a16z crypto

November 6, 2023

BY ELECTRONIC SUBMISSION

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

Re: RIN 3038-AF28: Provisions Common to Registered Entities

Dear Mr. Kirkpatrick:

Andreessen Horowitz ("a16z") appreciates the opportunity to comment on proposal RIN 3038-AF28, issued by the Commodity Futures Trading Commission ("CFTC") regarding proposed changes to the CFTC's Provisions Common to Registered Entities ("Proposed Rules").[1] We applaud the CFTC's efforts generally to ensure the integrity and encourage the development of innovative derivatives products, and we appreciate the opportunity to provide input on this important topic.

Our comment letter addresses three main issues. First, we share our perspective on the potential effect of the Proposed Rules on digital asset derivatives. Second, we discuss the Commission's authority to engage in more extensive reviews of product certifications. Third, we offer suggestions for potential improvements to the "completeness requirement" of the Proposed Rules.

I. Background on a16z

A16z is a venture capital firm that invests in seed, venture, and late-stage technology companies, focused on bio and healthcare, consumer, crypto, enterprise, fintech, and games. A16z currently has more than $35 billion in committed capital under management across multiple funds, with more than $7.6 billion in crypto funds. In crypto, we primarily invest in companies using blockchain technology to develop protocols that people will be able to build upon to launch Internet businesses. Our funds typically have a 10-year time horizon, as we take a long-term view of our investments, and we do not speculate in short-term crypto-asset price fluctuations.

At a16z, we believe we need an Internet that can foster competition and mitigate the dominance of large technology companies, unlock opportunities in the innovation economy, and enable people to take control of their digital information. The solution is web3 — the third generation of the Internet — a group of technologies that encompasses blockchains, digital assets, decentralized applications and finance, and decentralized autonomous organizations. Together, these tools enable new forms of human

[1] Provisions Common to Registered Entities, 88 Fed. Reg. 61,432 (Sept. 6, 2023).

collaboration that can help communities make better collective decisions about critical issues, such as how networks will evolve and how economic benefits will be distributed. We are optimistic about the potential of web3 to strengthen trust in institutions and expand access to opportunity.

II. The Proposed Rules Do Not Specifically Address Digital Assets.

We strongly urge the Commission to clarify its position regarding the self-certification of products and rules relating to digital assets prior to finalizing the Proposed Rules. We note that the terms “crypto,” “cryptocurrency,” and “digital asset” are nowhere to be found in the preamble of the Proposed Rules, though two of the Commissioners mentioned them in their statements supporting the introduction of the notice of proposed rulemaking.[2] Without further guidance on how the Proposed Rules affect digital assets, market participants will struggle to meaningfully engage in the self-certification process for digital asset derivatives.

As an initial matter, we suggest that the Commission state explicitly that it will not treat the self-certification of digital asset products and rules differently from other commodities.[3] This is in line with established processes: “[T]he great principle that like cases must receive like treatment is . . . black letter administrative law.” *Grayscale Invs., LLC v. SEC*, Case No. 22-1142, Slip Op. at 8 (D.C. Cir. Aug. 29, 2023) (citing *Baltimore Gas & Elec. Co. v. FERC*, 954 F.3d 279, 286 (D.C. Cir. 2020) (cleaned up)).

Because digital assets merit the same treatment as other commodities, we are particularly concerned with Commissioner Goldsmith Romero’s concurring statement to the Proposed Rules, asserting that “[t]his proposal will help achieve the purposes of the

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[2] *See, e.g.,* Proposed Rules, at 61,458 (Statement of Commissioner Johnson) (“In the decade since the [Bitcoin] white paper’s release, we have witnessed exponential growth in the market for digital assets, including cryptocurrencies, as well as the explosion of the digital asset ecosystem.”); *id.* at 61,459 (Statement of Commissioner Goldsmith Romero) (“Exchanges have listed new contracts that reference novel commodities, such as digital assets and voluntary carbon market credits.”); *id.* (“This proposal will help achieve the purposes of the Commission’s existing heightened review standard for digital assets.”).

We note that the self-certification process, adopted by Congress in the Commodity Futures Modernization Act of 2000, has led to a plethora of new product offerings in the CFTC space long before the introduction of Bitcoin futures products in late 2017. Appendix A shows a chart compiled from a CFTC database regarding the number of new products certified from 2000-2017. Available at https://www.cftc.gov/sites/default/files/idc/groups/public/%40aboutcftc/documents/file/mrac013118_newproducts.pdf (last visited Nov. 6, 2023).

[3] We note that, although there is a significant debate as to whether certain *transactions* in digital assets are securities transactions, there appears to be widespread agreement that digital assets *themselves* are generally *not* securities. *See, e.g., Terraform Labs, Inc. et al. v. SEC*, Case No. 23-cv-1346 (S.D.N.Y. July 31, 2023) (“Much as the orange groves in *Howey* would not be considered securities if they were sold apart from the cultivator's promise to share any profits derived by their cultivation, the term ‘security’ also cannot be used to describe any crypto-assets that were not somehow intermingled with one of the investment ‘protocols,’ did not confer a ‘right to ... purchase’ another security, or were otherwise not tied to the growth of the Terraform blockchain ecosystem.”) (quoting *SEC v. Telegram Grp. Inc.*, 448 F. Supp. 3d 352, 379 (S.D.N.Y 2020)).

Commission's existing *heightened* review standard for digital assets."[4] We respectfully disagree with Commissioner Goldsmith Romero that a legal basis exists for the CFTC to engage in heightened review of digital asset derivative self-certifications, as discussed further in Section III below, and we note that her statement cites a CFTC Office of Public Affairs document issued on January 4, 2018[5] that is not, like all documents issued by that Office, binding policy on the Commission. At a minimum, if the Proposed Rules truly were to enshrine a heightened standard of review for digital assets derivatives, we would respectfully posit that the Proposed Rules should at least mention digital assets. Administrative law requires more—such as notice and comment rulemaking—for such desires to become an effectuated agency demand.

Moreover, neither the Proposed Rules nor any Commission statement refers to the only CFTC *Staff* Advisory regarding self-certification of digital asset derivatives, CFTC Staff Advisory No. 18-14.[6] It is indeed strange that the CFTC, which regularly refers to staff actions that relate to the subject matter of a rulemaking, omits any reference to Advisory No. 18-14. Some assessment of Advisory No. 18-14 is particularly necessary, given that the Proposed Rules appear to *reject* Advisory No. 18-14 as the manner for staff to consider digital asset-based derivatives products. Nowhere does the Commission address the experience gained by the staff regarding Advisory No. 18-14 and whether that activity had any benefits or costs for the self-certification of digital asset-based derivatives products. "The baseline for the Commission's consideration of the costs and benefits of this proposed rulemaking is the existing statutory and regulatory framework applicable to DCMs, DCOs, SDRs, and SEFs, in 17 CFR part 40." Proposed Rules, 88 Fed. Reg. at 61,446. An agency cannot conduct a proper consideration of costs and benefits if it does not identify the proper regulatory baseline from which a proposed rule makes changes. *See American Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178 (D.C. Cir. 2010) ("The SEC could not accurately assess any potential increase or decrease in competition, however, because it did not assess the baseline level of price transparency and information disclosure under state law."). As such, we urge the Commission to identify the regulatory baseline from which these Proposed Rule changes emanate and the impact of Advisory No. 18-14.

The Proposed Rules also appear to reject Advisory No. 18-14 because they identify activities that would be sufficient to meet the Proposed Rules for self-certification but would not meet Advisory No. 18-14. The Commission repeatedly notes that an entity complying with Appendix C to Part 38 will satisfy the new "completeness" requirement under the Proposed Rules.[7] But Advisory No. 18-14 requires *more* than Appendix C of Part

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[4] Proposed Rules, at 61,459 (emphasis added).

[5] *See id.* at 61,459 n.1 (citing CFTC, *CFTC Backgrounder on Oversight of and Approach to Virtual Currency Futures Markets*, (Jan. 4, 2018) available at https://tinyurl.com/y9j85k7x).

[6] We understand that Advisory No. 18-14 has served as the basis for CFTC Staff to evaluate self-certifications of digital asset-based derivatives products for the past 5 years. *See* CFTC Advisory No. 18-14 at 1-2 (May 21, 2018) ("This advisory is not a compliance checklist; rather, it clarifies the Commission staff's priorities and expectations in its review of new virtual currency derivatives to be listed on a designated contract market ("DCM") or swap execution facility ("SEF"), or to be cleared by a derivatives clearing organization ("DCO").").

[7] Proposed Rules, 88 Fed. Reg. at 61,345 (for Proposed Amendments to Rule 40.2(a)(3)(v)) ("The Commission notes that a DCM or SEF that provides the information described in appendix C to part 38 that applies to a

38. For example, Advisory No. 18-14 requires the following regarding information-sharing agreements:

> Commission staff believes that a well-designed market surveillance program of an exchange (*i.e.*, a DCM or SEF) for virtual currency derivatives includes an information sharing agreement with the underlying spot market(s) that make up the cash-settlement price to facilitate the exchange's access to a broader range of trade data. Such arrangements would provide the exchange with the right and ability to access trade data on the relevant spot market(s). Such data may include, but not be limited to, information relating to the identity of the trader, prices, volumes, times, and quotes from the relevant market makers or traders.

Id. at 3. Appendix C to Part 38, however, does not *require* an information-sharing agreement with the underlying spot market(s). Instead, those agreements should be made only "whenever practicable." Appendix C, Section (c)(3)(i).[8]

In sum, the Commission should make explicit what is implicit in the Proposed Rules: the Commission is not adopting heightened review for digital asset derivatives and is not adopting CFTC Staff Advisory No. 18-14. Simply stated, there is no need for a special set of rules for digital asset derivatives. Such derivatives have been trading in CFTC-regulated markets for more than 5 years now, and the CFTC in the Proposed Rules does not identify any deficiencies in self-certifications that were specific to digital asset derivatives. They should be on the same playing field as the rest of the products that are self-certified.

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contract would be sufficient for the Commission to determine the compliance of the contracts terms and conditions with the applicable core principles."); *id.* ("As noted above, the information described in appendix C to part 38 that applies to a contract would be sufficient for the Commission to determine the compliance of a contract's terms and conditions with the applicable core principles."); *id.* ("Accordingly, to be complete, submissions pursuant to § 40.2(a)(3)(v) should be guided by portions of appendix C to part 38 that apply to the contract being listed.").

[8] That paragraph states in its entirety (emphasis added):

> Where an independent, private-sector third party calculates the cash settlement price series, the designated contract market should verify that the third party utilizes business practices that minimize the opportunity or incentive to manipulate the cash-settlement price series. Such safeguards may include lock-downs, prohibitions against derivatives trading by employees, or public dissemination of the names and sources and the price quotes they provide. Because a cash-settled contract may create an incentive to manipulate or artificially influence the underlying market from which the cash-settlement price is derived or to exert undue influence on the cash-settlement computation in order to profit on a futures position in that commodity, a designated contract market should, *whenever practicable*, enter into an information-sharing agreement with the third-party provider which would enable the designated contract market to better detect and prevent manipulative behavior.

III. The Commission should explain its authority for more extensive product self-certifications.

We urge the Commission to reconsider its rationale and authority for more extensive product self-certifications, given the differences in statutory documentation requirements for product self-certification versus rule self-certifications.

Rule 40.2's requirements have grown extensively over the years. The first product self-certification provision under the Commodity Futures Modernization Act of 2000, adopted in August 2001, consisted of only one paragraph:

> To list a new product for trading, to list a product for trading that has become dormant, or to accept for clearing a product (not traded on a designated contract market or a registered derivatives transaction execution facility), a registered entity must file with the Secretary of the Commission at its Washington, D.C., headquarters no later than the close of business of the business day preceding the product's listing or acceptance for clearing, either in electronic or hardcopy form, a copy of the product's rules, including its terms and conditions, or the rules establishing the terms and conditions of products that make them acceptable for clearing, and a certification by the registered entity that the trading product or other instrument, or the clearing of the trading product or other instrument including any rules establishing the terms and conditions of products that make them acceptable for clearing), complies with the Act and rules thereunder.[9]

This original formulation of Rule 40.2 is much more consistent with Section 5c(c) of the Commodity Exchange Act (CEA), which, for product self-certifications, requires **only** a "written certification that the new contract . . . complies with this Act (including regulations under this Act)." 7 U.S.C. § 7a-2(c)(1).

The CFTC expanded the requirements for Rule 40.2 submissions in 2011, despite some comments suggesting that the Commission might not have the authority to require the submission of documentation with newly-certified products. *See* CFTC, Provisions Common to Registered Entities, 76 Fed. Reg. 44,776, 44,779 (July 27, 2011). In that vein, we believe that the Commission should consider the different statutory provisions regarding product self-certifications and rule self-certifications in assessing the amount of documentation and analysis that should be required. While both products and rules require a "written certification," 7 U.S.C. § 7a-2(c)(1), Section 5c(c) has extensive provisions for the Commission to review and stay certifications of rules, but it has no similar provision for products. *See id.* § 7a-2(c)(2)-(3). The CEA also has a laxer standard for the Commission to deny a rule (if the rule "is inconsistent with this subtitle (including regulations)") than to deny a product (only if a product "would violate this Act (including regulations)"). *Compare* 7 U.S.C. § 7a-2(c)(5)(A) *with* § 7a-2(c)(5)(B).

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[9] CFTC, Final Rule, A New Regulatory Framework for Trading Facilities, Intermediaries and Clearing Organizations, 66 Fed. Reg. at 42,256, 42,284 (Aug. 10, 2001) (codifying 17 C.F.R. § 40.2 (2001)).

If these statutory differences do not suggest that the CFTC lacks the authority to require extensive disclosures as part of the "written certification" of a product, at a minimum they suggest that a product self-certification should be materially more limited than a rule self-certification. Otherwise, it is unclear whether the Commission applies a meaningful distinction to these different statutory requirements.

IV. <u>The Commission's discussion of the new "Completeness" requirement would benefit from further clarification.</u>

As an initial matter, it would be helpful to understand what aspects of the self-certification process the Commission seeks to change with the Proposed Rules' introduction of the new "completeness" language. To level set, here is what we understand are the changes to the rules regarding the new completeness standard with the proposed changes:

- Rule 40.2(a)(3)(v) (Product Self-Certification): Adding the language "that is complete with respect to the product's terms and conditions, the underlying commodity. . ."
- Rule 40.3(a)(4) (Commission approval of product): Adding the language "that is complete with respect to the product's terms and conditions, the underlying commodity. . ."
- Rule 40.5(a)(5) (Commission approval of rules): Adding the language "that is complete with respect to . . ."
- Rule 40.6(a)(7)(v) (Self-certification of rules): Adding the language "that is complete with respect to . . ."

Additional clarification would be beneficial regarding Rules 40.2(a)(3)(v) and 40.6(a)(7)(v), specifically explaining the relationship the CFTC envisions between "complete" and "concise." In particular, it would be helpful for the CFTC to provide guidance on how market participants can simultaneously satisfy the requirements to be "complete" while also being "concise." We also posit that further guidance on the following five issues would help increase clarity for market participants.

First, we suggest that the CFTC provide a specific example of how the new product provisions in Rules 40.2(a)(3)(v) and 40.3(a)(4) apply to digital assets. For instance, we understand that the Proposed Rules introduce two new categories of analysis, such that the "concise" — and now "complete" — explanation must address (1) the product's "terms and conditions" (itself a defined term being modified under the Proposed Rules) as well as (2) the underlying commodity.[10] Although we note and appreciate the two examples regarding a physically-settled futures contract on copper (Proposed Rules, 88 Fed. Reg. at 61,436) and a cash-settled futures contract on a stock index price series, such as the S&P 500 (*id.*), it would be especially useful if the Commission were to provide an example focused on a digital asset. We make this suggestion in light of the Commissioners'

[10] In the current requirements, the explanation has to cover the product only.

concurring statements suggesting that the Proposed Rules could have an effect on digital asset self-certification (as discussed in Section II).

Second, a final rule would also benefit from a more fulsome explanation of the requirements necessary to satisfy the completeness standard. Alternatively, further clarification would be beneficial regarding what factors could make a submission incomplete if a registered entity were to submit a product to the Commission for approval under Rule 40.3. It would be helpful to know what additional activity, burden, and costs are necessary to comply with the new rule. This would help stakeholders understand what additional information, if any, the Commission requires.

Third, the Commission also notes that for the products and rules submitted to the Commission for approval under Rule 40.3 and Rule 40.5, respectively, there is no "concise" requirement. But the Proposed Rules add a "complete" requirement "for the same reasons completeness is being proposed in §§ 40.2(a)(3)(v), 40.3(a)(4), and 40.6(a)(7)(v)." Proposed Rules, 88 Fed. Reg. at 61,439. The only explanation for the "complete" but not "concise" language in the Commission approval provisions for products and rules is found in a footnote: "The Commission requires registered entities to provide a more detailed explanation and analysis of rules voluntarily submitted for Commission approval under the provisions of § 40.5." Proposed Rules, 88 Fed. Reg. at 61,439 n.47; *see also id.* at 61,436 at n.37 ("While the Commission proposes to include the word 'complete,' the Commission notes that the 'explanation and analysis' requirement in proposed § 40.3(a)(4) does not include the qualifier that the submission be 'concise' ***for the same reasons discussed below in note 47***." (emphasis added)). We are left only with a statement that the Commission requires "a more detailed explanation" without any further exposition about what additional details are required.

Fourth, the Commission's discussion of the Paperwork Reduction Act (''PRA'') and costs and benefits of the completeness requirements in the Proposed Rules may confuse market participants because of what appear to be contradictory statements. In the PRA burden estimates regarding the proposed changes to Rules 40.2(a)(3)(v), 40.3(a)(4), and 40.6(a)(7)(v), "[t]he Commission anticipates that, if adopted, these amendments are likely to ***increase reporting burden*** for registered entities, although some registered entities are already providing the information." Proposed Rules, 88 Fed. Reg. at 61,443 (emphasis added). For the product submissions (both Rule 40.2 self-certifications and Rule 40.3 requests for Commission approval) "the proposed amendments to §§ 40.2(a)(3)(v) and 40.3(a)(4) would add an additional average 1 hour burden (for a new total of 22 hours)." Proposed Rules, 88 Fed. Reg. at 61,443. "[F]or rule submissions under § 40.6, these new requirements would add an additional average of 30 minutes (for a new total of 2.5 hours)." *Id.*; *see also id.* at 61,444 at n.80 ("The aggregate number of hours per report for §§ 40.5 and 40.6 adds 0.5 hours to the existing burden of 2 hours per report, for a total of 2.5."). The Commission, however, takes a different position when discussing the cost and benefit considerations of the completeness requirement in the Proposed Rules. In the cost-benefit section regarding changes to Rules 40.2 and 40.3, the Commission states that it "believes that ***there will not be new costs*** associated with the proposed amendments to §§ 40.2 and 40.3 requiring registered entities to provide complete explanations of their

products as this information is already required under the current regulations." 88 Fed. Reg. at 61,447 (emphasis added). The Commission continues: "The amendment [to Rules 40.2 and 40.3] is intended to clarify the Commission's original intent that the explanation and analysis contain sufficient detail for the Commission to evaluate submissions for the purpose intended—to assess whether the new products would comply with the CEA and associated regulations." *Id.*[11] We suggest that the Commission clarify its position on the costs and benefits of the completeness requirements.

Fifth, we note that at least two costs that the Commission identifies may not actually be costs, and we urge the Commission to reevaluate its cost-benefit analysis in light of these judgments. The Commission states that the following is a "cost" of the new "completeness" requirement: "In general, the proposed amendments to §§ 40.2 and 40.3 will provide greater specificity, leaving less room for regulatory ambiguity, improve the quality of submissions, and reduce any administrative costs registered entities might incur when determining what information must be submitted to the Commission for a product self-certification or product approval request." Proposed Rules, 88 Fed. Reg. at 61,447-448. It is not clear how this point is a cost of the Proposed Rules, unless the completeness requirement would increase regulatory ambiguity. Indeed, as discussed above, we do believe that the completeness requirement, as written, would have the effect of increasing regulatory ambiguity, but the Commission's cost-benefit analysis is unclear on this point. Similarly, the Commission asserts in the "Costs" section for Rules 40.5 and 40.6 that "the proposed amendments to §§ 40.5(a) and 40.6(a), (b)(2), and (c)(5), regarding filing instructions for rules ***will not place any additional costs or burdens*** on registered entities because the proposed amendments clarify the Commission's expectations." 88 Fed. Reg. at 61,449 (emphasis added). The Proposed Rules state: "The proposed amendments to § 40.6(a)(7) [which includes the completeness requirement] inform registered entities of the quality of explanations and analysis needed for rule submissions and will lessen the likelihood that registered entities would need to amend or supplement submissions." *Id.* It is also not clear what "cost" of this statement represents. This section does not identify any purported "costs" of the new completeness requirement while the PRA section specifically identifies an additional burden due to the requirement. It would thus appear that the Commission has not fully considered the potential costs of the Proposed Rules.[12]

[11] *See also* Proposed Rules, 88 Fed. Reg. at 61,450 ("The proposed improvements to the regulations providing for 'complete' products and rule submissions sets forth in more detail the Commission's original intention regarding the level of detail thereby better ensuring that the Commission can provide adequate oversight with minimal disruption to market efficiency."). Assessing the Commission's "original intent" is a tricky endeavor. The most natural place to start is at the words of the regulation itself. *See, e.g., Kisor v. Wilkie*, 139 S. Ct. 2400, 2405 (2019). Because the Commission proposes to change the terms in these provisions, it is logical to assume that the meaning (and associated burdens) have changed as well. In addition, none of the Commissioners who adopted the original rule are still on the Commission.

[12] Such a failure could lead to a rule being found arbitrary and capricious. *See Business Roundtable v. SEC*, 647 F.3d 1144, 1148-49 (D.C. Cir. 2011).

V. Conclusion

A16z appreciates the opportunity to share its perspective on the Proposed Rules. We hope that you find our suggestions useful for the rulemaking process, and we look forward to continued engagement with the Commission on these issues.

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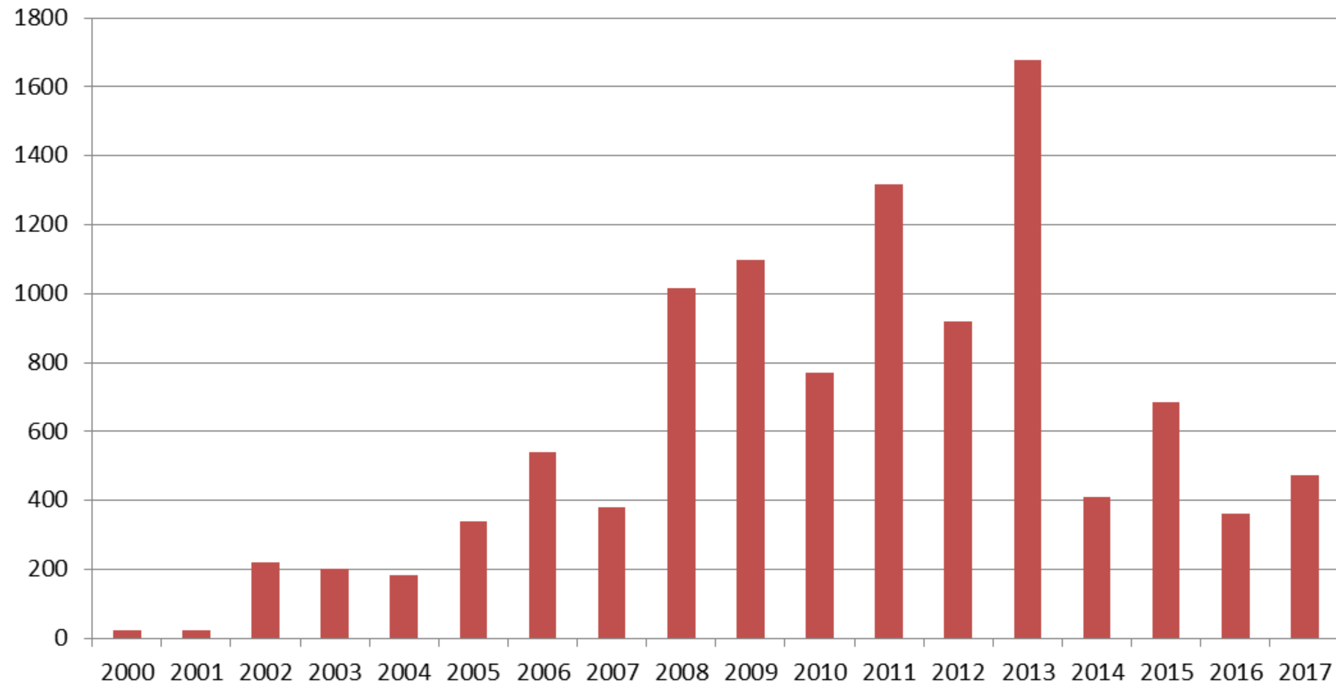
Appendix A



*-Data compiled from the CFTC's Filings and Actions database, which includes submissions from DCMs, DCOs, and SDRs. The data includes 4,849 security futures products and 1,223 products (all but one in electricity) certified by Nodal Exchange in 2013.