

October 19, 2017

Cryptocurrency Update: CFTC Reaffirms Jurisdiction Over Certain Virtual Currency Transactions

There is little question that virtual currency will be subject to increasing regulatory oversight as it continues its steady march towards the mainstream. On October 17, 2017, the Commodity Futures Trading Commission (CFTC) made that all the more clear through the release of “[A Primer on Virtual Currencies](#),” the first of a series of publications “to help market participants and innovators navigate the FinTech landscape.” The primer reiterates the CFTC’s view that virtual currency is a commodity but denies any conflict with recent pronouncements by the Securities and Exchange Commission (SEC) also asserting jurisdictional authority in this space.

Attorneys
[Marc P. Berger](#)
[Helen Gugel](#)

The primer was put together by LabCFTC, an initiative that the CFTC launched in May to “facilitate market-enhancing financial technology innovation” and to “inform the Commission’s understanding of emerging technologies.” That the LabCFTC focused on virtual currency for its inaugural publication is a testament to the growing importance of virtual currency to the marketplace and to the CFTC’s regulatory agenda. Nonetheless, the primer cautions that “it is not intended to describe the official policy or position of the CFTC, or to limit the CFTC’s current or future positions or actions.”

The primer proceeds in three parts. First, it provides an overview of virtual currency and its underlying technology. The primer adopts the definition of virtual currency favored by the Internal Revenue Service – i.e., a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. This definition also tracks that adopted by the SEC. The primer notes that blockchain, the distributed ledger technology that underpins many virtual currencies, may be used within public and private systems and has a vast range of potential applications. For example, financial institutions may use blockchain for clearing and settlement, regulatory reporting and compliance, or know-your-customer and anti-money laundering checks. The government may use it for general records management or regulatory reporting. And companies may use it to develop self-executing agreements (smart contracts) or as proof of identity when entering into a contract.

Second, the primer discusses the role of the CFTC with respect to virtual currency and related financial activities, such as initial coin offerings. The definition of “commodity” in the CFTC’s activating statute, the Commodities Exchange Act, is very broad and includes “all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt with.” The CFTC first found that virtual currency is a commodity in 2015. Consistent with this classification, and taking into account that the CFTC has oversight over futures, options, and derivatives contracts, the primer concludes that the “CFTC’s jurisdiction is implicated when a virtual currency is used in a derivatives contract, or if there is fraud or manipulation involving a virtual currency traded in interstate commerce.”

The primer emphasizes that the CFTC will “look[] beyond form and consider[] the actual substance and purpose of an activity when applying the federal commodities laws and CFTC regulations.” This case-by-case assessment mirrors the approach that the SEC follows in determining whether it has authority over a virtual currency transaction. As referenced in the primer, a recent SEC report concludes that virtual tokens or coins issued in initial coin offerings may constitute securities for purposes of the federal securities laws. Interestingly, the primer notes that “[t]here is no inconsistency between the SEC’s analysis and the CFTC’s determination that virtual currencies are commodities and that virtual tokens may be commodities or derivatives contracts depending on the particular facts and circumstances.”

This leaves open the possibility that certain transactions may be subject to overlapping oversight by the CFTC and SEC.

Third, the primer notes that, while virtual currencies have potential benefits, they also pose various risks. For example, they may pose operational risk in that many virtual currency platforms that purport to convert virtual currency into legal tender are not subject to the supervision that applies to regulated exchanges and may be missing critical system safeguards and customer protections. As another example, virtual currency may present a cybersecurity risk in the form of hacking or other digital misappropriation.

The primer is but the latest regulatory initiative relating to virtual currency, and there will certainly be more as the CFTC, SEC, and other regulators seek to assert their authority in this area. Moving forward, a strong regulatory framework may prove beneficial to financial innovation by encouraging more market participants to engage with virtual currency and blockchain.

[Note: We discuss a recent SEC enforcement action involving virtual currency in our previous alert, available [here](#)]