virtual currency of "legal tender status" is exchanged for virtual currency of "commodity status." Such transactions could lead to a Foreign Exchange market where government-backed virtual currencies and commodity virtual currencies and are considered, virtually, substitutes.

The CFTC's definition of "actual delivery" and the 2-day delivery requirement for exempting FOREX transactions should retain some flexibility to account for the evolving role of virtual currency.

2. How will the CFTC coordinate or divide jurisdiction with the SEC for cryptocurrencies that may be characterized as both commodities and securities?

A challenge in regulating cryptocurrencies may arise if certain coins or tokens cannot be easily categorized as either commodities or securities. The CFTC has brought enforcement against virtual currency under the authority that "where a futures market exists for a good, service, right, or interest, it may be regulated by the CFTC without regard to whether the dispute involves futures contracts."⁶ The SEC has also brought enforcement actions against allegedly fraudulent Initial Coin Offerings (ICOs).⁷ The SEC uses the Howey test⁸ to determine whether or not an instrument is a security.⁹

³ See Jay Clayton, Chairman SEC, Public Statement, Statement on Cryptocurrencies and Initial Coin Offerings (Dec. 11, 2017), ("Although the design and maintenance of cryptocurrencies differ, proponents of cryptocurrencies highlight various potential benefits and features of them, including (1) the ability to make transfers without an intermediary and without geographic limitation, (2) finality of settlement, (3) lower transaction costs compared to other forms of payment and (4) the ability to publicly verify transactions. Other often-touted features of cryptocurrencies include personal anonymity and the absence of government regulation or oversight.") <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11>.

⁴ Amelia Heathman, *Move Over Bitcoin, These Countries Are Creating Their Own Digital Currencies*, VERDICT (Sept. 27, 2017), <https://www.verdict.co.uk/bitcoin-countries-digital-currency/>.

⁵ Rene Chun, *Big in Venezuela: Bitcoin Mining*, THE ATLANTIC (Sept. 2017), <https://www.theatlantic.com/magazine/archive/2017/09/big-in-venezuela/534177/>.

⁶ CFTC v. McDonnell, No. 18-CV-361, 2018 WL 1175156, at *11 (E.D.N.Y. 2016); See also *In re Coinflip Inc.*, CFTC No. 15-29, 2015 WL 5535736 (Sept. 17, 2015).

⁷ See, e.g., Press Release, Securities and Exchange Commission, SEC Halts Alleged Initial Coin Offering Scam (Jan. 30, 2018) <https://www.sec.gov/news/press-release/2018-8>.

⁸ SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

⁹ See, e.g., Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81,207, at 11 (July 25, 2017).

The reason for this shared jurisdiction over virtual currencies rests on the fact that some coins or tokens are functional for use on an app or as means of payment,¹⁰ while others may function more like an investment in an underlying asset or business venture.¹¹ However, there is not always a bright line. Howey only determines whether something is an investment contract and presumably has no bearing on whether something is a commodity. Where cryptocurrencies simultaneously serve both functional/commodity purposes and investment purposes, how will the CFTC and SEC divide regulatory jurisdiction?

This may be an area where it is important to either draw a clear line separating CFTC and SEC jurisdiction or explicitly state intent for shared jurisdiction over virtual currency. The CEA expressly exempts securities.¹² When a token, like the above hybrid example, meets the criteria of both a security and a commodity, it is both within and outside the jurisdiction of the statute. This is inherently confusing. Prioritization of certain characteristics as distinctive for CFTC/SEC jurisdiction would provide clarity and allow businesses to predict what laws are applicable to them.

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¹⁰ Phil Glazer, *The Different Categories of Cryptocurrencies*, HACKERNOON (Jan. 31, 2018) <https://hackernoon.com/the-different-categories-of-cryptocurrencies-a57ba4d77c9a>.

¹¹ See Jay Clayton, *supra* note 3.

¹² 7 U.S.C. § 2(c)(2)(D)(ii)(II)