

GMAC/CFTC Hosts Open Meeting Regarding Bitcoin and Digital Currency

The CFTC discusses first Bitcoin swap listed on a CFTC-regulated platform and Bitcoin regulation generally with panel of industry participants.

The Global Markets Advisory Committee (GMAC) of the U.S. Commodity Futures Trading Commission (CFTC) held an open meeting on October 9, 2014 regarding crypto-currency developments as they relate to the CFTC and the markets it regulates. CFTC Chief Counsel David Van Wagner and CFTC Associate Director Thomas Leahy delivered remarks at the meeting, which also convened a panel of industry participants, including: Leonard Nuara of TeraExchange, Tim Byun of BitPay (a Bitcoin payment processor), Jerry Brito of the Coin Center (a non-profit research and advocacy group) and Houman Shadab (a New York Law School professor and industry commentator).

Only one day earlier, TeraExchange, a swap execution facility (SEF) regulated by the CFTC, began offering for trading the first Bitcoin swap to be listed on a CFTC-regulated platform.

CFTC Discusses First Bitcoin Swap Listed on a CFTC-Regulated Platform

Associate Director Thomas Leahy and Leonard Nuara discussed their collaboration with TeraExchange during the certification process, which included significant interaction from when TeraExchange's draft section 40.2 filing was submitted in March 2014 through when the contract was first listed for trading by self-certification on October 8, 2014.

The contract is a bilateral, non-deliverable, non-cleared forward swap contract based on a proprietary index developed by TeraExchange that is cash-settled in US dollars. TeraExchange's proprietary index calculates a Bitcoin spot price based on data from a variety of Bitcoin exchanges that is filtered with a volume-weighted methodology to reduce the impact of outlier prices.

The CFTC noted that TeraExchange's development of a proprietary Bitcoin price index was central to the CFTC's review and approval, particularly with respect to the contract's ability to comply with SEF Core Principle Three, which prohibits SEFs from listing contracts that are readily susceptible to manipulation. The CFTC also noted that TeraExchange and each of the Bitcoin marketplaces that affect the calculation of the TeraExchange Bitcoin spot price have mutual information sharing agreements to facilitate surveillance and guard against manipulation.

CFTC Displays Regard for Crypto-Currency Innovation

The CFTC acknowledged the growing number of merchants accepting Bitcoin as payment for goods and services and that these merchants now face significant risk due to price fluctuations in the value of the crypto-currency. In addition to the registered SEF on which the first Bitcoin swap contract was listed, the CFTC indicated several other platforms are already registered or soon-to-be registered that also intend to list Bitcoin-referencing contracts.

Industry participants spoke to the nature of Bitcoin as a protocol with other applications besides its use as a crypto-currency, and stressed that Bitcoin's reliance on an open-source, distributed public ledger represents the crypto-currency's most significant innovation. Participants stressed that regulators considering crypto-currency developments should be sensitive to Bitcoin's potential use as a platform and the innovation that may result from applications built upon its root technology as a publicly distributed ledger system. Regulatory uncertainty or a restrictive regulatory approach could stifle innovation, according to certain of the panelists.

In his remarks, CFTC Commissioner Mark Wetjen displayed regard for these concepts and underscored the need for the CFTC to continue to understand the potential benefits that Bitcoin and Bitcoin-like protocols could provide to the derivatives marketplace. Specifically, Mr. Wetjen alluded to the settlement and trustee-like services inherent in an open-source, distributed public ledger protocol such as Bitcoin, and how those services could have applications in the derivatives space. CFTC Associate Director Thomas Leahy also expressed sensitivity to the multifaceted nature of the technology underlying Bitcoin and the needs of market participants, and suggested the CFTC should look to its own core principles for guidance when evaluating submissions relating to crypto-currencies.

Crypto-Currency Issues Under Consideration by the CFTC

The CFTC is currently considering the following issues in determining how to approach and potentially regulate Bitcoin:

1. Is Bitcoin a "commodity" and, if so, what type of commodity (*i.e.*, exempt or excluded)?
2. If Bitcoin is a commodity, do contracts on Bitcoin qualify as "commodity interests"? If so, are they swaps, futures, forwards, options or spots?
3. Should Bitcoin be regulated as currency, similar to contracts that are not Non-Deliverable Forwards (NDFs) or Treasury Determination contracts (*i.e.*, foreign exchange forwards and foreign exchange swaps)?
4. Should systems and facilities where Bitcoin is mined or originates qualify as SEFs, swap data repositories, or derivatives clearing organizations (or none of the above)?
5. Are Bitcoin products cleared, or should they be cleared?
6. If Bitcoin is a commodity, to what extent should the CFTC exercise its anti-fraud and anti-manipulation authority? Does the CFTC have the resources to do so?

While it is unlikely that the CFTC will have clear guidance on these issues in the near future, the CFTC is currently analyzing whether Bitcoin is a commodity. Classifying Bitcoin as a commodity — subject to the CFTC's authority — could dramatically impact both the Bitcoin industry and the CFTC's activities. For

example, the Bitcoin market as a whole could be subject to the CFTC's anti-fraud and anti-manipulation authority, and any contracts that resemble swaps (such as cash-settled Bitcoin contracts), futures or rolling spots could be subject to the CFTC's plenary authority. Given the open-source nature of Bitcoin, a number of Bitcoin applications could resemble such products.

Conclusion

Industry participants are closely monitoring developments in the potential regulation of Bitcoin and cryptocurrency generally. The open meeting indicates that the CFTC is still considering whether Bitcoin is a commodity subject to CFTC regulation, a process which will continue to unfold and may be complicated by political pressures given the high-profile nature of Bitcoin. The CFTC also indicated its willingness to continue to gather information about Bitcoin through dialogue with industry participants and displayed regard for Bitcoin's complexity as an open-source distributed ledger and technology platform with additional applications.

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