

Virtual Currency

## SEC Waits on Sidelines as New Bitcoin Market Opens

### BNA Snapshot

- Securities regulator expected to take cues from success or failure of bitcoin exchange
- SEC rejected ETF based on cryptocurrency in March but is reviewing decision



By Richard Hill

The SEC likely will wait to see how a new market approved by the U.S. futures regulator for bitcoin options fares before moving forward with an application for an exchange-traded fund that would trade shares based on the cryptocurrency.

The Securities and Exchange Commission will want to take into account how the trading platform and clearinghouse for bitcoin options traded on LedgerX matures and gains liquidity, said John Servidio, a partner with Winston & Strawn, New York. LedgerX's swap execution facility was approved by the Commodity Futures Trading Commission in July.

"The success or failure of the bitcoin option would drive the SEC's analysis," said Servidio, who focuses on capital markets with an emphasis on derivatives and structured products. LedgerX aims to launch in September, according to its website.

To the extent that the bitcoin ETF is based on the trading of instruments under the CFTC's jurisdiction, it makes sense that the SEC would want those markets to be fully developed before approving a product—in this case an ETF—that derives its prices from those markets, Paul Architzel, co-head of the futures and derivatives group at Wilmer Cutler Pickering Hale and Dorr LLP, Washington, told Bloomberg BNA.

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### Rejection, Review

The SEC rejected an exemption for the bitcoin ETF in March, citing a lack of surveillance-sharing agreements with regulated markets that traded the commodity. The agency began reviewing its decision on the ETF in April based on a request by Bats BZX Exchange Inc., which is seeking to list the fund and which made the initial submission.

The SEC will watch to see the volume on LedgerX, and likely keep tabs on how the SEF and clearinghouse oversee trading under the CFTC's supervision.

Registration allows trading venues and clearinghouses to begin operations, but doesn't necessarily predict how well a particular entity will comply. "There have been self-regulatory organizations whose registrations were approved, but not long after were struggling with ongoing compliance with regulatory requirements," said Wenchi Hu, a Latham & Watkins partner in New York who previously was head of the SEC's Office of Clearance and Settlement Supervision and a senior counsel in the Office of Derivatives Policy.

The SEC declined to comment for this story.

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LedgerX probably won't bear the entire burden of establishing a secondary market for trading cryptocurrencies like bitcoin. The Chicago Board Options Exchange has said it plans to create a futures contract based on bitcoin, possibly by the end of the year. Such a development would be "much more significant" than LedgerX, given CBOE's higher profile and retail investors' easier access to futures, said Jeffrey Robins, a partner at Cadwalader, Wickersham & Taft LLP, New York, and co-chairman of its Financial Services Group.

### Piece of the Puzzle

The CFTC's decision on LedgerX is "more of a piece of the puzzle for the SEC," said Nicolette Kost de Sevres, a partner in Mayer Brown LLP's Washington office who represents derivatives exchanges and trading firms in compliance matters.

It's too early to say whether bitcoin will be the dominant cryptocurrency in the long run, Robins said, given its competition with other digital assets.

Attorneys had different ideas about how long the SEC's review might take. The agency has no statutory time frame to abide by and no incentive to make a fast decision, Architzel said. Kost de Sevres, however, said that given interest in the new product, the commission might be inclined to act sooner rather than later.

### Differing Mandates

The differing approaches to bitcoin from the SEC and CFTC can partly be explained by the two market regulators' distinct mandates.

The SEC is primarily responsible for protecting retail investors and facilitating capital formation. The CFTC is tasked mainly with keeping derivatives markets, which typically have more sophisticated users than SEC-regulated markets, functioning efficiently.

The SEC's March decision and the CFTC's July decisions are consistent with those mandates.

"What you see are cautious steps by both agencies that are driven by the specific challenges facing each market," Brian Daly, a Schulte Roth & Zabel, New York, partner who specializes in SEC and CFTC compliance, told Bloomberg BNA.

Jeff Bandman, the former director of the CFTC financial technology unit, said the SEC's March decision and its July report on the sale of digital tokens are in keeping with its investor protection and capital raising mandates. The July statement is "providing a path to legal certainty" for digital assets and digital coin offerings, Bandman, who now operates consulting firm Bandman Advisors in New York, said. By saying it could have brought an enforcement action against a startup known as

DAO, which raised about \$150 million through an unregistered digital coin offering in 2016, the SEC is “putting the market on notice,” Bandman said.

The CFTC's LedgerX decisions and the SEC's July report “are both very pro the evolution and maturation of these markets,” Bandman said. “I view those as very positive.”

To contact the reporter on this story: Richard Hill in Washington at [rhill@bna.com](mailto:rhill@bna.com)

To contact the editor responsible for this story: Phyllis Diamond at [pdiamond@bna.com](mailto:pdiamond@bna.com)