SULLIVAN & CROMWELL LLP

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# CFTC Virtual Currency Guidance

## CFTC Issues Guidance on What Constitutes the "Actual Delivery" of Virtual Currencies in the Context of Retail Commodity Transactions

### SUMMARY

On March 23, 2020, the Commodity Futures Trading Commission voted unanimously to approve publication of final interpretive guidance, following a 2017 proposal, on the definition of "actual delivery" in the context of a retail commodity transaction involving virtual currencies and entered into with a party that is not an "eligible contract participant," as defined under the Commodity Exchange Act . The guidance, consistent with prior guidance on retail commodity transactions, provides that "actual delivery" in a retail virtual currency transaction occurs if, within 28 days of the transaction:

- The buyer has the ability to (i) take possession and control of the entire quantity of the virtual currency involved in the transaction, irrespective of whether the transaction was purchased on margin, using leverage, or another financing arrangement, and (ii) freely use the entire amount of the virtual currency; and
- The offeror or counterparty seller does not retain any interest in or control over any amount of the virtual currency that is transferred.

### BACKGROUND

The Commodity Exchange Act ("*CEA*") grants the Commodity Futures Trading Commission (the "*CFTC*") jurisdiction over various types of derivatives, including futures, certain options and most types of swaps.[1] The CFTC also has broad power to prevent fraud and manipulation in futures, swaps and related commodity markets.[2] For a time, judicial decisions called into question the CFTC's assertion that retail commodity transactions fell within its purview.[3] The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 clarified and expanded the CFTC's authority, confirming its jurisdiction over certain retail commodity transactions, but also exempting other such transactions from the CEA.[4] In particular, the CEA exempts from the CFTC's regulatory authority any transaction that "results in actual delivery within 28 days or such other longer period as the Commission may determine by rule or regulation based upon the typical commercial practice in cash or spot markets for the commodity involved."[5]

In 2013, the CFTC published guidance (the "*2013 Guidance*") on what qualifies as "actual delivery" under this provision of the CEA.[6] According to the 2013 Guidance, the CFTC would adopt a "functional approach and examine how the agreement, contract, or transaction is marketed, managed, and performed," rather than just looking at the wording of the contract in question.[7] The 2013 Guidance offered a non-exhaustive list of factors that the CFTC would consider when determining whether "actual delivery" had occurred:

- Ownership;
- Possession;
- Title;
- Physical location of the commodity purchased or sold, both before and after execution of the agreement, contract, or transaction;
- The nature of the relationship among the buyer, seller, and possessor of the commodity purchased or sold; and
- the manner in which the purchase or sale is recorded and completed.[8]

Additionally, the 2013 Guidance stated that "actual delivery" would not be deemed to have occurred if, within 28 days of an agreement, the transaction is "rolled, offset, or otherwise netted with another transaction or settled in cash."[9] Physical delivery of the complete asset to the buyer within 28 days is required for "actual delivery" to occur.[10]

In 2015, the CFTC determined that virtual currency is a "commodity" for purposes of the CEA, thereby including retail transactions in virtual currencies within the scope of these provisions.[11] The Final Interpretive Guidance reflects the CFTC's views on the application of the "actual delivery" requirement to virtual currencies.

## THE FINAL INTERPRETIVE GUIDANCE

### Two-Part Test

The final interpretive guidance (the "*Final Interpretive Guidance*"),[12] which closely follows the 2017 proposal (the "*2017 Proposal*")[13] subject to a few changes noted below, adopts a broad definition of what constitutes a virtual currency. Specifically, a virtual currency is defined as "a digital asset that encompasses any digital representation of value or unit of account that is or can be used as a form of currency (*i.e.*, transferred from one party to another as a medium of exchange; may be manifested through units, tokens, or coins, among other things; and may be distributed by way of digital "smart contracts," among other structures."[14] In evaluating whether "actual delivery" has occurred, the Final Interpretive Guidance modifies the list of factors and the "functional approach," which are set forth in the 2013 Guidance, to apply to virtual currencies.[15] The Final Interpretive Guidance builds on the 2017 Proposal's requirement that, in order for "actual delivery" to occur, the purchaser must be able to use the commodity freely in commerce no later than 28 days after the transaction is entered into. Under the Final Interpretive Guidance, the purchaser must be able to use "the entire quantity" of the commodity no later than 28 days of the transaction "and at all times thereafter."[16]

Under the two-part test in the Final Interpretive Guidance, "actual delivery" in a retail virtual currency transaction requires that:

- The purchaser secures 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
- 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.

### Five Examples

The Final Interpretive Guidance includes five non-exhaustive examples intended to clarify the CFTC's process for analyzing whether actual delivery has occurred in a retail commodity transaction involving a virtual currency.[17]

### Examples 1 and 2 – Good Actual Delivery

In Example 1,[18] actual delivery of a virtual currency will have taken place if, within 28 days of entering into the transaction, there is a record on the relevant public distributed ledger or blockchain address of the transfer of virtual currency, whereby the entire quantity of the purchased virtual currency, including any portion of the purchase made using leverage, margin, or other financing, is transferred from the seller to the purchaser so that the purchaser then maintains sole control and possession of the asset. When an intermediary is involved, the public-distributed ledger should reflect the purchased virtual currency transferring from the seller's blockchain address to the third-party offeror's blockchain address and, separately, from the third-party offeror's blockchain address to the purchaser's blockchain address.

In Example 2,[19] the transaction includes a depository, which acts on behalf of the purchaser. Three factors must be satisfied, each within the 28-day window, in order for there to be "actual delivery." First, the offeror must have delivered the entire quantity of the virtual currency purchased, including any portion of the purchase made using leverage, margin or financing, into the possession of the depository that has entered into an agreement with the purchaser to hold the virtual currency on the purchaser's behalf. Second, the purchaser needs to have full control over the virtual currency, including the ability to utilize the full amount of the purchased commodity held by the depository. Third, the commodity must be delivered free of any liens (or other interests or legal rights) relating to the use of margin, leverage, or financing used to obtain the entire quantity of the commodity delivered. Any lien or legal interest must cease prior to the 28-day window expiring.

### Examples 3, 4 and 5 – No Actual Delivery

Example 3 illustrates the principle that "actual delivery" will not have occurred if, within 28 days of entering into the transaction, the commodity's full purchase amount is not transferred from the offeror or seller's digital account or ledger system to the purchaser, or, in the case of Example 2, a properly authorized depository acting on the purchaser's behalf. Example 4 shows that a mere book entry (made within 28 days of the transaction) that purports to record a transfer from the seller to the purchaser will not suffice on its own to establish "actual delivery." Rather, "actual delivery" requires that the entire amount of the virtual currency be transferred to the purchaser. Finally, in Example 5, "actual delivery" does not occur if, within 28 days of entering into the transaction, the agreement is "rolled, offset, against, netted out, or settled in cash or virtual currency (other than the purchased virtual currency) between the customer and offeror or counterparty seller."[20] Example 5 illustrates the difference between physical settlement and settlement that involves payment in a currency or asset other than the virtual currency that the transaction originally involved.

### 90-Day Grace Period

In remarks accompanying the release of the Final Interpretive Guidance, CFTC Chairman Heath P. Tarbert stated that the CFTC would allow for a 90-day grace period during which the agency would not pursue enforcement actions under the Final Interpretive Guidance "that were not plainly evident from prior CFTC guidance, enforcement actions, and case law."[21]

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## ENDNOTES

[1] 7 U.S.C. § 2(a)(1)(A).

[2] 7 U.S.C. § 9(1).

[3] *See*, *e.g.*, *CFTC* v. *Zelener*, 373 F.3d 861 (7th Cir. 2004); *CFTC* v. *Erskine*, 512 F.3d 309 (6th Cir. 2008).

[4] 7 U.S.C. § 2(c)(2)(D)(iii).

[5] 7 U.S.C. § 2(c)(2)(D)(ii)(**III**)(aa).

[6] *Retail Commodity Transactions Under Commodity Exchange Act*, 78 Fed. Reg. 52426 (Aug. 23, 2013), *available at:* https://www.govinfo.gov/content/pkg/FR-2013-08-23/pdf/2013-20617.pdf.

[7] 78 Fed. Reg. at 52428.

[8] 78 Fed. Reg. at 52427.

[9] 78 Fed. Reg. at 52429.

[10] *Id*.

[11] *In re Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan*, CFTC Docket No. 15-29, 2015 WL 5535736, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 33,538 (CFTC Sept. 17, 2015) (consent order); *In re TeraExchange LLC*, CFTC Docket No. 15-33, 2015 WL 5658082, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 33,546 (CFTC Sept. 24, 2015) (consent order).

[12] *Retail Commodity Transactions Involving Certain Digital Assets*, 17 CFR Part 1 (Mar. 23, 2020), *available at:* https://www.cftc.gov/PressRoom/PressReleases/8139-20.

[13] *Retail Commodity Transactions Involving Virtual Currency*, 82 Fed. Reg. 60335 (Dec. 20, 2017), *available at:* https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2017-27421a.pdf.

[14] *Retail Commodit y Transactions Involving Certain Digital Assets*, 17 CFR Part 1, 27, (Mar. 23, 2020), *available at:* https://www.cftc.gov/PressRoom/PressReleases/8139-20.

[15] *Id*. at 30.

[16] *Id*.

[17] *Id*. at 32.

[18] *Id*.

[19] *Id*. at 33.

[20] *Id*. at 34-35.

[21] *See* Statement of Chairman Heath P. Tarbert in Support of Interpretive Guidance on Actual Delivery for Digital Assets, (Mar. 24, 2020), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement032420a.

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