

# CFTC Cryptocurrency Regulation: What's Next?



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### 1. Speakers

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### 2. Scope of CFTC jurisdiction

- a. Generally: The CFTC has jurisdiction to regulate various commodity and other derivatives, including swaps, futures, and options (7 U.S.C. § 2(a)), in the United States.
  - i. "Commodities" generally include goods and articles in which contracts for future delivery are presently or in the future may be dealt in (7 U.S.C. § 1a(9)).
    - 1. Bitcoin futures exist, and as such, the CFTC treats Bitcoin and other cryptocurrencies as commodities (not currencies).
  - ii. The CFTC generally does not have jurisdiction over spot commodity transactions, except where the transactions involve leverage, margin, or financing.
  - iii. The CFTC also has general antifraud and anti-manipulation authority with respect to commodity transactions (including spot commodity transactions).
- b. U.S. connection requirement
  - i. The Commodity Exchange Act (CEA) generally does not apply extraterritorially, subject to a few exceptions relating to swaps and registered entities.
  - ii. However, the CFTC has broad authority to pursue fraudulent or manipulative conduct that occurs domestically—that is, conduct involving (1) transactions executed on U.S. exchanges; (2) domestic purchases or sales; or (3) U.S. persons.
    - 1. To meet the second rubric (domestic transactions), a domestic transaction not executed on a U.S. exchange must involve either (1) the transfer of title in the United States, or (2) the incurrence of irrevocable liability, such as liability to pay for or deliver the commodity, in the United States.
- c. Registration requirements
  - i. The CFTC has authority to regulate registered entities, including futures commission merchants (FCMs), swap execution facilities (SEFs), derivatives clearing organizations (DCOs), designated contract markets (DCMs), and others.
    - 1. Registered entities in turn are subject to a number of recordkeeping, reporting, and other requirements, which in some instances include requirements to comply with Bank

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Secrecy Act (BSA) provisions, including with respect to anti-money laundering (AML) and know-your-customer (KYC) requirements.

- ii. Entities that operate trading platforms, including cryptocurrency trading platforms, may need to register with the CFTC to the extent that they offer trading in cryptocurrency futures, swaps, or options.
  - 1. *Retail customers:* The CFTC also regulates transactions with “retail customers” (that is, customers who are not eligible contract participants (ECPs)) and generally prohibits transactions with retail customers that involve leverage, margin, or financing unless actual delivery occurs within 28 days.
    - a. These transactions are treated “as if” they are futures contracts, and thus must take place on a registered exchange (absent actual delivery within 28 days).
  - 2. The CFTC has issued guidance regarding actual delivery in the context of digital assets, available here: <https://www.cftc.gov/PressRoom/PressReleases/8139-20>. Pursuant to this guidance, actual delivery requires the following:
    - a. (1) a customer securing: (i) possession and control of the entire quantity of the commodity, whether it was purchased on margin, or using leverage, or any other financing arrangement, and (ii) the ability to use the entire quantity of the commodity freely in commerce (away from any particular execution venue) no later than 28 days from the date of the transaction and at all times thereafter; and
    - b. (2) the offeror and counterparty seller (including any of their respective affiliates or other persons acting in concert with the offeror or counterparty seller on a similar basis) do not retain any interest in, legal right, or control over any of the commodity purchased on margin, leverage, or other financing arrangement at the expiration of 28 days from the date of the transaction.
  - iii. Failure to register with the CFTC as an FCM, SEF, DCO, or DCM may subject an exchange to CFTC enforcement action.

### 3. Recent CFTC cryptocurrency enforcement actions and BSA/AML overlay

- a. The CFTC has pursued a number of cryptocurrency and other trading platforms for failure to register with the CFTC.
  - i. *Types of charges:* In pursuing cryptocurrency market participants for failure to register, the types of charges the CFTC may bring include the following:
    - 1. Offering, entering into, confirming the execution of, or otherwise dealing in leveraged, margined, or financed transactions with retail customers that do not fall within the 28-day actual delivery exception
    - 2. Acting as an unregistered entity
    - 3. Failing to supervise
    - 4. Failing to comply with applicable provisions of the BSA (including failure to implement sufficient KYC or AML procedures)
  - ii. *Parallel criminal actions:* Violations of the CEA (or related violations arising from CEA violations) can be criminal as well, and DOJ prosecutions often accompany CFTC enforcement actions in the cryptocurrency space.

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- b. CFTC focus on BSA/AML issues: The CFTC recently has brought a series of AML-related cases, both inside and outside the digital asset space.

## 4. Potential for falling outside U.S. CFTC jurisdiction

- a. It may be possible to develop and offer a cryptocurrency product outside the U.S. that falls outside the scope of the CFTC's jurisdiction.
- b. Factors that the CFTC (and courts) may consider in determining whether the CFTC has regulatory jurisdiction with respect to cryptocurrency transactions include the following (the more factors present, the more likely jurisdiction will be exercised):
  - i. Registration status of the platform on which the transaction occurs
  - ii. Existence/participation of U.S. customers
  - iii. Whether a company advertises or markets products in the United States and/or to U.S. customers
  - iv. Physical/operational presence in the United States
  - v. Place of incorporation/principal place of business in the United States
  - vi. Trading platform or internet website hosted in the United States
  - vii. Locations of the “nodes” used to validate the transaction (if most nodes are located in the United States, that tends to weigh in favor of U.S. jurisdiction)
- c. Whether it is wise or advisable to attempt to create a product that falls outside the CFTC's jurisdiction is another question, however, and other laws may apply even if the CEA does not.

## 5. Applicability of other laws

- a. Even if the conduct falls outside the CFTC's jurisdiction, it still could be subject to other U.S. laws and regulations, including certain AML, OFAC/sanctions, and criminal laws and requirements under the Patriot Act. Accordingly, even if the CFTC cannot pursue the conduct, other U.S. regulators like the DOJ potentially could.
  - i. OFAC sanctions apply to U.S. persons wherever located, and often to foreign subsidiaries of U.S. persons.
  - ii. The civil forfeiture law (18 U.S.C. § 981(k)) has been invoked to seize funds located abroad through a U.S. interbank account, based on overseas activity targeting U.S. persons.
  - iii. Federal regulations (31 C.F.R. § 1022.380) require foreign-based money services businesses to register with FinCEN. At least one court has applied the law prohibiting unlicensed money transmission (18 U.S.C. § 1960) against a foreign company acting on behalf of overseas customers based on use of U.S. bank accounts to facilitate transfers, implicating state money transmission laws.

## 6. Recommendations/Takeaways

- a. The CFTC will look at the actual structure of the product—it will look beyond the name/terminology associated with the product—when determining whether registration may be required.
- b. The CFTC similarly will look beyond corporate formalities to determine whether a particular transaction has a U.S. tie sufficient to exercise CFTC jurisdiction.

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- i. The CFTC and DOJ will look critically at entities structured or operating in a manner deliberately designed to evade U.S. requirements.
- c. Even though it may be possible to structure a cryptocurrency product in a manner such that the CEA does not apply, cryptocurrencies offered outside the United States still could be subject to other U.S. laws.

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