

Virtual Currency Disclosure Requirements Webinar
October 11, 2018
10:30 AM EDT

Christie Hillsman: Good morning, everyone. Welcome to NFA's webinar—Virtual Currency Disclosure Requirements. My name is Christie Hillsman and I'm a Communications Manager at NFA. With me today are Blake Brockway, Assistant General Counsel, and Sarah Iverson, Director of Compliance.

As you know, the growth of the virtual currency market has attracted a significant amount of attention from investors. In light of the risks inherent in virtual currencies and related derivatives, NFA has issued an Interpretive Notice implementing new disclosure requirements for members trading these products. The Interpretive Notice will become effective on October 31, 2018. During this webinar, we will briefly discuss the requirements established in the Interpretive Notice.

Following our prepared remarks, we've allocated ample time to answer member questions. To ask a question, locate the box labeled "Ask A Question" on the left side of your webinar screen. Please type the question you would like to ask into the box and click the send button. We are able to see questions as they are submitted. You can submit your questions now or at any time during today's webinar. We will answer any questions at the end of our presentation. For questions that are firm specific, we will reach out to you individually.

Additionally, a recording of this webinar along with a written transcript will be on NFA's website in the coming weeks, so no need to take detailed notes throughout this presentation. I'd like to also note that you can access a number of other virtual currency related resources on NFA's website. And now, I'll turn it over to Blake to provide background on the new Virtual Currency Disclosure Requirements.

Blake Brockway: Thanks, Christie. Although virtual currencies have been available for several years, the listing of virtual currency derivatives by the Chicago Mercantile Exchange and CBOE Futures Exchange in December of last year prompted NFA to carefully review the risks arising from virtual currencies, virtual currency derivatives and our Members' activities in these products.

NFA's responsibility to protect investors was the driving force behind this review. Around the same time, NFA implemented Virtual Currency Reporting Requirements for CPOs, CTAs, IBs and FCMs for which NFA is the DSRO. NFA also issued an Investor Advisory, reminding market participants considering an investment in virtual currency futures, that it is critical for investors to educate themselves about these products, understand the risks, and conduct due diligence before making an investment.

In researching virtual currency products, we found that both spot market virtual currencies and virtual currencies present some unique risks. At the request of our Executive Committee and Board of Directors, NFA developed an Interpretive Notice establishing disclosure requirements for Members engaging in activities involving virtual currencies or virtual currency derivatives. On August 9th, we issued a Notice to Members establishing effective dates for the various requirements set forth in the Interpretive Notice.

The requirements set forth in the Interpretive Notice are the result of many months of

discussions in collaboration with others in the industry including the CFTC, exchanges and members of NFA's Advisory Committees. Today, we will discuss those requirements and effective dates in more detail. I will begin by discussing the requirements applicable to FCM and IB Members and then Sarah will discuss the requirements applicable to CPO and CTA Members.

The Interpretive Notice requires that FCM and IB Members provide their customers with two advisories at or before the time they trade a virtual currency derivative with or through the Member. The "NFA Investor Advisory—Virtual Currency, Futures on Virtual Currencies Including Bitcoin," which can be found on the NFA website, and the "CFTC Customer Advisory: Understand the Risks of Virtual Currency Trading," which can be found on the CFTC's website. I'd like to point out that the advisories may be provided to eligible contract participants through an FCM or IB Member's website. However, they must be provided to retail investors in a prominent manner that is designed to make sure the customer is aware of them. For introduced accounts, the advisories may be provided by either the FCM or the IB.

The Interpretive Notice also requires FCM and IB Members who engage in spot market virtual currency activities to provide customers with standardized disclosure language clarifying that NFA has no regulatory oversight authority over spot market virtual currency products or transactions. The standardized disclosure language can be found in the Interpretive Notice on NFA's website. FCM and IB Members are required to provide this disclosure to retail customers at or before the time they begin trading spot market virtual currencies. And the disclosure language must be included in any promotional materials related to spot market virtual currency products.

If a firm is only offering these products to eligible contract participants, prominently displaying this disclosure language on the firm's website and including it in virtual currency promotional material is sufficient.

I'd also like to briefly discuss the effective dates for the FCM and IB requirements. The disclosure requirements are effective October 31, 2018. However, for customers that began trading virtual currency derivatives prior to the effective date, FCM and IB Members must provide the advisories no later than November 30, 2018. Now I will turn it over to Sarah to talk about the requirements for CPO and CTA Member firms.

Sarah Iverson:

Thanks, Blake. Under the Interpretive Notice, CPOs and CTAs trading spot market virtual currencies or related derivatives in an exempt or nonexempt pool or trading program will be required to provide robust disclosures in their disclosure documents, offering documents and promotional materials. We view this as a principles-based requirement to provide the robust disclosures related to the Members' specific activities. The Interpretive Notice outlines a number of risks the firm should consider including in their disclosures. However, that list is not necessarily comprehensive. Firms should consider the risks outlined in the Interpretive Notice as well as consider whether any other risks might exist in relation to their specific business operations.

Examples of some of the risks to disclose include the unique features of virtual currencies, price volatility, liquidity, valuation, cyber security, and the risks arising from the opaque underlying spot markets among others. Firms trading virtual currency derivatives should also note that the Interpretive Notice identifies several risks that they should consider including in their disclosure documents, offering documents, or any other promotional materials such as risks arising from the price volatility, trading halts and margin requirements. The Interpretive Notice also requires that any CPO or CTA Member that operates a pool, exempt pool, or trading program that trades underlying virtual currency products, to provide customers with standardized disclosures. This language must state that NFA has no regulatory oversight authority over underlying

virtual currency products or transactions and that there is no acceptable practice that NFA can use to verify the exclusive ownership and control of the underlying virtual currencies.

The requirements that I have discussed so far apply to pools, exempt pools and trading programs offered by CPO or CTA Members. We also understand that certain CPO or CTA Members may engage in other virtual currency activities not subject to NFA's regulatory oversight. The Interpretive Notice includes standardized disclosure language that must be included in promotional materials related to these activities.

I'd also like to give a brief overview of the effective dates for the CPO and CTA requirements. Promotional materials distributed or used after October 31, 2018 must satisfy the disclosure requirements set forth in the Interpretive Notice. This requirement also applies to promotional material used by FCM and IB Members. Disclosure documents and offering documents currently in use must be updated, and when required, filed with NFA within 21 days of the effective date of the Interpretive Notice which would be November 21, 2018. Disclosure documents with no material changes may be filed for expedited review or as a supplement where permitted.

Updated disclosures or offering documents also should be provided to previously solicited prospective investors before accepting an investment from such person, and in any event, no later than 21 days after the effective date. So again, November 21, 2018. Given this, if there is a filing requirement with NFA, firms should update and submit their documents to NFA for review as soon as possible.

Christie Hillsman: Thanks, Sarah. This concludes the prepared portion of our webinar. Throughout this discussion, we've received some great questions. We will answer as many questions as we can in the time remaining and should we not get to your question, or if you submit a firm-specific question, an NFA staff member will respond to you via email. Our first question is, how do you define virtual currency? Blake, can you answer that question for us, please?

Blake Brockway: Sure. We intentionally elected not to define virtual currency as the definitions for these products are still evolving. We intend to apply the requirements set forth in the Interpretive Notice broadly to cover any form of virtual currency, cryptocurrency, or digital asset coin or token even if they are called by a different name.

Christie Hillsman: Great. Thanks, Blake. Our next question is, could you clarify which exempt pools are covered by the Interpretive Notice? Sarah, can you address that for us, please?

Sarah Iverson: Sure. The disclosure requirements apply to pools relying on an exemption under CFTC Regulations 4.7, 4.12 and 4.13(a)3. The disclosure requirements also would apply to any Members relying on the guidance set forth in CFTC Letter Number 1238 which is applicable to fund-to-fund operators. The requirements for disclosure documents do not apply to non-Members or pools relying on the exclusions set forth in CFTC Regulation 4.5. Members relying on this exclusion should include the standardized disclosure language that applies to virtual currencies not subject to the regulatory oversight of NFA.

Christie Hillsman: Great. Thanks, Sarah. Our next question is, how do these requirements apply in the context of a pool or exempt pool operating as a fund of funds? Blake, can you answer that for us, please?

Blake Brockway: Absolutely. The first thing to remember is the reporting requirements that we implemented in December of 2017. If a CPO is aware that one of its pools is indirectly investing in one or more virtual currency products through a fund-to-fund structure, it should report that it is engaged in virtual currency transactions by amending its Annual Questionnaire. We also expect such pools and exempt pools to provide robust

disclosures related to their specific situation as set forth in the Interpretive Notice.

Christie Hillsman: Great. Thanks, Blake. And I will pose our next question to Sarah and that is, is providing links to the NFA and CFTC Advisories in a risk disclosure booklet sufficient for retail investors?

Sarah Iverson: No. So the requirement for retail investors would be to provide the advisories in a prominent manner designed to ensure that the customer is fully aware of them. The Interpretive Notice indicates that sending the customer an email with the links to the Advisory and explaining what the links are would be sufficient in most circumstances. But just adding the links into or to the advisories in a risk disclosure booklet would not be sufficient.

Christie Hillsman: Great. Thanks, Sarah. Our next question is, can I recreate the advisories as part of an electronically distributed risk disclosure booklet? Blake, can you answer that for us, please?

Blake Brockway: Absolutely. The advisories can be recreated as long as the content is not altered and the advisories are prominently displayed.

Christie Hillsman: Great. Thank you, Blake. And our next question is, can an NFA Member use Twitter to promote a spot market virtual currency offering? Sarah, can you answer that for us, please?

Sarah Iverson: Sure. The short answer is yes, as long as the standardized disclosure language is also tweeted in a prominent manner designed to ensure that the customers are fully aware of it. Assuming the disclosure language exceeds the Twitter character limit, we would recommend tweeting the language as multiple tweets or as an image. We also would expect firms to retweet the disclosures regularly to ensure that it's prominently displayed and not buried under other tweets.

Christie Hillsman: Great. Thank you, Sarah. And it looks like at this point we may just have one more question. And Sarah, I will pose that one to you. That question is, when you state disclosure documents, are you referring to the disclosure document required of CPOs and CTAs that are not exempt under 4.7? Or some other general type of disclosure document like the Form ADV Part 2 brochure?

Sarah Iverson: Sure. So as part of the requirements for any CPOs and CTAs that are not exempt, so not claiming a 4.7 exception, they are required to submit their disclosure document to NFA for review. So that was what we were referring to when we mentioned disclosure document. I'd also like to mention that another program that NFA has is a promotional material review. So if there is promotional material that you're updating that you want to have NFA review prior to using, you can take advantage of that program and we can provide you with any feedback on it prior to first use.

Christie Hillsman: Great. Thanks, Sarah. And as there are no more questions, I'd first like to thank everyone for their participation today. We hope that you found the information we provided to be helpful. I'd also like to thank our presenters for contributing to today's webinar. And then to close, I would like to remind everyone that you'll be able to access that recording and transcript of today's webinar on NFA's website by the end of the month. And additionally, if we did not get to your question, an NFA staff member will respond to you with an answer via email. You may also contact us at any time using the information on your screen.

Thank you for participating in today's webinar.