Objectives

- Initial committee focus of the TAC Virtual Currency Subcommittee ("VCS")
  - Q1: What are characteristics, standards, or best practices that can be gleaned from largely institutional regulated derivatives markets that can enhance the integrity and degree of trust in underlying/spot markets?
  - Q2: What are the hallmarks or characteristics of crypto assets that would subject them to the CEA and render them appropriate for regulated derivatives markets?
Virtual currencies or “digital assets” offer great promise to:

- enhance efficiency, privacy, and trust
- boost economic growth, create jobs and benefit businesses and consumers
- foster new economic value and enable decentralized competition to gatekeepers of the Internet.

What are the virtual currency spot markets?

What is good about them?

What are the concerns?

What are the solutions?
What are the spot markets?

- Largely-unregulated spot exchanges
- Decentralized exchanges
- Over-the-counter (OTC) markets
- Still largely a retail market
What is good about the spot markets?

- Innovation and creativity
- Rapid adoption
- Expanded user base
- Competition and diversity
What are the concerns?

- Transparency
- Venue risks
- Bad behaviors
- Conflicts of interest
- Supervision and surveillance
- KYC/AML
What are the solutions?

- Smart regulation
- Using technology
- Applying market best practices
- Stakes are high—
  - Will regulatory uncertainty drive market activity elsewhere?
  - Or can the U.S. attract responsible market participants to invest and build technologies and markets here?
Regulatory Uncertainty

What are the characteristics of crypto assets that should likely make them subject to CFTC oversight for fraud-based manipulation and enable the CFTC to authorize futures or swaps to be based on such crypto assets and traded on designated contract markets or swap execution facilities?

- To qualify the crypto assets must be commodities.
- The crypto assets cannot by securities.
There are generally regarded as three types of crypto assets:

1. Cryptocurrencies or virtual currencies
   - Store of value
   - Unit of account
   - Medium of exchange
   - Two federal courts has expressly ruled that cryptocurrencies are potentially commodities under the CEA and the CFTC’s fraud-based manipulative authority applies.

   - CFTC v. Patrick McDonnell et al., August 2018: [link](https://www.cftc.gov/sites/default/files/2018-08/enfdropmarketsmemorandum082318.pdf) (USDC, EDNY); and
Three Types of Crypto Assets

• 2. Crypto assets that the SEC would likely regard as securities
  - Unless of the nature of traditional equity or debt instruments, qualifying digital assets would typically be investment contracts under the 1946 Supreme Court decision SEC v WJ Howey Co.

• 3. Utility tokens
  - Digital assets that provide access or are exclusively integrated with a particular blockchain.
  - Unclear status.
Categorizing Crypto Assets

- The CFTC has exclusive authority to designate contract markets for futures and swaps based on cryptocurrencies and SEFs to trade swaps on cryptocurrencies.
  - Follows from cryptocurrencies = commodities
  - To date, DCMs and SEFs have only been authorized by the CFTC to trade futures and swaps on bitcoin.
  - William Hinman, SEC Director of Corporation Finance, has said ether today is not a security.
  - What is the status of other digital assets generally regarded as cryptocurrencies?
Some Attributes That Drive Commodity Status Under CEA

- How issued/role of initial developer(s)/promoter(s)
- Purpose and use/is the relevant blockchain functional?
- Governance/degree of decentralization
- How promoted?

Objective: develop a framework that provides practical guidance, but is malleable, as criterion may change over time