CFTC Clarifies Meaning of 'Actual Delivery' in Margined, Leveraged or Financed Retail Transactions in Virtual Currencies

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On March 24, 2020, the Commodity Futures Trading Commission (CFTC or Commission) voted unanimously to adopt an interpretation of the term "actual delivery" with respect to retail virtual currency transactions (2020 Guidance).[1] More than two years ago, in December 2017, the Commission had issued a proposed interpretation on the same subject.[2]

Under the 2020 Guidance, transactions in virtual currencies (which are commodities according to the CFTC)[3] with retail customers conducted with margin, leverage or other financing must be traded on a CFTC-licensed futures exchange, unless the virtual currency is free of any liens, other interests or legal rights of the offeror or seller and the purchaser has full control of the virtual currency within 28 days of the transaction. Trading platforms, custodians and other market participants considering entering into virtual currency transactions on margin or with financing should ensure they are familiar with the 2020 Guidance to avoid running afoul of the Commodity Exchange Act (CEA).

The 2020 Guidance will become effective on the date it is published in the Federal Register. CFTC Chairman Heath Tarbert noted, however, that for a period of 90 days after publication, the CFTC will refrain from bringing enforcement actions based on aspects of the 2020 Guidance "that were not plainly evident from prior CFTC guidance, enforcement actions, and case law" to help maintain orderly and liquid digital asset markets.[4]

Background

Uner the CEA, derivatives transactions on commodities with the retail public are generally required to be traded on a CFTC-licensed futures exchange.[5] In 2010, Congress reaffirmed that principle by making clear that any swaps with the retail public must be offered on such a futures exchange.[6] At the same time, Congress also adopted an exemption from that exchange-trading requirement for retail transactions in commodities that are margined, financed or leveraged, where "actual delivery" of the commodity occurs within 28 days of entering into the transaction.[7]

The CFTC has been wrestling for years with its interpretation of the term "actual delivery." In August 2013, the CFTC issued a final interpretation of "actual delivery" in the context of margined, financed or leveraged retail commodity transactions generally

[1] See press release, "CFTC Issues Final Interpretive Guidance on Actual Delivery for Digital Assets," CFTC (Mar. 24, 2020). The CFTC noted that the final interpretive guidance applies only to retail commodity transactions in "virtual currencies," which the CFTC described as "certain types of digital assets that serve as a medium of exchange."

[2] See Retail Commodity Transactions Involving Virtual Currency, 82 Fed. Reg. 60,335 (Dec. 20, 2017); see also "CFTC Issues Proposed Interpretation of 'Actual Delivery' in Virtual Currency Retail Commodity Transactions," Skadden client alert, Dec. 26, 2017.

[3] Since 2015, the CFTC has consistently treated virtual currency as a commodity under the Commodity Exchange Act. See *In re Coinflip, Inc.*, CFTC Docket No. 15-29, 2015 WL 5535736, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 33,538 (Sept. 17, 2015) (consent order); *In re TeraExchange LLC*, CFTC Docket No. 15-33, 2015 WL 5658082, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 33,546 (Sept. 24, 2015) (consent order).

[4] Statement of Chairman Heath P. Tarbert in Support of Interpretive Guidance on Actual Delivery for Digital Assets (Mar. 24, 2020).

[5] The types of entities that would not be considered a retail customer include financial institutions, insurance companies and investment companies trading for their own account. Individuals meeting certain investment thresholds are also not considered retail customers. See CEA Section 1a(18) (defining "eligible contract participants").

[6] See CEA Section 2(e).

[7] See CEA Section 2(c)(2)(D)(ii)(III)(aa). If a retail customer pays outright for the full value of the commodity at the time of the transaction, that transaction does not need to take place on an exchange.

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(2013 Guidance).[8] The 2013 Guidance emphasized that whether actual delivery is accomplished turns on a "functional approach" that considers facts beyond the language used by parties to the transaction. In that regard, the 2013 Guidance included a list of factors the Commission will consider in determining whether a transaction has resulted in actual delivery. For example, actual delivery occurs if there is a transfer of title and possession of the commodity to the buyer or a depository acting on the buyer's behalf. In contrast, mere book entries and certain instances where a purchase is "rolled, offset, or otherwise netted with another transaction or settled in cash" do not constitute actual delivery.[9]

In recent years, that wrestling has focused on whether certain retail transactions in virtual currencies call for "actual delivery" and are therefore *not* required to be traded on regulated exchanges. The need to clarify the meaning of actual delivery in virtual currency transactions became more pronounced in 2016, when the CFTC brought its first enforcement action against a trading platform that offered retail commodity transactions in virtual currency without registering with the Commission.[10]

The Commission has now issued a final interpretation of the term "actual delivery" as it applies to virtual currencies in an effort to signal which kinds of such transactions may be offered to the retail public without being listed on a CFTC-registered exchange.

CFTC Guidance on the Meaning of 'Actual Delivery' for Virtual Currencies

Consistent with the principles established in the 2013 Guidance, the 2020 Guidance explains that in interpreting the term "actual delivery" for purposes of retail commodity transactions, the CFTC will employ a functional approach and examine how the transaction is marketed, managed and performed, instead of relying solely on language used by the parties. Under the 2020 Guidance, actual delivery occurs in retail virtual currency transactions 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 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.

The 2020 Guidance provides further direction on "actual delivery" of virtual currency through illustrative examples. Some notable aspects of these examples include the following:

- Actual delivery will have occurred if, within 28 days of entering into a transaction, the virtual currency's public distributed ledger reflects the transfer of the entire quantity of the purchased virtual currency to the purchaser's blockchain address.
- Actual delivery will not have occurred if, within 28 days of entering into a transaction, the transaction is rolled, offset against, netted out, or settled in cash or virtual currency.
- When a transaction involves a depository that acts on behalf of the purchaser, three conditions must be met for actual delivery: (i) the offeror or seller has delivered the entire quantity of the virtual currency purchased into the possession of the depository; (ii) the purchaser has secured full control over the virtual currency; and (iii) the virtual currency delivered to the depository must be free of liens or other interests or legal rights of the offeror or seller 28 days after the transaction.
- A book entry made by the offeror or counterparty seller purporting to show delivery will not by itself establish actual delivery; instead, the entire quantity of the virtual currency purchased must have been delivered to the customer.

In light of the 2020 Guidance, trading platforms, custodians, brokers and other market participants engaged in virtual currency transactions with retail customers involving margin, leverage or other financing should become familiar with the 2020 Guidance to ensure that they are complying with the actual delivery requirement to the extent transactions are not conducted on a registered futures exchange.

[8] Retail Commodity Transactions Under Commodity Exchange Act, 78 Fed. Reg. 52,426 (Aug. 23, 2013).

[9] Id. at 52,428-29.

[10] *In re BFXNA INC.*, CFTC Docket No. 16-19, [2016-2017 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 33,766 (June 2, 2016) (consent order).

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