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CLIENT ALERT
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CFTC Issues Final Interpretive Guidance regarding the "Actual Delivery" Exception to Retail Commodity Transactions Involving Virtual Currency

The Commodity Futures Trading Commission (the "CFTC" or "Commission") published in the Federal Register on June 24, 2020, final interpretive guidance regarding the "actual delivery" exception to the prohibition under the Commodity Exchange Act ("CEA") on off-exchange retail commodity transactions involving digital assets that serve as a medium of exchange, known as "virtual currencies" (the "Final Interpretive Guidance").[1] The Final Interpretive Guidance describes the primary factors that the Commission will consider when evaluating whether "actual delivery" has occurred for purposes of the exemption from the CEA that permits leveraged, margined or financed off-exchange retail commodity transactions. The Final Interpretive Guidance became effective June 24, 2020.

Background

Section 2(c)(2)(D)(i) of the CEA prohibits any off-exchange agreement, contract or transaction in a commodity that is: (1) entered into with, or offered to (even if not entered into with), a person that is neither an eligible contract participant nor an eligible commercial entity (i.e., a "retail" customer), and (2) on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis.[2] Absent an exception, such transactions must be executed on a designated contract market "as if" they were futures contracts, and intermediaries offering such transactions must be registered as futures commission merchants.

An important exception to the prohibition applies to contracts of sale resulting 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."[3] In 2013, the Commission issued guidance regarding the meaning of "actual delivery" for purposes of the exception ("2013 Guidance").[4] The 2013 Guidance explained that the Commission will "employ a functional approach and examine how the agreement, contract or transaction is marketed, managed and performed, instead of relying solely on language used by the parties in the agreement, contract or transaction."[5] The 2013 Guidance also listed factors the Commission will consider in determining whether a transaction results in actual delivery and provided examples of what may constitute actual delivery.[6]

After the CFTC determined in 2015 that virtual currencies, such as bitcoin, are commodities for purposes of the CEA,[7] the CFTC recognized that virtual currencies required additional guidance in the

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[1] *Retail Commodity Transactions Involving Certain Digital Assets*, 85 Fed. Reg. 37,734 (June 24, 2020), available at https://www.cftc.gov/LawRegulation/FederalRegister/finalrules/2020-11827.html.
[2] 7 U.S.C. §2(c)(2)(D)(i).
[3] 7 U.S.C. §2(c)(2)(D)(ii)(III)(aa).
[4] *Retail Commodity Transactions Under Commodity Exchange Act*, 78 Fed. Reg. 52,426 (Aug. 23, 2013).
[5] *Id.* at 52,428.
[6] *Id.*
[7] *See 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)

context of the actual delivery exception and, in December 2017, proposed a virtual currency-specific interpretation of the "actual delivery" exception to the prohibition on off-exchange, leveraged, margined or financed retail commodity transactions (the "Proposed Interpretation").[8] The Proposed Interpretation set out two central tenets of the CFTC's view on when "actual delivery" of virtual currency has occurred:

- a customer has the ability to: (i) take 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) use it freely in commerce (both within and away from any particular platform) no later than 28 days from the date of the transaction; 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) does not retain any interest in 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.

The CFTC sought public comment on the Proposed Interpretation, for which the comment period closed on March 30, 2018. Among other issues raised by commenters included the meaning of "title" in the context of virtual currency and retail commodity transactions, the length of time during which "actual delivery" could occur, the demonstration of possession and control and depository independence.[9]

Final Interpretive Guidance on the Actual Delivery of Virtual Currency

In the Final Interpretive Guidance, the CFTC acknowledged the many potential uses of virtual currency and related technology and noted its desire not to stifle nascent technological innovation. However, the Commission also expressed concern about potential risk to retail customers and noted that any interpretation should not frustrate the protections for such customers afforded by Congress.[10] Specifically in that regard, one of the Commission's concerns was that a seller might fraudulently assert control over digital assets transferred to an affiliated depository and that requiring the transaction to be executed using a futures commission merchant on an exchange may offer protection to retail customers.[11] In light of this concern, the Final Interpretive Guidance provides that the CFTC will "continue to follow the 2013 Guidance and 'employ a functional approach and examine how the agreement, contract or transaction is marketed, managed and performed, instead of relying solely on language used by the parties to the agreement, contract or transaction."[12] The Final Interpretive Guidance generally follows the Proposed Interpretation, stating that "actual delivery" has occurred when:

- A customer secures: (i) 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

(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).
[8] *See Retail Commodity Transactions Involving Virtual Currency*, 82 Fed. Reg. 60,335 (Dec. 20, 2017).
[9] *See* 85 Fed. Reg. at 37,736-741.
[10] *See* 85 Fed. Reg. at 37,742.
[11] (85 Fed. Reg. at 37,739
[12] *Id.*

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.[13]

The CFTC stated its belief that "actual delivery occurs when the offeror and counterparty seller, including their agents, cease to retain any interest, legal right, or control whatsoever in the virtual currency acquired by the purchaser at the expiration of 28 days from the date of entering into the transaction or at any time prior to expiration of the 28-day period once actual delivery occurs."[14] Moreover, physical settlement involving the entire amount of purchased commodity must occur within 28 days.[15] A "cash settlement or offset mechanism," according to the Final Interpretive Guidance, is not consistent with the Commission's interpretation.[16]

The CFTC provided five examples of successful and unsuccessful "actual delivery," with the first two examples involving successful actual delivery and the remaining three examples illustrating when actual delivery has not occurred. In summary form the examples are as follows:[17]

> Example 1: Actual delivery of virtual currency will have occurred if, within 28 days after entering into an agreement, contract or transaction, there is a record on the relevant public distributed ledger or blockchain address of the transfer of the entire quantity virtual currency purchased to the purchaser's blockchain address, over which the purchaser maintains sole possession and control.
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> Example 2: Actual delivery of virtual currency will have occurred if, within 28 days after entering into a transaction: (1) the counterparty seller or offeror has delivered the entire quantity of the virtual currency purchased into the possession of an unaffiliated depository (i.e., a wallet or other relevant storage system),[18] (2) the purchaser has secured full control over the virtual currency and (3) with respect to the commodity being delivered, no liens (or other interests or legal rights of the offeror, counterparty seller, or persons acting in concert with the offeror or counterparty seller on a similar basis) resulting or relating to the use of margin, leverage, or financing used to obtain

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[13] *Id.* at 37,742-743.
[14] *Id.* at 37,743.
[15] *Id.*
[16] *Id.*
[17] *See id.* at 37,743-744.
[18] The offeror may associate with an affiliated depository in Example 2 that the customer chooses to utilize, but such an affiliated depository should be: (i) A ''financial institution'' as defined by CEA section 1a(21); (ii) a separate line of business from the offeror not subject to the offeror's control; (iii) a separate legal entity from the offeror and any offeror execution venue; (iv) predominantly operated for the purpose of providing custodial services for virtual currency and other digital assets; (v) appropriately licensed to conduct such custodial activity in the jurisdiction of the customer; (vi) offering the ability for the customer to utilize and engage in cold storage of the virtual currency; and (vii) contractually authorized by the customer to act as its agent. *See id.* at 37,743 n.170.

the entire quantity of the commodity delivered will continue after the 28-day period has elapsed.[19]

Example 3: Actual delivery will not have occurred if, within 28 days of entering into a transaction, the full amount of the purchased commodity is not transferred away from a digital account or ledger system owned or operated by, or affiliated with, the offeror or counterparty seller (or their respective execution venues) and received by a separate, independent, appropriately licensed, depository or blockchain address in which the customer maintains possession and control.

Example 4: Actual delivery will not have occurred if, within 28 days of entering into a transaction, a book entry is made by the offeror or counterparty seller purporting to show that delivery of the virtual currency has been made to the customer, but the counterparty seller or offeror has not actually delivered the entire quantity of the virtual currency purchased.

Example 5: Actual delivery will not have occurred if, within 28 days of entering into a transaction, the agreement, contract or transaction for the purchase or sale of virtual currency is rolled, offset against, netted out or settled in cash or virtual currency (other than the purchased virtual currency) between the customer and the offeror or counterparty seller (or persons acting in concert with the offeror or counterparty seller).

Conclusion

The Final Interpretive Guidance relies heavily on the CFTC's 2013 Guidance regarding actual delivery, including the requirements that possession and control of the commodity must be obtained by the purchaser within 28 days of the sale, and that cash settlement or book entry is not sufficient. What the Final Interpretive Guidance adds in the area of virtual currency is that actual delivery can be shown by an appropriate record on the public distributed ledger or blockchain or through a depository unaffiliated with the seller or offeror. Some flexibility is provided with respect to a depository affiliated with the seller or offeror that the purchaser chooses to utilize. In an evolving area fraught with ambiguity, the Final Interpretive Guidance provides welcome regulatory guidance with respect to virtual currencies, although it is likely that additional questions as to the meaning of actual delivery will continue to arise.

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[19] The CFTC noted that actual delivery may still occur where liens remain on collateral other than the specific virtual currency that is the subject of the transaction.

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