REPORT

Futures & Derivatives Law

The Journal on the Law of Investment & Risk Management Products

April 2018 ▪ Volume 38 ▪ Issue 4

# FROM THE EDITOR

## "You Can't Regulate Bitcoins With Virtual Money"

Similar to other "breaking news" topics subject to over-coverage in the media and testimony on the Hill, Virtual Currencies ("VC's) are difficult to understand, and provide fodder for television comedians running low on Washington foils.

Recently, comedian John Oliver took a turn at trying to explain VC's and the blockchain ledger technology quipped, ". . .people are buying Bitcoins for no other reason than others are buying them. . ." It appears that Oliver's observation is playing out in the markets as the price of VC's have been driven to unsustainable levels followed by rapid declines.

For example, a VC token traded on the Bitfinex Exchange (bitfinex.com) climbed from a price of $4,400 on October 5, 2017, to $19,300 on December 17, 2017, and then dropped to $6,900 on March 31, 2018. As I have witnessed over and over again, hyped-up interest in a speculative product that promises unlimited wealth, is loaded with potential risk; many people loose money and question the integrity of the financial markets.

The Internal Revenue Service describes VCs as "a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value [and] does not have legal tender status in any jurisdiction." Unlike traditional digital transfers of value, VCs do not represent a claim on value; rather the VC's are the value. Finally, none of the VCs are backed by the full faith and credit of a sovereign nation, including the United States.

There are calls for additional regulation and debates as to which agency or agencies will have jurisdiction over the new instrument and trading venues. The chairs of both the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC"), Jay Clayton and J. Christopher Giancarlo, respectively, said in a joint piece in the Wall Street Journal that:

> Our task, as market regulators, is to set and enforce rules that foster innovation while promoting market integrity and confidence. In recent months we have seen a wide range of market participants, including retail investors, seeking to invest in distributed ledger technologies initiatives, including through cryptocurrencies and so-called ICOs, initial coin offerings. Experience tells us that while some market participants may make fortunes, the risks to all investors are high. Caution is merited.

While the regulators, along with some courts, have patched together a protocol for possible regulatory boundaries and jurisdiction without impeding the growth of innovation, the questions surrounding oversight of VCs ultimately lead to the matter of funding regulators. Will the

THOMSON REUTERS®

regulators charged with policing the products and the trading platforms have sufficient resources to carry out their assignments?

Presently, the states, and the federal government under the Bank Secrecy Act and the IRS have some regulatory responsibilities over VCs. But the most significant oversight tasks fall on the CFTC and the SEC. As noted by the agency chairs in their *WSJ op-ed*:

> Recently, two of the largest CFTC-regulated exchanges listed Bitcoin futures products. [To accomplish this] they spent significant time engaging with CFTC staff and agreed to implement risk-mitigation and oversight measures, including heightened margin requirements and a requirement that the exchanges have information-sharing agreements in place with underlying Bitcoin trading platforms.
>
> The SEC does not have direct oversight of transactions in currencies or commodities. Yet some products that are labeled cryptocurrencies have characteristics that make them securities. The offer, sale and trading of such products must be carried out in compliance with securities law.

Unfortunately, while the agencies appear to be aligned on their jurisdictional divide, Congress denied the CFTC's request for a moderate increase in staff and budget to $281.5 million. The recently passed federal budget, instead, *reduces* the CFTC's 2019 allocation to $249 million from $250 million for fiscal 2018. The SEC, on the other hand, received a $47 million *increase* to $1.658 billion for 2019 up from $1.605 billion in 2018.

As an alumnus of the SEC and having worked with the CFTC since just after its formation, I'm very familiar with the staffs of both agencies. Both have professionals of the highest levels of commitment, integrity and intelligence. However, with the CFTC's recently assigned VC related responsibilities in addition to its present roster of swaps and traditional futures products, it appears that the legitimate concerns over possible VC fraud and manipulation were given a heavy and unjustified discount by the congressional powers that be.

The CFTC is thus left with less funding than before while at the same time its regulatory responsibilities and the public's expectations of its expertise are increasing. While we understand that reduced regulation may be justified in certain areas, additional regulatory compliance without proper funding is feckless at best. When it comes to such essential matters as the oversight of our financial markets we have learned from experience that we can't expect quality performance with only phantom resources as virtual money.

**Donald L. Horwitz**

Managing Director, Oyster Consulting, LLC

Founding Principal, Donald Horwitz Consulting, LLC

don@donaldhorwitzconsulting.com

 