CONSENSYS

March 20, 2018

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

RE: Proposed Interpretation of Retail Commodity Transactions Involving Virtual Currency

Ladies and Gentlemen,

On December 20, 2017, the Commodity Futures Trading Commission (**CFTC**) published in the Federal Register a Proposed Interpretation of Retail Commodity Transactions Involving Virtual Currency (**Proposal**).[1] We appreciate the opportunity to comment on the Proposal.

I.   WHO WE ARE

ConsenSys AG (**ConsenSys**) is a venture production studio that specializes in building decentralized applications, enterprise solutions and various developer tools for blockchain ecosystems, focused primarily on Ethereum. In addition to our venture production studio, our consulting arm helps developers build, test and deploy blockchain solutions worldwide. Our educational arm is dedicated to bridging the knowledge gap to foster the development of the global blockchain ecosystem.

In collaboration with The Cardozo Law School Blockchain Project, ConsenSys also leads The Brooklyn Project (**BKP**), an industry-wide initiative to promote a responsible and consumer-friendly virtual token economy. BKP is an open and transparent initiative that encourages market participation. We are currently collaborating with approximately 1,000 participants, who represent a broad cross-section of the players in blockchain and the crypto markets (including, but not limited to, lawyers, regulators, developers, entrepreneurs, consumers and enthusiasts). BKP is developing thought-leadership, best practices and technical solutions, all with the goal of ensuring that the industry matures in a way that allows blockchain technology and tokenization to achieve their full potential while also protecting and empowering consumers.

We wish to note, that our broad industry network has had an opportunity to provide feedback on the Proposal, discuss concerns and evaluate potential solutions. We have endeavored to incorporate that feedback into the views represented here.

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[1]   Retail Commodity Transactions Involving Virtual Currency, 82 Fed. Reg. 60335 (Dec. 20, 2017), *available at* https://www.gpo.gov/fdsys/pkg/FR-2017-12-20/pdf/2017-27421.pdf (**Proposal**).

II.   EXECUTIVE SUMMARY

Under Section 2(c)(2)(D) of the Commodity Exchange Act, as amended (**CEA**), the CFTC has explicit oversight authority over all leveraged, margined or financed retail commodity transactions (**Retail Commodity Rules**). The CFTC has long been concerned that certain leveraged or margined retail commodity transactions in the cash markets have indicia of futures contracts, which would subject them to regulation by the CFTC. The CFTC's Proposal is an important step to ensuring that consumers are protected from sham deliveries in financed and leveraged virtual currency transactions as well as to ensure against the purchase and sale of off-exchange virtual currency futures contracts. However, we believe that if finalized without further modification, the Proposal would significantly stifle innovation of blockchain technology and related virtual token projects.[2]

The Proposal should be modified to accommodate for the unique technological nature of blockchain technology. There are important characteristics of virtual tokens and the current storage solutions for which the Proposal should account. First, not all virtual tokens are transferable. For example, a developer may legitimately limit the transferability of a particular token to ensure that the virtual token is not resold to speculators until the platform has achieved a desired level of functionality or a developer may create a system in which transferability is not a desired attribute. Second, the current Proposal does not take into consideration the unique nature of multi-signature wallets — often referred to as "**multi-sig**" — a current popular storage solution that requires several key holders to sign off on a transaction before it can be executed. A solution used by the Ethereum Foundation, the security of multi-sig wallets is derived from the fact that no one person or entity has complete authority to execute a transaction on behalf of an account holder. Instead, a set of known rules govern the ability for an account to execute a transaction. Under the current Proposal, it appears that such a system would be at odds with the notion of "full control," despite the retail recipient fully consenting to such a system of shared control as a security feature deployed on their behalf.

We urge the CFTC to modify the Proposal in order for the Proposal to work in harmony with blockchain technology by utilizing flexible definitions of "control" and "use" in order to properly determine "actual delivery." In particular, as further discussed below, we respectfully request that the CFTC consider determinations of control and use from the vantage point of similarly situated virtual currency holders.

Additionally, we also urge the CFTC to reconsider its proposed third-party depository requirement, because this requirement may detrimentally limit the number of available depositories that can receive virtual

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[2]   An important note regarding our use of the terms "virtual currency" and "virtual token" throughout our comments below: The CFTC defines "virtual currency" broadly. Notably, the CFTC states in the Proposal that:

> In the context of this interpretation, virtual or digital currency: Encompasses any digital representation of value (a "digital asset") that functions as a medium of exchange, and any other digital unit of account that is used as a form of currency (*i.e.,* transferred from one party to another, as a medium of exchange); may be manifested through units, **tokens**, or **coins**, among other things; and may be distributed by way of digital "smart contracts," among other structures. . . .

Proposal, 82 Fed. Reg. at 60338 (emphasis added). We use the term "**virtual token**" herein to distinguish (i) virtual currencies that are widely traded and used as a medium of exchange for any number of goods and services (such as Bitcoin and Ether), from (ii) virtual currencies (*i.e.,* virtual tokens) that meet the definition of virtual currency, but the "currency" function of which may be limited to use on the particular project(s) or network(s) for which it was developed. We wish to stress the importance of ensuring that virtual tokens are carefully considered in any finalized interpretation because they have distinguishing features from other mainstream virtual currencies such as Bitcoin and Ether, and are - in our view — a central part of the innovation and growth of the distributed ledger technology. As a result, we have used the term "virtual token" where we wish to stress such consideration.

currency. Instead, the CFTC should modify the Proposal to require robust custodial contractual agreements between buyer and depository.

Finally, we also request that the CFTC expressly clarify that — where a virtual currency spot transaction does not meet the "retail commodity transaction" definition under Section 2(c)(2)(D) of the CEA — any finalized interpretation would not apply in the context of determining whether such virtual currency was delivered in the "spot" or "cash" markets.

III.   OUR COMMENTS

A.   *"Actual Delivery" for Virtual Currencies Should be Determined by "Control" and "Use," Not "Possession."*

The Proposal would require that, in order for "actual delivery" to have occurred within the context of virtual currency (among other requirements), the customer must have the ability to "(i) [t]ake **possession and control** of the entire quantity of the financed commodity and (ii) **use** it freely in commerce (both within and away from any particular platform)" within the 28-day statutory period (**Prong 1**).[3] The current Proposal fails to take into consideration important characteristics of virtual tokens and consumer-friendly storage solutions.

1.   The Proposal (i) Fails to Take Into Consideration That Some Virtual Tokens May Not Be Transferable and (ii) Fails to Accommodate for Consumer-Friendly Multi-Signature Storage Solutions.

First, not all virtual tokens are transferable. For example, a developer may legitimately limit the transferability of (*i.e.,* "lock up") a particular virtual token to ensure that the virtual token is not resold to speculators until the platform has achieved a desired level of functionality, or a developer may create a system in which transferability is not a desired attribute. In such cases, the buyer of the virtual token would agree to such transfer restrictions as a condition to purchase such virtual token. Additionally, there are a number of reasons why third-party networks may never technologically support some virtual tokens — for instance, the network and token economy may still be in nascent stages for any given virtual token / token project, and the virtual token may not have a market beyond the developer platform.

Second, the current Proposal does not take into consideration the unique nature of multi-sig wallets, which (as discussed above) require several key holders' sign-off before executing a transaction and are commonly used in the virtual currency market. In fact, the Ethereum Foundation itself is known to rely on a multi-sig solution to custody the tokens of value held by the Foundation. The security of multi-sig wallets derives from the fact that no one person or entity has complete authority to execute a transaction on behalf of an account holder. Instead, a set of known rules govern the ability for an account to execute a transaction. The most popular arrangement is what is referred to as an "m-of-n" multi-sig where a specific number of signatures out of a total number of eligible signatories is required to sign a transaction. The most popular arrangements are (x) two-of-three or (y) three-of-five signatures, each of which promotes a high degree of probability that if one account is compromised, the entire account cannot be compromised. Such a system is not dissimilar to how we have long recognized access to legacy storage systems like safety deposit boxes, where a box owner sets the rules about who can access the box and the bank validates those rules upon entry. Here, the box is a digital account and the rules are programmable into code instead of being reliant on centralized human systems such as a paper account ledger. Under the current Proposal, it appears that such a system would be at odds with the notion of "control," despite the retail recipient fully consenting to such a system of shared control as a security feature deployed on their behalf.

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3   Proposal, 82 Fed. Reg. at 60339 (emphasis added).

2.   The CFTC Should (i) Eliminate the "Possession" Requirement in Prong 1 and (ii) Evaluate "Use" in the Context of Similarly Situated Virtual Token Holders.

We recommend that the CFTC revise sub-clauses (i) and (ii) of Prong 1 of the proposed guidance in the Proposal to more closely align with market realities in the virtual currency context. We propose the following amendments:

● **Possession and Control.**[4] Regarding sub-clause (i) of Prong 1, we recommend eliminating the "possession" requirement. While the concepts of physical possession or title (*i.e.,* ownership) as distinguished from control of such commodity (*i.e.,* purchase, sell, transfer) may be relevant and important distinct features of determining "actual delivery" in the traditional commodities context, the issue of whether "actual delivery" has occurred in the virtual currency context is based on one factor — whether or not the purchaser has **control**. Indeed, no equivalent to a "title" concept exists in the virtual currency context and, as a result, the requirements of possession in addition to control raises the question as to what additional element must be satisfied.[5] If a buyer is the only person that can execute or restrict the sale, transfer, use or exploitation of a virtual currency — **to the extent such functions are available** for such virtual currency — then "actual delivery" should inherently be satisfied if the buyer acquires such function(s) within 28 days from the date of the transaction.

● **Use.** Because any two given virtual currencies will not necessarily have any one particular set of functionalities in common, any definition or determination of "control" must look to the "use" and then-existing functionalities of such virtual currency for a particular holder of such virtual currency vis-à-vis other similarly situated holders. With regards to sub-clause (ii) of Prong 1, we recommend this sub-clause be reworded as follows:

> "(1)   A customer having the ability to:
>
> […]
>
> (ii)   use such virtual currency in a manner that is consistent with the functionality of the virtual currency available to any similarly situated holder on the date and no later than 28 days from the date of the transaction[.]"

Importantly, the functional approach to defining "use" is captured from the vantage point of other holders at the time of the virtual currency transaction. The reason for this is that virtual currencies are distinct in their features. For instance (and as discussed above under III.A.1), not all virtual currencies are readily transferrable and can be moved from one platform to another as the Proposal would require.[6] Our proposed language would account for this reality, in addition to accommodating the multi-sig functionality that — as noted above — is widely used in the virtual currency space. Notwithstanding this security feature, the virtual token developer may have structured such virtual token so that the holder can still use the virtual token on the token platform

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[4]   With respect to the Proposal, Question 6 requests comment regarding what types of circumstances would ensure a purchaser has obtained "full control" of the virtual currency. *See* Proposal, 82 Fed. Reg. at 60341.

[5]   With respect to the Proposal, Question 8 asks what additional examples the CFTC should consider to address the status of "title" for purposes of determining whether "actual delivery" has occurred. *See* Proposal, 82 Fed. Reg. at 60341.

[6]   As discussed above, sub-clause (ii) of Prong 1 would require the buyer to have the ability to "use [the virtual currency] freely in commerce (both within and away from any particular platform)" within the 28-day statutory period. *See* Proposal, 82 Fed. Reg. at 60339.

despite such holder not being able to transfer the token externally without other key holders' sign-off.

As a result, we urge the CFTC to avoid expressly mandating certain "use" profiles of virtual currencies, as this has the likelihood to unnecessarily inhibit innovation where the concern of "use" can otherwise be addressed through our proposed language above. Any definition of "use" should be flexible enough to account for differences among virtual currencies, their different functionalities and profiles, and in all cases, we wish for the CFTC to appreciate that not all virtual tokens are or will be transferable. Additionally, the functionalities of the virtual token may change over time.

We urge the CFTC to consider defining "use" and "control" from the vantage point of other similarly situated holders as we have proposed in the language above. That is, for any date of determination, if a virtual currency allows similarly situated holders[7] to perform a given function at such given date of determination, then a holder would be expected to have the authority to perform that function in order to satisfy the determination of "use," and if such holder has the authority to "use" all the functions of a virtual currency available to similarly situated holders, then such holder would have "control" of such virtual currency.

We note that evaluating and assessing all relevant factors aligns with the approach taken by the CFTC in its 2013 interpretation regarding retail commodity transactions (**2013 Interpretation**).[8] As it states, the CFTC will "employ a functional approach and examine how the agreement, contract, or transaction is marketed, managed, and performed, instead of relying solely on language used by the parties in the agreement, contract, or transaction."[9]

B. *The CFTC Should be Flexible and Not Require Delivery to Depositories Who are Independent from Counterparty Sellers and Offerors.*

The Proposal would require that the depository of virtual currencies (*i.e.,* the e-wallet or other relevant storage system) not be affiliated with or controlled by the counterparty seller or offeror (*i.e.,* the trading platform or other intermediary).[10] We are concerned that this Proposal could impede innovation, and suggest a more flexible approach in determining potential depositories of virtual currencies.

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[7]   We note that virtual currencies may possibly be multi-dimensional in their use. One holder with certain characteristics may have certain rights and privileges while other holders with distinct characteristics may not have similar rights and privileges.

[8]   Retail Commodity Transactions Under Commodity Exchange Act, 78 Fed. Reg. 52426 (Aug. 23, 2013), *available at* https://www.gpo.gov/fdsys/pkg/FR-2013-08-23/pdf/2013-20617.pdf (**2013 Interpretation**); s*ee* Proposal, 82 Fed. Reg. at n. 65 (citing 2013 Interpretation, 78 Fed. Reg. at 52428) ("This list includes, but is not limited to '[o]wnership, possession, title, and physical location of the commodity purchased or sold, both before and after execution of the agreement, contract, or transaction, including all related documentation; the nature of the relationship between the buyer, seller, and possessor of the commodity purchased or sold; and the manner in which the purchase or sale is recorded and completed.'").

[9]   2013 Interpretation, 78 Fed. Reg. at 52428; *see also* Proposal, 82 Fed. Reg. at 60339.

[10]   Proposed Example 1 would provide that the purchaser's wallet may not be "affiliated with or controlled by the counterparty seller or third party offeror in any manner"; proposed Example 2 would provide that the depository may not be "owned, controlled or operated by the counterparty seller (including any parent companies, partners, agents, affiliates, and others acting in concert with the counterparty seller)." *See* Proposal, 82 Fed. Reg. at 60340.

1.   **Requiring Delivery to Non-Affiliated Depositories Could Impede Responsible Market Growth and Innovation.**[11]

We are concerned that the Proposal's approach could stifle technological innovation for two reasons.

First, no robust market exists for depositories of crypto-assets. As a result, it may be difficult for the purchase or sale of a virtual currency to effect delivery to an independent third-party depository. While cold storage[12] by a transaction participant may be an option, any finalized interpretation should not inadvertently mandate a cold storage delivery in order to effect "actual delivery." Cold storage itself carries many risks and complications that not all industry participants are equipped or willing to undertake.

Second, the Proposal could inadvertently require or result in increased transfers on public blockchain ledgers, which could drastically increase transaction costs and create an enormous amount of traffic on the relevant blockchains. Where scalability of blockchain networks is still being developed, congestion on the public ledgers may cause unnecessary errors in the transfers to third-party custodians, and as congestion increases, the time to expected settlement may increase unless transaction fees increase linearly. Transfers to affiliate platforms may reduce the number of transactions needed on the main net public ledger and, as a result, reduce the amount of transfers and therefore risk of error, maintain the value proposition of public blockchains — low cost transactions — and not add additional strain on these nascent public blockchain platforms while they scale throughput capability.

2.   **Allowing Flexibility — Including by Delivering to Affiliates of Counterparty Sellers and Offerors — Could Better Support this Nascent Industry While Still Accomplishing the CFTC's Goals.**

We suggest that a better approach would be to allow more flexibility in terms of the potential depositories, including by allowing counterparty sellers / offerors and their affiliates to maintain custody of transferred virtual currencies.

This type of flexibility is not unprecedented. Importantly, we note that under the 2013 Interpretation, the CFTC addressed the issue of whether depositories needed to be unaffiliated with counterparty seller in the context of "actual delivery" and took a broader, more holistic, approach to affiliation with the counterparty seller. While the language of Example 2 as set forth in the 2013 Interpretation would require depositories to be unaffiliated with the counterparty seller or any affiliate of the seller, the CFTC later went on to state:

> [W]ith regard to Example 2, the Commission may determine that actual delivery has occurred if a commodity is delivered to an affiliate of the seller or is already physically located at a depository, so long as the commodity is otherwise delivered in accordance with the methods described in Example 2, if a careful consideration of the other relevant factors enumerated in the [2013] Interpretation demonstrates that the purposed delivery is not simply a sham and that actual delivery has occurred . . .[13]

The CFTC should take a similar flexible approach here in considering actual delivery to virtual currency depositories that may be affiliated with the counterparty seller and/or the offeror.

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[11]   With respect to the Proposal, Question 5 asks whether the CFTC should further prohibit a depository from being owned or operated by the offeror (including any offeror parent company, partner, agent and other affiliates). *See* Proposal, 82 Fed. Reg. at 60341.

[12]   In the virtual currency context, the term "**cold storage**" or "**cold wallets**" refers to generating and storing the virtual currency's private keys in an offline environment.

[13]   2013 Interpretation, 78 Fed. Reg. at 52427.

Similarly, we note that the Model State Commodity Code[14] addresses similar concerns in the precious metals context. Under the Model State Commodity Code, only the seller is prohibited from taking delivery — the Model State Commodity Code does not go so far as to prohibit a seller's affiliates from taking delivery of precious metals in order to satisfy the "actual delivery" requirement.[15] While the Model State Commodity Code is not a determining factor for ascertaining whether "actual delivery" has occurred, its application to virtual currency transactions would more accurately reflect market realities relating to e-wallets and other virtual currency depositories than the Proposal. As is the case in the precious metals markets, the unaffiliated depository requirement — assuming any third party's technology could even support the virtual currency in question — may result in the delivery of virtual currency to a competitor of the counterparty seller / offeror due to the limited number of depositories which are set up from a technological perspective to support any one particular virtual currency.

Additionally, we believe that the concerns of the drafters of the Retail Commodity Rules over fraudulent off-exchange futures contracts and sham deliveries can be controlled by other means when considering controls regarding deliveries to depositories. Instead of requiring a third-party depository, the CFTC should allow for depositories to be affiliated with the counterparty seller or offeror, but require robust contractual agreements, in all cases, which will require that depository disregard any instructions, control or interest from the counterparty seller or offeror (including any parent companies, partners, agents, affiliates and others acting in concert with the counterparty seller or offeror) in respect of the custodial account.

> ### C. *The Finalized Interpretation Should Clarify that the Effect of the Proposal Has No Impact on What Constitutes "Delivery" in the Virtual Currency Spot Market.*[16]

While we appreciate that the Proposal is rooted in defining what "actual delivery" means in the context of the statutory language of the Retail Commodity Rules, the CFTC should be mindful that any interpretation regarding "actual delivery" of leveraged or margined commodity transactions may have unintended knock-on consequences in the virtual currency spot market.

The CFTC should clearly state that this Proposal is not applicable and will not be applicable in the context of determining whether a virtual currency was delivered in the "spot" markets — where such virtual currency spot transactions do not meet the "retail commodity transaction" definition under Section 2(c)(2)(D) of the CEA. Indeed, without such clarification, the legal and regulatory uncertainty and reach of the Proposal may have a chilling effect on the nascent virtual currency spot market in the United States and will be at a disadvantage in comparison to its competitors. In order to prevent opportunities of regulatory arbitrage driving markets offshore and the inevitably accompanying loss of the U.S. virtual currency market share, we respectfully request such clarification in any finalized interpretation.

<p align="center">*   *   *   *   *</p>

We appreciate the opportunity to comment on the Proposal. As the CFTC progresses in its ongoing effort to review the application of its regulations in the virtual currency space, we would welcome the opportunity to assist in the process. Should you have any questions, please feel free to contact Joyce Lai at

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[14]   North American Securities Administrators Association, Model State Commodity Code, [1984-1986 Transfer Binder] 2 Comm. Fut. L. Rep. (CCH) ¶ 22568, NASAA Reports (CCH) ¶ 4401 (April 5, 1985) (**Model Code**).

[15]   Model Code at § 1.04(a)(2).

[16]   With respect to the Proposal, Question 4 asks what factors may be relevant to consider regarding the CFTC's potential use of its exemptive authority under Section 4(c) of the CEA to protect U.S. retail customers regarding transactions falling within the CFTC's jurisdiction, while avoiding the stifling of innovation. *See* Proposal, 82 Fed. Reg. at 60341.

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Very truly yours,

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