



March 20, 2018

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

Re: Retail Commodity Transactions Involving Virtual Currency (RIN 3038-AE62)

Dear Mr. Kirkpatrick:

Gemini Trust Company, LLC (“Gemini” or “we”) submits this letter in response to the notice of proposed rulemaking published by the Commodity Futures Trading Commission (the “CFTC” or the “Commission”) regarding the proposed interpretation of “actual delivery” in the context of transactions in virtual currencies, under Rule 2(c)(2)(D)(ii)(III)(aa)¹ of the CFTC under the Commodity Exchange Act (the “CEA”)² (the “Proposal,” or the “proposal”).³ The Proposal implicates several important considerations in the evolving landscape of virtual currency regulation, specifically the treatment of virtual commodities, and whether the Commission should employ a distinct regulatory and compliance regime for entities offering retail commodity transactions in virtual commodities (“Retail Virtual Commodity Transactions”), which entities should qualify as virtual commodity exchanges⁴ and virtual commodity depositories, and how the Commission’s oversight of virtual commodity markets should interact with that of other regulatory agencies, including the Securities and Exchange Commission.

As the Commission noted in the Proposal, the CFTC does not have jurisdiction over spot commodity transactions. However, Gemini appreciates the opportunity to comment on these important questions, which will have significant implications for the stability of the virtual commodity markets and protection of virtual commodity market participants.

¹ 7 U.S.C. § 2(c)(2)(D)(ii)(III)(aa).

² 7 U.S.C. §§ 1-27f.

³ *Retail Commodity Transactions Involving Virtual Currency*, 82 Fed. Reg. 60335 (Dec. 20, 2017).

⁴ All references to “exchanges” in this letter, unless otherwise specified, refer to offerors of Retail Virtual Commodity Transactions, and should be distinguished from Designated Contract Markets (also known as DCMs), which are subject to CFTC oversight pursuant to 7 U.S.C. § 7.

Gemini's Interest in the Proposal

Gemini operates a virtual commodity exchange, acts as a custodian of virtual commodities, and provides related services for its customers. Gemini is a New York trust company regulated by the New York Department of Financial Services (“NYDFS”). We are a fiduciary under §100 of the New York Banking Law (the “NYBL”) and are subject to the capital reserve requirements, cybersecurity requirements, and banking compliance standards as set forth by the NYDFS and the NYBL.⁵

In our role as a virtual commodity exchange operator, Gemini provides data to virtual commodity market participants to increase transparency into the virtual commodity markets. Gemini entered into a licensing agreement with the Cboe Futures Exchange, LLC (“CFE”) in July of 2017, which allowed CFE to launch the first-ever Bitcoin (USD) futures contract on December 10, 2017 under the ticker symbol “XBT.” XBT futures are cash-settled contracts based on Gemini's auction price for bitcoin denominated in U.S. dollars. In addition, Gemini entered into an information sharing agreement (the “Information Sharing Agreement”) with the CFE and other Cboe Global Markets, Inc. (“Cboe”) trading venues, which allows CFE to monitor the Gemini virtual commodity spot market and perform cross-market surveillance to detect and deter any fraudulent and manipulative acts and practices, including with respect to XBT futures.

Gemini monitors regulatory developments affecting the trading of virtual commodities and continuously seeks to stabilize and enhance the security of the virtual commodity markets. Therefore, Gemini appreciates and supports the CFTC's efforts to address the safe and efficient trading of virtual commodities and clarify its virtual commodity regulatory framework. We believe actual delivery is an important concept that needs to be further defined due to the new and unique features of virtual commodities — namely the concept of “full control” and the non “physical” nature of virtual commodities.

The following comments address many of the specific questions on which the Commission requests comments in the Proposal. We wish to note at the outset the following key points of our comments, each of which is discussed in more depth below:

- The Commission correctly has not undertaken to regulate offerors of retail commodity transactions in physical commodities. The non-physical nature of virtual commodities should not change this outcome. The Commission should treat Retail Virtual Commodity Transactions as it treats retail commodity transactions in physical commodities, with the exception of shortening the delivery period for virtual commodities to reflect market practices.

⁵ N.Y. Banking Law § 100.

- An onerous regulatory regime for Retail Virtual Commodity Transactions could stifle innovation in the virtual commodity markets and impose an undue financial and regulatory burden on virtual commodity market participants.
- However, virtual commodity exchanges on which retail customers trade should be subject to some minimum level of regulation by the states, or other oversight bodies, as discussed further below.
- The Commission should not expand the definition of “depository” in the context of Retail Virtual Commodity Transactions. Depositories, as defined in the CEA, are regulated institutions whose compliance regimes are focused on safeguarding customer assets, which is crucial to protecting retail consumers in times of high volatility and uncertainty.
- The Commission should continue to distinguish virtual commodities from tokens built “on top of” blockchains that may be securities under the federal securities laws (*i.e.*, “security tokens,” which may be issued via initial coin offerings (“ICOs”)).

A 28-Day Delivery Window is Unnecessary and Risky

Gemini believes a 28-day delivery window for virtual commodity transactions is unnecessarily long, does not reflect market practices, and may give rise to fraudulent activity. We appreciate that section 2(c)(2)(D) of the CEA requires delivery within a 28-day delivery window, and that the CFTC has not adopted any regulations permitting a longer or shorter actual delivery period. Nonetheless, CEA section 2(c)(2)(D)(ii)(III)(aa) exempts from CFTC jurisdiction any contract that “results in actual delivery *within* 28 days or such other longer period as the Commission may determine.”⁶ We do not read the statute as *requiring* a 28-day delivery window, but rather permitting a delivery window *up to* 28 days (or a longer period determined by the Commission). It is clear that Congress intentionally and expressly included the word “within” to allow the Commission to create delivery windows of lesser duration. We therefore believe that the CFTC currently has statutory authority to adopt a shorter delivery window.

As a preliminary matter, the 28-day delivery window of CEA section 2(c)(2)(D) was developed for physical commodity markets, such as precious metals — a context in which an extended delivery period makes more sense.⁷ Although physical commodities can be, and often are, delivered within shorter time frames, the variety of participants and transactions, and the

⁶ 7 U.S.C. § 2(c)(2)(D)(ii)(III)(aa) (emphasis added).

⁷ We note that several states have shortened the delivery window for retail commodity transactions provided by the Model State Commodity Code, even for physical commodities. The Model State Commodity Code contemplates a lengthening *or shortening* of the statutory delivery window to reflect market practices for different commodities. Model State Commodity Code § 1.01. In order to better reflect market practices, several states, such as Maine, Georgia and Idaho have reduced the delivery window to seven days. See 32 M.R.S.A. § 11204 (Maine), Ga. Code Ann., § 10-5A-4 (Georgia) and I.C. § 30-1504 (Idaho).

potential need to transport the commodities, were factors in the establishment of a longer settlement period. In the context of virtual commodity transactions, in contrast, physical delivery is done electronically, and nearly (or actually) in real-time, and therefore an extended delivery window is unnecessary.

In addition, a 28-day delivery window could promote regulatory uncertainty, as a 28-day delivery window could allow for rolling spot transactions, *i.e.* multiple transactions could be completed within the delivery window. Such rolling spot transactions are regulated by the Commission as swap transactions, pursuant to CEA section 2(h).⁸

Furthermore, a longer settlement period increases the risk of fraud, intervening defaults by market participants, operational failures, and other problems that could result in losses by customers. In light of the nature of the virtual commodity markets, and particularly the absence of a need for an extended settlement period, there is no reason to subject customers to such risks.

Given the statutory permissibility of a shorter delivery window, we encourage the CFTC to require settlement within a shorter delivery period, absent some extraordinary circumstance, for all virtual commodity transactions, including Retail Virtual Commodity Transactions. If the CFTC chooses to redefine the delivery window for Retail Virtual Commodity Transactions, Gemini believes a 1-day window appropriately reflects the standard delivery time for spot transactions in virtual commodities.

The Commission Should Limit Conflicts of Interest

Gemini shares the Commission's concerns discussed in Question 3 of the Proposal, regarding conflicts of interests of offerors of Retail Virtual Commodity Transactions. We believe that offerors (or principals of offerors) of Retail Virtual Commodity Transactions (*i.e.*, exchanges and other offerors) generally should not take the opposite side of a participant transaction, either directly or through an affiliated liquidity provider or market maker. Allowing an exchange operator to take the opposite side of participant transactions may create incentives to influence prices and/or trading volumes as offerors would operate with an informational advantage with respect to its participants. A virtual commodity exchange operator could post multiple bids and offers in a manner designed to manipulate prices in a manner that is favorable to the offeror and adverse to market participants. To illustrate, the offeror on the opposite side of multiple customer transactions could sell at the highest bids and buy at the lowest asks, and subsequently resell at normalized and efficient market prices, thereby extracting a spread from its customers. In contrast to a system in which exchanges exclusively match bids and offers, a system which allows an offeror to take the opposite side of a participant transaction could promote this type of market manipulation, and ultimately undermines the confidence and stability of virtual commodity markets more broadly.

⁸ See 7 U.S.C. § 2(h).

The Commission Should Treat Retail Virtual Commodity Transactions like Retail Physical Commodity Transactions

The Commission should treat Retail Virtual Commodity Transactions in the same manner as physical commodity transactions under CEA section 2(c)(2)(D). Gemini believes that it would be costly and burdensome to market participants, and would stifle the growth of these markets, if the CFTC imposed a new regulatory regime on Retail Virtual Commodity Transactions. As CFTC Chairman Giancarlo explained before the Senate Banking Committee on February 6, 2018, the CFTC is an experienced regulator of the commodities markets and need not expand its regulatory authority to virtual commodity spot markets — “such an extension of regulatory authority would be a dramatic expansion of the CFTC’s regulatory mission.”⁹

In 2015, the Commission concluded that bitcoin and other virtual commodities are encompassed in the definition of “commodity” under section 1a(9) of the CEA.¹⁰ Nonetheless, other than the prosecution of fraud and manipulation in the spot markets underlying commodity futures and swaps, the Commission does not have jurisdiction to regulate cash or spot market commodity transactions. There is no basis for treating virtual commodities in a manner that is different from other commodities purchased and sold by retail investors. And, regulation of spot virtual commodity transactions would require significant CFTC resources, thereby diverting resources from other regulatory priorities, in an area never regulated by the CFTC.

Minimum requirements for offerors of Retail Virtual Commodity Transactions already exist in the form of state regulatory requirements. States have imposed certain requirements on virtual commodity exchanges in order to ensure that only reputable and creditworthy entities are able to offer services in connection with virtual commodities. The CFTC should continue to allow states to regulate offerors of virtual commodities, as state regulations already generally prohibit an unlicensed offeror (*i.e.*, an unlicensed exchange) to interact directly with retail participants, absent some form of regulation. We believe that New York State licensing requirements for virtual commodity offerors, as discussed further below, exemplify the minimum requirements to

⁹ *Written Testimony of Chairman J. Christopher Giancarlo before the Senate Banking Committee*, February 6, 2018, available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo37>. Note that the Office of the Comptroller of the Currency (OCC) in October 2016 announced plans to implement a framework for special purpose national bank charter for financial technology companies. See OCC, *Exploring Special Purpose National Bank Charters for Fintech Companies*, December 2016, available at <https://www.occ.gov/topics/responsible-innovation/comments/special-purpose-national-bank-charters-for-fintech.pdf>. To date, the OCC has finalized or accepted applications for such charters.

¹⁰ *In re Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan*, CFTC Docket No. 15-29 at 3 (September 17, 2015). The Commission’s characterization of bitcoin and other virtual currencies as “commodities” under the CEA was affirmed by the Eastern District of New York on March 6, 2018. *Commodity Futures Trading Comm’n v. McDonnell*, No. 18-CV-361, 2018 WL 1175156, at *1 (E.D.N.Y. Mar. 6, 2018).

which a Retail Virtual Commodity Transactions offeror should be subject.¹¹ Outside of New York, states generally require virtual commodity exchanges to obtain money transmitter licenses before offering virtual commodities for sale. In addition, several states (Georgia, Illinois, Kansas, Massachusetts, Tennessee, Texas, and Washington) have collaborated to create a streamlined money transmitter licensing procedure to allow market participants to obtain money transmitter licenses that will facilitate standardized licensing and oversight of virtual commodities. This development demonstrates the manner in which states can simultaneously provide proper oversight of virtual commodity markets and encourage new participants to enter the virtual commodity markets by streamlining regulatory requirements between states.

Given that New York and other states have already imposed robust regulatory requirements on offerors of Retail Virtual Commodity Transactions, it would be unnecessarily costly, burdensome and duplicative for both the Commission and virtual commodity market participants if the Commission imposed an additional, federal regulatory regime to oversee virtual commodity markets. It would also impose on the Commission additional regulatory responsibilities that would require diversion of CFTC resources. Therefore, we believe that the Commission should not take steps to impose regulation that would duplicate the various state regulatory programs that already apply to virtual commodity exchanges. In addition to — and more important than — the foregoing, we understand that multiple regulators¹² have called for and would support self-regulation in this industry, and we similarly believe that responsible self-regulation is an efficient tool that exchanges can use to police virtual commodity markets.

In addition to existing state regulation, the establishment of a virtual commodity self-regulatory organization (“SRO”) would provide another layer of oversight over virtual commodity exchanges and further obviate any need for CFTC regulation of spot virtual commodity markets. On March 13, 2018, Gemini published a proposal for the Virtual Commodity Association (the “VCA”), which would be an industry-sponsored SRO for U.S. virtual commodity exchanges and custodians.¹³ The VCA will be a non-profit, independent regulatory organization that will not operate any market, but will serve to:

¹¹ The NYSDFS requires virtual commodity exchanges to submit detailed applications, maintain sophisticated cybersecurity policies, produce annual cybersecurity reports and undergo annual audits, maintain adequate capitalization, disclose risks of trading and comply with anti-fraud provisions, among other regulations. These types of requirements ensure that virtual commodity exchanges are safe, adequately capitalized and subject to sufficient oversight to both protect investors' assets and promote stability in the virtual commodity markets.

¹² See *Opening Statement of Commissioner Brian Quintenz before the Technology Advisory Committee*, February 14, 2018, available at <http://www.cftc.gov/PressRoom/PressReleases/quintenzstatement021418>.

¹³ See <https://gemini.com/blog/a-proposal-for-a-self-regulatory-organization-for-the-u-s-virtual-currency-industry/>.

- Foster financially sound, responsible, and innovative virtual commodity markets through a system of industry-sponsored standards, sound practices, and oversight that promotes price discovery, efficiency, and transparency.
- Incentivize the detection and deterrence of manipulative and fraudulent acts and practices, including partnering with regulators and particularly the CFTC, to share or refer information.
- Require member firms to commit in writing, upon joining the VCA, to operate their virtual commodity markets in compliance with a set of sound practices, which include: (a) establishing a transparent program of financial responsibility and controls; (b) providing appropriate transparency regarding bids, offers, executions, and other relevant data to the public and adopting policies to avoid conflicts of interest; (c) maintaining and enforcing a system of marketplace conduct rules; (d) implementing and maintaining sound practices with respect to cybersecurity, information security, and recordkeeping; (e) monitoring and surveilling markets to detect and deter (and where appropriate, discipline) manipulative and fraudulent acts and practices; (f) entering into information sharing agreements with other members of the VCA for purposes of marketplace surveillance; (g) reporting instances of manipulative and fraudulent conduct to the CFTC and other regulators, as appropriate; and (h) performing proper diligence and legal analysis when determining the legal status of a virtual commodity for listing and trading in order to avoid listing and trading security tokens, unless the member has obtained necessary licenses for security tokens.

We believe that the development of industry self-regulation in the virtual commodity markets will further enhance the integrity of the markets and the protection of its participants. We urge the Commission to support and facilitate this effort and to look to industry self-regulatory efforts, in addition to state regulation, as the principal means of overseeing the virtual commodity markets.

Financial Institutions Should Remain the Exclusive Entities Eligible to Serve as Depositories

Gemini believes the definition of depositories for purposes of the CEA and CFTC rules should continue to be limited to “financial institutions” as defined by CEA section 1a(21). This definition includes banks, savings associations, trust companies, and “depository institutions,” which, per 12 U.S.C. 1813(c)(1), means any bank or savings association. Trust companies, such as those regulated by the NYDFS as limited purpose trust companies, are subject to requirements similar to those applicable to a bank subject to state banking laws.

Gemini, as a limited purpose trust company, has fiduciary powers under the NYBL. Pursuant to its charter, Gemini holds fiat currency (currently U.S. Dollars) for the benefit of Gemini's customers in an omnibus account maintained at one or more depository institutions insured by

the Federal Deposit Insurance Corporation. Gemini also provides segregated and omnibus custody services for virtual commodities to its customers.

Many states have recognized the value and regulatory scrutiny placed on trust companies and have therefore created exemptions from state money transmitter licensing requirements for limited purpose trust companies, but have not created similar exemptions for firms with a Bitlicense. A Bitlicense or a money transmission license does not confer fiduciary powers. Therefore, an entity with a NYSDFS Bitlicense (or equivalent) or an entity with a money transmission license should not qualify as an authorized depository on that basis alone. Historically, the CFTC and other regulators have relied on the regulatory regime governing financial institutions, as depositories, to protect customer assets for physical commodity transactions. We believe that the CFTC should continue to rely on these existing regulatory schemes for virtual commodities.

Possession of Requisite Private Keys Should Constitute “Full Control”

Question 6 of the Proposal requests comments on the meaning of “full control” of virtual commodities. Gemini believes that possession of a private key, or in some instances multiple private keys or other credentials, necessary for the transfer of the virtual commodity should be sufficient to constitute full control. The Proposal notes that a customer obtains “full control” over virtual commodities when it has the ability to “immediately remove the full amount of the purchased commodity from the depository.”¹⁴ Depositories often establish omnibus accounts for their customers, through which they pool customers' assets and then credit portions of those assets to a particular customer's account on their own books and records.

Gemini maintains a similar system through which we pool customers' virtual commodities into an omnibus account, record each customer's balance on our internal ledger, and credit each customer's portion of virtual commodities to the individual customer's respective account. Only Gemini maintains the private keys necessary to transfer the virtual commodities. Only the customer has the necessary credentials to access his or her account and request a transfer of his or her virtual commodities on demand. Gemini first authenticates the customer's request before initiating a transfer. Only with the consent of Gemini can a transfer be made. In our view, only Gemini has “full control” — defined as the ability to transfer virtual commodities without the consent of any other parties, and the ability to preclude any other parties from doing so.

The custody system employed by Gemini serves to protect Gemini's customers' assets and virtual commodity markets more broadly: Gemini has established a system of internal controls that safeguards private keys. In addition, Gemini's authentication of customer withdrawal requests provides an additional layer of security to limit unauthorized access to customer accounts. And, importantly, this system does not deprive Gemini's customers of control of their virtual commodities; customers may still withdraw their virtual commodities on demand, by

¹⁴ 82 Fed. Reg. 60340.

instructing Gemini to transfer such commodities. This is, in effect, no different from the manner in which other custody relationships are maintained in the financial markets. The owner of the assets has the right to instruct its custodian to make transfers on demand, but the action of the custodian is necessary in order to complete the transfer.

Internal Ledger Adjustments Constitute Transfer of Title only for Financial Institutions

Gemini believes that account balances reflected on the internal ledger of a depository should continue to be sufficient to constitute transfers of title for Retail Virtual Commodity Transactions. Therefore, book entries reflecting transfers *within* a depository — between an offeror and an offeree — should constitute actual delivery within the meaning of the Proposal. This type of internal transfer reflects the current framework of the virtual commodity market and is analogous to current market practices for physical commodity transactions.

However, internal transfers (book entries) should only be permissible at depositories; non-depositories, such as offerors with a Bitlicense or a money transmitter license, should be required to actually transfer virtual commodities on blockchain to transfer title. As mentioned above, Gemini maintains an internal ledger which credits assets held within an omnibus account to individual customer accounts. Gemini's customers may immediately withdraw funds that have been credited to their accounts on the internal ledger, even when those assets are held in an omnibus account at the time of the withdrawal request. Regulators have historically recognized depositories' ability to affect transfers in this manner because the heightened regulatory oversight required of depositories limits the potential for abuse and/or losses in these internal transfers. Non-depositories are not subject to the same level of oversight or regulatory scrutiny and therefore should not be allowed to make internal transfers to effect title transfers.

Status Under Securities and Commodities Laws

Gemini believes that the Commission should continue to distinguish virtual commodity tokens and security tokens when assessing whether a virtual currency, including but not limited to those issued via an ICO, is subject to CFTC or SEC jurisdiction.

In a typical ICO, a portion of the new virtual commodities is allocated to investors in exchange for fiat currency or other virtual commodity. While ICOs represent a new funding method utilizing a virtual commodity, the SEC has made clear that the analysis of whether the coins issued in ICOs are securities involves the application of longstanding securities law: In determining whether a given token is a security, the SEC has traditionally been guided by the *Howey* test, which holds that an “investment contract” — defined as “an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others” — is a security.¹⁵ The application of this longstanding and

¹⁵ *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946). See also *Munchee Inc.*, SEC Securities Act Release No. 10445 at 8, File No. 3-18304 (Dec. 11, 2017).

well-understood test promotes regulatory certainty, and therefore Gemini believes the Commission should not change its current thinking on the application federal securities laws to ICOs.

Some ICOs meet the elements of the *Howey* test, and, therefore are securities. SEC Chairman Jay Clayton stated in July 2017 that he had “yet to see an ICO that does not have a sufficient number of hallmarks of a security.”¹⁶ Certain virtual commodity offerings, however, are not investment contracts under the *Howey* test and such offerings should be treated as exempt commodities or virtual commodities similar to Bitcoin.¹⁷ Examples include ether, which is the token of the Ethereum network.

It is important that the CFTC continue to distinguish virtual commodities from security tokens and allow virtual commodities to continue to trade on virtual commodity exchanges. Notwithstanding the plethora of security tokens, which have recently been offered that are subject to the federal securities laws, virtual commodities such as bitcoin and ether are exempt commodities under the CEA and have been trading on licensed virtual commodity exchanges in compliance with the rules and regulations of the CFTC for many years.

Conclusion

Gemini appreciates the opportunity to comment on the Proposal. We would be pleased to offer our assistance to the Commission in elaborating on any of the issues addressed in this letter.

Sincerely,



Cameron Winklevoss
President
Gemini Trust Company, LLC



Tyler Winklevoss
CEO
Gemini Trust Company, LLC

¹⁶ See Dave Michaels and Paul Vigna, *SEC Chief Fires Warning Shot Against Coin Offerings*, Wall Street J., Nov. 9, 2017, available at <https://www.wsj.com/articles/sec-chief-fires-warning-shot-against-coin-offerings-1510247148>.

¹⁷ *In re Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan*, CFTC Docket No. 15-29 (September 17, 2015).