

# Client Alert

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## CFTC Defines Bitcoin and Digital Currencies as Commodities

In a ruling of particular importance to the digital currency community, the US Commodity Futures Trading Commission (CFTC) for the first time has definitively ruled that Bitcoin and other digital currencies (also known as virtual currencies or cryptocurrencies) are commodities subject to the CFTC's jurisdiction. Specifically, in an enforcement action announced on September 17, 2015, the CFTC issued an order against an online platform and its CEO for facilitating the trading of Bitcoin options contracts. We discuss some of the implications of this order below.

In the CFTC's enforcement action, the products listed on the trading platform were designated as put and call options contracts for which the underlying asset was Bitcoin, the most well-known form of digital currency.<sup>1</sup> Additionally, the strike and delivery prices were denominated in US dollars, and premiums and payments of settlement were to be paid using Bitcoin at a spot rate determined by a designated third-party Bitcoin currency exchange. Platform users were also able to post bids and offers on the platform for the Bitcoin options contracts, and the trading platform acted as an intermediary to match bids and offers.

The CFTC's order makes a number of important legal findings. First, the CFTC defined the term "virtual currency" as "a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value, but does not have legal tender status in any jurisdiction." In doing so, the CFTC distinguished virtual currencies from "real" currencies, which it defined as "coin and paper money of the United States or another country that are designated as legal tender, circulate, and are customarily used and accepted as a medium of exchange in the country of issuance." Finally, the CFTC held that Bitcoin and other virtual currencies are encompassed in the definition of a "commodity" under the Commodity Exchange Act and are thus "properly defined as commodities."

In light of the holding that virtual currencies are commodities, options contracts that reference a virtual currency are "commodity options" and "commodity option transactions" under CFTC regulations. By offering and entering those contracts on the trading platform, the platform violated CFTC regulations regarding trading in options contracts, and the platform also constituted an unregistered swap execution facility, also in violation of CFTC rules. The trading platform and its CEO agreed to cease and desist from future violations of CFTC rules, but were not required to pay any monetary penalties.

Although individual CFTC commissioners have in the past made public comments suggesting that they believed digital currency is a commodity, this enforcement action marks the first time that the agency as a whole has spoken definitively on the issue. The consequences of the CFTC's order could be significant to digital currency businesses and will subject derivative transactions in digital currencies to required trading on recognized exchanges unless an exemption is available. It will also subject parties to such transactions to possible registration as commodity pool operators or commodity trading advisers (unless an exemption is available) or, depending on the nature of the party's role and other activities, to possible registration as a swap dealer or major swap participant.

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<sup>1</sup> The complete text of the CFTC order is available at <http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinfliprorder09172015.pdf>.

This CFTC order clarifies, at least for the time being, the CFTC's official view that digital currencies are commodities, and it may foreshadow further CFTC rulemaking on the subject. But it is not the last word on the regulatory treatment of digital currency, and numerous other regulators have taken sometimes conflicting positions on the issue. The Securities and Exchange Commission and state securities regulators, for example, have pursued enforcement actions against promoters of fraudulent pooled investment schemes involving Bitcoin, though they have not yet ruled that digital currency is itself a security. The Financial Crimes Enforcement Network has issued guidance stating that virtual currency is considered currency and exchangers will be viewed as money service businesses subject to the Bank Secrecy Act. Working with federal prosecutors, FinCEN has subsequently initiated enforcement proceedings against operators of digital currency platforms that run afoul of the Bank Secrecy Act. And various states have interpreted their money transmitter laws to cover certain activities involving digital currency trading, while other states have sought to promulgate new regulations on the subject. Under newly adopted regulations, New York State's Department of Financial Services recently issued its first "BitLicense" to a digital currency business. In short, the CFTC's action is not binding on any other regulatory agencies, and this remains a rapidly evolving area of the law.

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