

July 20, 2018

**Via Federal Express**

Mr. Christopher J. Kirkpatrick  
Secretary  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, DC 20581

Re: National Futures Association: Proposed Interpretive Notice: *Disclosure Requirements for NFA Members Engaging in Virtual Currency Activities*

Dear Mr. Kirkpatrick:

Pursuant to Section 17(j) of the Commodity Exchange Act ("CEA"), as amended, National Futures Association ("NFA") hereby submits to the Commodity Futures Trading Commission ("CFTC" or "Commission") the proposed adoption of the Interpretive Notice entitled *Disclosure Requirements for NFA Members Engaging in Virtual Currency Activities*. NFA's Board of Directors ("Board") approved the adoption of this Interpretive Notice on May 17, 2018 and provided that NFA's Executive Committee may submit the Interpretive Notice to the CFTC for approval. NFA's Executive Committee, as authorized by the Board, approved additional amendments on July 19, 2018. The Board will ratify the Executive Committee's action at its August 16, 2018 meeting.

NFA is invoking the "ten-day" provision of Section 17(j) of the CEA and plans to make this Interpretive Notice effective ten days after receipt of this submission by the Commission unless the Commission notifies NFA that the Commission has determined to review the proposed Interpretive Notice for approval.

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**PROPOSED INTERPRETIVE NOTICE  
(additions are underscored)**

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**NATIONAL FUTURES ASSOCIATION**

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## INTERPRETIVE NOTICES

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### DISCLOSURE REQUIREMENTS FOR NFA MEMBERS ENGAGING IN VIRTUAL CURRENCY ACTIVITIES

The growth of the virtual currency market has attracted a significant amount of investor attention. Virtual currencies and virtual currency derivatives (i.e., futures, options and cleared swaps) have a variety of unique and potentially significant risks. NFA's Board of Directors is concerned that these products may be attracting customers that do not fully understand their nature, the substantial risk of loss that could arise from trading them and the limitations of NFA's oversight role. To address these concerns, NFA is implementing new disclosure requirements for NFA Members engaging in virtual currency products. Section I is applicable to FCMs and IBs and Section II is applicable to CPOs and CTAs.

NFA also reminds Members that NFA Compliance Rule 2-29 prohibits the use of any promotional material that is misleading or deceptive.

#### I. Disclosure Obligations of FCMs and IBs Engaging in Virtual Currency Derivatives and Virtual Currency Transactions

##### A. Virtual Currency Derivatives

FCM or IB Members must provide the NFA Investor Advisory – Futures on Virtual Currencies Including Bitcoin and the CFTC Customer Advisory: Understand the Risk of Virtual Currency Trading to any customer that engages in a virtual currency derivative transaction with or through the FCM or IB Member. For introduced accounts the advisories may be provided by either the FCM or IB Member. If the FCM or IB Member has any customers who traded a virtual currency derivative with or through the FCM or IB Member prior to the issuance of this Interpretive Notice, the FCM and/or IB Member must provide the advisories to the customer within thirty calendar days of the date of this Interpretive Notice.

##### B. Underlying or Spot Virtual Currencies

NFA is also aware that certain FCM and IB Members may seek to solicit or engage in transactions involving underlying or spot virtual currencies with customers or counterparties. NFA's Board of Directors is concerned that market participants may not understand that NFA does not regulate in any manner an FCM or IB Member's activities with customers or counterparties involving underlying or spot virtual currencies. Moreover, NFA Compliance Rule 2-22 prohibits a Member from, among other things,

stating or implying that it has been sponsored, recommended or approved by NFA. To provide clear disclosure about the lack of NFA's regulatory oversight, any FCM or IB Member engaging in activities with customers or counterparties involving underlying or spot virtual currencies in any manner must provide the customer or counterparty with the following disclosure language:

**[NAME OF NFA MEMBER] IS A MEMBER OF NFA AND IS SUBJECT TO NFA'S REGULATORY OVERSIGHT AND EXAMINATIONS. HOWEVER, YOU SHOULD BE AWARE THAT NFA DOES NOT HAVE REGULATORY OVERSIGHT AUTHORITY OVER UNDERLYING OR SPOT VIRTUAL CURRENCY PRODUCTS OR TRANSACTIONS OR VIRTUAL CURRENCY EXCHANGES, CUSTODIANS OR MARKETS.**

The advisories and disclosure language described in Sections I.A and I.B may be provided to eligible contract participants through an FCM or IB Member's web site but must be provided to retail customers in writing or electronically in a prominent manner designed to ensure a customer is aware of them. Merely having the advisories and disclosure language on a Member's web site is not adequate for retail customers. Including the advisories and disclosure language in a risk disclosure booklet that is distributed to retail customers or sending retail customers an e-mail including links to the advisories and disclosure language and explaining what the links are would be sufficient provided the communication is reasonably designed to achieve customer awareness and the disclosure language is prominently displayed. The advisories must be provided to a customer at or before the time the customer first engages in a virtual currency derivatives transaction with or through the FCM or IB Member. The disclosure language must be prominently displayed in any promotional materials related to underlying or spot virtual currencies and must be provided to any customer or counterparty at or before the time they engage in any underlying or spot virtual currency activities with or through the FCM or IB Member.

## II. Disclosure Obligations of CPOs and CTAs Engaging in Virtual Currency Derivatives and Virtual Currency Transactions

A few CPO and CTA Members are offering pools, exempt pools or trading programs that trade virtual currencies or virtual currency derivatives. NFA's Board of Directors is concerned that these pools and trading programs may be attracting pool participants and managed account clients who do not fully understand the nature of these products or the substantial risk of loss that may arise from trading them. Virtual currencies and virtual currency derivatives have unique features and present some potentially significant risks that warrant enhanced disclosures to pool participants and managed account clients.

CPO and CTA Members should carefully consider the risks arising from their activities in virtual currencies and virtual currency derivatives and customize their disclosure documents, offering documents and promotional material to address the unique risks related to their specific activities. The guidelines set forth below are designed to ensure that CPO and CTA Members provide robust disclosures related to the risks of virtual currencies and virtual currency derivatives. The guidelines are not an exhaustive list of disclosure items, and Members should not necessarily limit their disclosures to those areas discussed in this Interpretive Notice. NFA recognizes that the risks associated with trading virtual currencies or virtual currency derivatives will vary over time, and this Interpretive Notice may be supplemented in the future.

NFA's Board of Directors is also concerned that investors may not understand NFA's role with respect to Member activities involving underlying or spot virtual currency products. Therefore, as set forth below, NFA is mandating a standardized disclosure that any CPO or CTA Member operating a pool (exempt or non-exempt) or managed account trading program that trades underlying or spot virtual currencies must display in its disclosure document, offering document and promotional material related to virtual currencies. NFA is also requiring a separate standardized disclosure that must be provided to customers and displayed in any promotional materials related to virtual currencies if a CPO or CTA engages in any other virtual currency activities.

A. Virtual Currency Disclosure Requirements for Pools and Managed Account Programs

While NFA does not intend to prescribe standardized disclosure language for CPO and CTA Members engaging in underlying or spot virtual currency transactions in a pool or managed account program, CPO and CTA Members that engage in these transactions must address any of the following areas that are applicable to their activities in their disclosure documents, offering documents and promotional material related to virtual currencies:

- **Unique Features of Virtual Currencies.** Virtual currencies are not legal tender in the United States and many question whether they have intrinsic value. The price of many virtual currencies is based on the agreement of the parties to a transaction. The risks associated with the unique features of virtual currencies should be explained.
- **Price Volatility.** The price of a virtual currency is based on the perceived value of the virtual currency and subject to changes in sentiment, which make these products highly volatile. Certain virtual currencies have experienced daily price volatility of more than 20%. The risks associated with the extreme price volatility

of virtual currencies and the possibility of rapid and substantial price movements, which could result in significant losses, should be explained.

- **Valuation and Liquidity.** Virtual currencies can be traded through privately negotiated transactions and through numerous virtual currency exchanges and intermediaries around the world. The lack of a centralized pricing source poses a variety of valuation challenges. In addition, the dispersed liquidity may pose challenges for market participants trying to exit a position, particularly during periods of stress. NFA generally expects the policies and procedures for valuing virtual currency products implemented by CPOs and CTAs to take into account their access to liquidity and the volatility of these markets. The valuation and liquidity risks and the procedures used for valuing virtual currencies and the related risks should be explained.
- **Cybersecurity.** The cybersecurity risks of virtual currencies and related “wallets” or spot exchanges include hacking vulnerabilities and a risk that publicly distributed ledgers may not be immutable. A cybersecurity event could result in a substantial, immediate and irreversible loss for market participants that trade virtual currencies. Even a minor cybersecurity event in a virtual currency is likely to result in downward price pressure on that product and potentially other virtual currencies. The cybersecurity risks associated with engaging in virtual currency transactions should be explained.
- **Opaque Spot Market.** Virtual currency balances are generally maintained as an address on the blockchain and are accessed through private keys, which may be held by a market participant or a custodian. Although virtual currency transactions are typically publicly available on a blockchain or distributed ledger, the public address does not identify the controller, owner or holder of the private key. Unlike bank and brokerage accounts, virtual currency exchanges and custodians that hold virtual currencies do not always identify the owner. The opaque underlying or spot market poses asset verification challenges for market participants, regulators and auditors and gives rise to an increased risk of manipulation and fraud, including the potential for Ponzi schemes, bucket shops and pump and dump schemes. The risks associated with the opaque nature of the underlying or spot virtual currency market should be explained.
- **Virtual Currency Exchanges, Intermediaries and Custodians.** Virtual currency exchanges, as well as other intermediaries, custodians and vendors used to facilitate virtual currency transactions, are relatively new and largely unregulated in both the United States and many foreign jurisdictions. Virtual currency exchanges generally purchase virtual currencies for their own account on the public ledger and allocate positions to customers through internal bookkeeping entries while maintaining exclusive control of the private keys. Under this structure, virtual currency exchanges collect large amounts of

customer funds for the purpose of buying and holding virtual currencies on behalf of their customers. The opaque underlying spot market and lack of regulatory oversight creates a risk that a virtual currency exchange may not hold sufficient virtual currencies and funds to satisfy its obligations and that such deficiency may not be easily identified or discovered. In addition, many virtual currency exchanges have experienced significant outages, downtime and transaction processing delays and may have a higher level of operational risk than regulated futures or securities exchanges. If virtual currencies are traded or held through an exchange, intermediary or custodian, then the risks associated with engaging in these transactions should be explained.

- **Regulatory Landscape.** Virtual currencies currently face an uncertain regulatory landscape in the United States and many foreign jurisdictions. In the United States, virtual currencies are not subject to federal regulatory oversight but may be regulated by one or more state regulatory bodies. In addition, many virtual currency derivatives are regulated by the CFTC, and the SEC has cautioned that many initial coin offerings are likely to fall within the definition of a security and subject to U.S. securities laws. One or more jurisdictions may, in the future, adopt laws, regulations or directives that affect virtual currency networks and their users. Such laws, regulations or directives may impact the price of virtual currencies and their acceptance by users, merchants and service providers. The risks associated with the current regulatory landscape for virtual currencies should be explained.
- **Technology.** The relatively new and rapidly evolving technology underlying virtual currencies introduces unique risks. For example, a unique private key is required to access, use or transfer a virtual currency on a blockchain or distributed ledger. The loss, theft or destruction of a private key may result in an irreversible loss. The ability to participate in forks could also have implications for investors. For example, a market participant holding a virtual currency position through a virtual currency exchange may be adversely impacted if the exchange does not allow its customers to participate in a fork that creates a new product. The risks posed by this nascent technology should be explained.
- **Transaction Fees.** Many virtual currencies allow market participants to offer miners (i.e., parties that process transactions and record them on a blockchain or distributed ledger) a fee. While not mandatory, a fee is generally necessary to ensure that a transaction is promptly recorded on a blockchain or distributed ledger. The amounts of these fees are subject to market forces and it is possible that the fees could increase substantially during a period of stress. In addition, virtual currency exchanges, wallet providers and other custodians may charge high fees relative to custodians in many other financial markets. The impact of these transaction fees on performance should be explained.

**In addition to the these disclosure items, any CPO or CTA Member engaging in an underlying or spot virtual currency transaction in a commodity pool, exempt pool or managed account program must prominently display the following language in its disclosure document, offering document and promotional material related to the Member's activity in virtual currencies:**

**[NAME OF NFA MEMBER] IS A MEMBER OF NFA AND IS SUBJECT TO NFA'S REGULATORY OVERSIGHT AND EXAMINATIONS. [NAME OF NFA MEMBER] HAS ENGAGED OR MAY ENGAGE IN UNDERLYING OR SPOT VIRTUAL CURRENCY TRANSACTIONS IN A [COMMODITY POOL OR MANAGED ACCOUNT PROGRAM]. ALTHOUGH NFA HAS JURISDICTION OVER [NAME OF NFA MEMBER] AND ITS [COMMODITY POOL OR MANAGED ACCOUNT PROGRAM], YOU SHOULD BE AWARE THAT NFA DOES NOT HAVE REGULATORY OVERSIGHT AUTHORITY FOR UNDERLYING OR SPOT MARKET VIRTUAL CURRENCY PRODUCTS OR TRANSACTIONS OR VIRTUAL CURRENCY EXCHANGES, CUSTODIANS OR MARKETS. YOU SHOULD ALSO BE AWARE THAT GIVEN CERTAIN MATERIAL CHARACTERISTICS OF THESE PRODUCTS, INCLUDING LACK OF A CENTRALIZED PRICING SOURCE AND THE OPAQUE NATURE OF THE VIRTUAL CURRENCY MARKET, THERE CURRENTLY IS NO SOUND OR ACCEPTABLE PRACTICE FOR NFA TO ADEQUATELY VERIFY THE OWNERSHIP AND CONTROL OF A VIRTUAL CURRENCY OR THE VALUATION ATTRIBUTED TO A VIRTUAL CURRENCY BY [NAME OF NFA MEMBER].**

**B. Virtual Currency Derivatives Disclosure Requirements for Pools and Managed Account Programs**

**While NFA does not intend to prescribe standardized disclosure language for CPO and CTA Members engaging in virtual currency derivative transactions in a pool, exempt pool or managed account program, virtual currency derivatives have a number of unique features that CPO and CTA Members that engage in these transactions must address in their disclosure documents, offering documents and promotional material related to the Member's activity in virtual currency derivatives. For example, virtual currency derivatives may experience significant price volatility and the initial margin for virtual currency derivatives may be set as a percentage of the value of a particular contract, which means that margin requirements for long positions can increase if the price of the contract rises. In addition, some futures commission merchants may pose restrictions on customer trading activity in virtual currency derivatives, such as requiring additional margin, imposing position limits, prohibiting naked shorting or prohibiting give-in transactions. The rules of certain designated contract markets impose trading halts that may restrict a market participant's ability to exit a position during a period of high volatility. The risks associated with the unique features of engaging in virtual currency**

derivatives should be disclosed and the impact these risks may have on a pool's or managed account program's performance should be explained.

C. Any Other Activities in Underlying or Spot Virtual Currencies

Moreover, as described above, NFA Compliance Rule 2-22 prohibits a Member from, among other things, stating or implying that it has been sponsored, recommended or approved by NFA. To provide clear disclosure about the lack of NFA's regulatory oversight, any CPO or CTA Member engaging in any manner in activities with customers or counterparties involving underlying or spot virtual currencies other than those described in Sections II.A and II.B above must provide its customer or counterparty with the following disclosure language at or before the time the CPO or CTA Member engages in any underlying spot or virtual currency activities with the customer or counterparty, which must also be prominently displayed in any promotional materials related to the Member's activity in virtual currencies:

**[NAME OF NFA MEMBER] IS A MEMBER OF NFA AND IS SUBJECT TO NFA'S REGULATORY OVERSIGHT AND EXAMINATIONS. HOWEVER, YOU SHOULD BE AWARE THAT NFA DOES NOT HAVE REGULATORY OVERSIGHT AUTHORITY OVER UNDERLYING OR SPOT VIRTUAL CURRENCY PRODUCTS OR TRANSACTIONS OR VIRTUAL CURRENCY EXCHANGES, CUSTODIANS OR MARKETS.**

Failure to follow the disclosure guidelines in this Interpretive Notice may be deemed conduct inconsistent with a Member's obligations under NFA Compliance Rule 2-4 to observe high standards of commercial honor and just and equitable principles of trade as well as violations of NFA Compliance Rule 2-29.<sup>1</sup>

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**EXPLANATION OF PROPOSED INTERPRETIVE NOTICE**

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Although virtual currencies (also called cryptocurrencies, digital currencies or digital assets) have been available for several years, recent events have had a direct impact on NFA and NFA Members. The most significant event was the listing of bitcoin futures by designated contract markets. NFA's Board of Directors is concerned that investors may not fully understand the nature of virtual currencies and virtual currency derivatives, the substantial risk of loss that may arise from trading these products and the limitations of NFA's regulatory authority over spot market virtual currencies. Therefore, NFA's Board of Directors directed staff to develop an Interpretive Notice that imposes enhanced disclosure requirements on FCM, IB, CPO and CTA Members.

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<sup>1</sup> NFA Compliance Rule 2-29 requires, among other things, that promotional material (including disclosure documents and offering documents) used by Members include all material information necessary to ensure that such material is not misleading.



The proposed Interpretive Notice has two separate sections—one for FCM and IB Members and another for CPO and CTA Members. The section governing FCM and IB Members requires that they provide their customers with the *NFA Investor Advisory – Futures on Virtual Currencies Including Bitcoin* and the *CFTC Customer Advisory: Understand the Risk of Virtual Currency Trading*. The Interpretive Notice specifically provides that for introduced accounts, the advisories may be provided by either the FCM or IB. If the FCM or IB Member has any customers who traded a virtual currency derivative prior to the issuance of the Interpretive Notice, the FCM and/or IB Member must provide the advisories to the customer within thirty calendar days of the Interpretive Notice's effective date.

NFA's Board is also concerned that FCM and IB Member customers may not understand that although they may be engaging in spot virtual currency activities with an NFA Member, NFA does not have regulatory oversight over those activities. Therefore, the Interpretive Notice also requires that FCM and IB Members offering services in spot market virtual currencies provide customers with a standardized disclosure that specifically states that NFA does not have regulatory oversight authority over underlying or spot virtual currency products or transactions or virtual currency exchanges, custodians or markets.

The Interpretive Notice also addresses the manner in which FCM and IB Members must provide the advisories and standardized disclosure language. In particular, an FCM or IB Member must provide the advisories at or before the time a customer engages in a virtual currency derivative transaction and the standardized disclosure at or before the time a customer or counterparty engages in any underlying or spot virtual currency activity with or through the FCM or IB Member. The Interpretive Notice allows FCM and IB Members to provide the advisories and disclosure language to eligible contract participants through an FCM or IB Member's web site. For retail customers, the Interpretive Notice requires that FCM and IB Members provide the advisories and standardized disclosure language in writing or electronically in a prominent manner designed to ensure a customer is aware of them. FCM and IB Members must also display the standardized disclosure language on any promotional materials related to spot market virtual currencies.

The section of the Interpretive Notice governing CPO and CTA Members requires that they provide investors with robust disclosures related to their activities in spot market virtual currencies and virtual currency derivatives. The Interpretive Notice identifies a number of areas that CPOs and CTAs should address (if applicable) in their disclosure documents, offering documents and promotional materials (*i.e.*, unique features of virtual currencies, price volatility, valuation and liquidity, cybersecurity, opaque spot market, virtual currency exchanges, intermediaries and custodians, regulatory landscape, technology and transaction fees). The Interpretive Notice makes clear that CPOs and CTAs are expected to customize their disclosure documents and

offering documents to address the unique risks related to their particular activities. Therefore, the Interpretive Notice requires CPO and CTA Members to address the areas discussed in the Interpretive Notice that are applicable to their activities but to also discuss any other risks not mentioned that are applicable to their offering.

NFA's Board is also concerned that pool participants and managed account customers understand the limitations of NFA's regulatory oversight with respect to spot virtual currency transactions being done in a commodity pool, exempt pool or through a managed account program. Therefore, the proposed Interpretive Notice requires any CPO or CTA Member that operates a pool, exempt pool or trading program that trades spot market virtual currencies to include a standardized disclosure addressing the limits of NFA's oversight and informing investors that, given certain characteristics of these products (*e.g.*, lack of centralized pricing source and opaqueness of market), there currently is no sound or acceptable practice that NFA can use to verify the ownership and control of underlying/spot virtual currencies. These Members will be required to include this standardized disclosure in their disclosure documents, offering documents and promotional materials related to virtual currencies.

Finally, the Board recognizes that a CPO or CTA Member may also engage in spot virtual currency transactions with customers or counterparties other than through a commodity pool, exempt pool or managed account program. The Board felt that it was important that those customers and counterparties understand the limits of NFA's regulatory oversight of those activities. Therefore, the Interpretive Notice also requires the same standardized disclosure required of FCM and IB Members that specifies that NFA does not have regulatory oversight authority over underlying spot or virtual currency products or transactions or virtual currency exchanges, custodians or markets. CPO and CTA Members must provide this disclosure to customers and counterparties and display it in any promotional materials for any spot market virtual currency activities (other than as an investment in a pool or managed account program) engaged in by a CPO or CTA Member.

NFA's FCM, IB and CPO/CTA Advisory Committees support the adoption of the proposed Interpretive Notice.

Mr. Christopher J. Kirkpatrick

July 20, 2018

As mentioned earlier, NFA is invoking the "ten-day" provision of Section 17(j) of the CEA. NFA intends to make the proposed Interpretive Notice entitled *Disclosure Requirements for NFA Members Engaging in Virtual Currency Activities* effective ten days after receipt of this submission by the Commission, unless the Commission notifies NFA that the Commission has determined to review the proposal for approval.

Respectfully submitted,

A handwritten signature in black ink that reads "Carol A. Wooding". The signature is written in a cursive style with a large, looping 'C' at the beginning and a long, sweeping tail at the end.

Carol A. Wooding  
Vice President and General Counsel