Cryptocurrency Market Evolution Outline

CFTC Technology Advisory Subcommittee:
Virtual Currency Subcommittee

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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?

Q1 – Virtual Currency Spot 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.

Three Types of Crypto Assets

- 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: https://www.cftc.gov/sites/default/files/2018-08/enfdropmarketsmemorandum082318.pdf (USDC, EDNY); and
      - CFTC v. My Big Coin Pay, Inc., September 2018: https://www.law360.com/dockets/download/5babc36d65effb369b6313f5?doc_url=https%3A%2F%2Fecf.mad.uscourts.gov%2Fdoc1%2F09518931273&label=Case+Filing

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