

CFTC advocates for expansion of cryptocurrency market jurisdiction

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More than a decade has passed since Bitcoin was created, yet lawmakers and regulators continue to wade through important questions, such as which regulator should be permitted to regulate digital assets. Despite a lack of digital asset legislation, federal regulators, including the Commodity Futures Trading Commission (CFTC), are adding resources to help police fraud in the digital asset markets in light of the rapidly increasing number of enforcement actions related to digital assets.

Despite the uncertainty with respect to digital asset legislation, the CFTC continues to propel its digital asset-related enforcement efforts.

The CFTC made its first official statement on its jurisdiction over “virtual currencies” (i.e., digital assets, including cryptocurrencies) as far back as 2014, when then Chairman, Timothy Massad, testified before the Senate Committee on Agriculture, Nutrition and Forestry:

“The [Commodity Exchange Act] defines the term commodity very broadly so that in addition to traditional agricultural commodities, metals, and energy, the CFTC has oversight of derivative contracts related to Treasury securities, interest rate indices, stock market indices, currencies, electricity, and heating degree days, to name just a few underlying products. Derivative contracts based on a virtual currency represent one area within our responsibility.” (CFTC, Testimony of CFTC Chairman Timothy Massad before the U.S. Senate Committee on Agriculture, Nutrition and Forestry (Dec. 10, 2014) available at <https://bit.ly/3tEjBuo>).

At the time, few paid much attention to the Chairman’s significant declaration.

Later, in 2015, the CFTC brought its first enforcement action involving a virtual currency, in which the CFTC asserted that “[b]itcoin and other virtual currencies are encompassed in the definition and properly defined as commodities.” (*In the Matter of Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan*, CFTC Docket No. 15-29 (Sept. 17, 2015)).

Still, market participants remained largely quiet about the declaration.

Then, in 2018, the CFTC’s classification was challenged in federal court. (*See Commodity Futures Trading Comm’n v. McDonnell*, 287 F.Supp.3d 213 (E.D.N.Y. 2018); *see also Commodity Futures Trading Comm’n v. My Big Coin Pay, Inc.*, 334 F.Supp.3d 492 (D. Mass. 2018)). The courts in those cases confirmed the CFTC’s authority to classify a virtual currency as a commodity under the Commodity Exchange Act (CEA), even if there was no futures contract listed or traded on the relevant virtual currency. (*See Id.*)

In agreeing with the CFTC’s broad assertion of jurisdiction, one such court recognized that courts have “generally defer[red] to an agency’s interpretation of a statute that the agency is responsible for administering.” (*Commodity Futures Trading Comm’n v. McDonnell*, 287 F.Supp.3d 213 (E.D.N.Y. 2018)).

Additionally, both courts noted that where a futures market exists for a good, service, right or interest, it may be regulated by the CFTC as a commodity, without regard to whether the dispute involves a futures contract and without regard to whether that specific type was the subject of a futures contract. “[T]he CEA only requires the existence of futures trading within a certain class ... in order for all items within that class ... to be considered commodities.” (*Commodity Futures Trading Comm’n v. My Big Coin Pay, Inc.*, 334 F.Supp.3d 492 (D. Mass. 2018)).

Although the CFTC has found that a virtual currency is a commodity, the CFTC’s jurisdiction over the digital asset markets has been limited to policing fraudulent and manipulative activities involving digital assets traded in interstate commerce and derivative contracts — i.e., “commodity interests” under CFTC Rule 1.3 — that derive their value from digital assets.

Section 9(1) of the CEA, and the CFTC regulation promulgated thereunder, grants the CFTC broad regulatory authority over fraud and manipulation in the spot markets underlying the already regulated derivatives markets. Specifically, Section 9(1) of the CEA makes it unlawful for any person to use or employ, or attempt to use or employ, in connection with any “contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or

deceptive device or contrivance, in contravention of such rules and regulations as the [CFTC] shall promulgate.” (Title 7 U.S.C. § 9(1)).

Further, CFTC regulation 180.1 makes it unlawful for any person, in connection with any “contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity, to intentionally or recklessly ... [u]se or employ, or attempt to use or employ, any manipulative device, scheme, or artifice to defraud.” (17 C.F.R. § 180.1.) However, the CFTC has long recognized that its jurisdiction over spot transactions is limited to instances where evidence of fraud or manipulation is present.

Therefore, beyond instances of fraud or manipulation, the CFTC does not currently oversee spot or cash market transactions involving digital assets that do not rely on margin, leverage, or financing (which are referred to as “retail commodity transactions”) nor does it oversee the market participants engaged in such transactions. (See CEA § 2(c)(2)(D), which provides that agreements, contracts or transactions in commodities — other than foreign currencies or securities — entered into by or offered to retail customers (i.e., non-eligible contract participants as defined in CEA § 1a(18)) on a leveraged, margined or financed transaction as subject to regulation by the CFTC, absent an exemption.)

Current CFTC Chairman Rostin Behnam, however, is looking to expand the agency’s remit.

In a confirmation hearing for Behnam last October, Chairman Behnam stated that the CFTC was ready to take primary responsibility for digital asset enforcement. “I think it’s important for this committee to reconsider and consider expanding authority to the CFTC,” Behnam said. (James Rubin, “CFTC Chair Indicates Agency Will Increase Crypto Enforcement: Report,” CoinDesk, May 19, 2022.)

Additionally, in testimony before the Senate Committee on Agriculture, Nutrition and Forestry in February, Behnam urged lawmakers to give the CFTC more authority and a \$100 million increase to the agency’s annual budget of \$300 million to take on additional responsibilities in regulating the digital asset markets. (Allyson Versprille and Robert Schmidt, “CFTC Seeks Bigger Role in U.S. Efforts to Oversee Crypto Trading,” Bloomberg, Feb. 9, 2022.)

In his testimony, Behnam advocated fiercely to permit the CFTC to regulate spot digital asset transactions:

“The CFTC is well situated to play an increasingly central role in overseeing the cash digital asset commodity market. Fundamentally, the CFTC is a market regulator that ensures market integrity and vibrancy aimed at supporting financial stability, while ensuring individual customer protections through principles-based oversight of exchanges, clearinghouses, data repositories, and market participants. This flexible approach has allowed the CFTC, with authority from Congress, to evolve along with the derivatives markets from their historical roots in overseeing agricultural markets to now overseeing markets in everything from energy and precious

metals to financial indices and swaps. And we now stand ready to do the same within the digital asset commodity market.” (Testimony of CFTC Chairman Rostin Behnam before the U.S. Senate Committee on Agriculture, Nutrition and Forestry (Feb 9, 2022), available at <https://bit.ly/301AtmM>).

Some in Congress have responded to Chairman Behnam’s statements by introducing bipartisan bills such as the Digital Commodity Exchange Act of 2022 (DCEA) and the Responsible Financial Innovation Act (RFIA), which each assign regulatory authority over digital asset spot markets to the CFTC. (The full text of the DCEA is available at <https://bit.ly/3mRnaJF>, while the full text of the RFIA is available at <https://bit.ly/3OgbOL4>.)

In response to the surging number of cases related to digital assets, CFTC Chairman Rostin Behnam has indicated that the CFTC will add resources and increase efforts to address digital asset-related fraud and manipulation cases.

Under the DCEA, the CFTC would be authorized to register and regulate trading venues (i.e., exchanges) offering spot or cash digital commodities, which would have to abide by certain requirements for safeguarding customer assets consistent with those currently applicable to futures commission merchants (FCMs).

Under the RFIA, the CFTC would have exclusive spot market jurisdiction over all fungible digital assets that do not confer debt or equity interest, a profit share, or similar right in a business entity. In addition, the RFIA would create a pathway for digital asset exchanges to register with the CFTC, similar to the DCEA.

The DCEA and the RFIA are the latest among a flurry of congressional proposals offering approaches to federal oversight of digital assets, with still more in the works. Despite the uncertainty with respect to digital asset legislation, the CFTC continues to propel its digital asset-related enforcement efforts.

During the past fiscal year, the CFTC filed 23 digital asset-related enforcement actions, nearly half the total number of digital asset-related enforcement actions brought by the CFTC since 2015. (James Rubin, “CFTC Chair Indicates Agency Will Increase Crypto Enforcement: Report,” CoinDesk, May 19, 2022.)

In response to the surging number of cases related to digital assets, Behnam has indicated that the CFTC will add resources and increase efforts to address digital asset-related fraud and manipulation cases. (*Id.*) “Headlines about the loss of tens of millions of dollars in digital assets due to protocol exploits, phishing attacks, preying on vulnerable people and other fraudulent and manipulative schemes have become far too common,” Behnam said. (*Id.*)

While the scope of the CFTC's authority to regulate the digital asset markets remains unclear, one thing is certain: The CFTC will continue to crack down on digital asset-related fraud and intends to bring more staff onboard to assist in these efforts. Accordingly, the industry can expect to see the CFTC bring an increasing number of

digital asset-related enforcement actions in the future, especially if Chairman Behnam's calls for increased responsibilities and funding are answered.

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