NFA Proposes New Disclosure Requirements for CPOs and CTAs Engaging in Virtual Currency Activities

Proposed Interpretive Notice:

By letter dated July 20, 2018, the National Futures Association ("NFA") submitted to the Commodity Futures Trading Commission ("CFTC") a proposed interpretive notice entitled *Disclosure Requirements for NFA Members Engaging in Virtual Currency Activities* (the "Interpretive Notice").[1] The Interpretive Notice would implement new disclosure requirements for NFA members engaging in activities involving virtual currency products, including specific disclosure requirements for any member commodity pool operator ("CPO") or commodity trading advisor ("CTA") with respect to a pool, whether or not exempt, or a managed account. Unless the CFTC notifies NFA that it has determined to review the proposed Interpretive Notice for approval, NFA is expected to make the Interpretive Notice effective sometime during the second half of September.

Overview of Requirements:

The section of the Interpretive Notice applicable to CPO and CTA members requires that they provide pool participants and managed account clients with disclosures related to (i) their activities in spot market virtual currencies, (ii) their activities in virtual currency derivatives, and (iii) NFA's lack of regulatory oversight of the virtual currency spot market.

- ***Spot Virtual Currency Transactions in a Pool or Managed Account Program****:* 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 when engaging in underlying or spot virtual currency transactions in a pool or managed account program (*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). While NFA does not intend to prescribe standardized disclosure language for this purpose, CPOs and CTAs are expected to customize their documents to address the unique risks related to their particular activities, including any other applicable risks not mentioned.

  The proposed Interpretive Notice would also require any CPO or CTA member that operates a pool, exempt pool or trading program that trades spot market virtual currencies to include a

[1] The proposed Interpretive Notice may be viewed in full here.

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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.

- ***Virtual Currency Derivative Transactions in a Pool or Managed Account Program***: While NFA does not intend to prescribe standardized disclosure language for this purpose, CPO and CTA members engaging in virtual currency derivative transactions in a pool, exempt pool or managed account program must address the unique features of virtual currency derivatives in their disclosure documents, offering documents and promotional material. NFA cites as examples price volatility, potential increases in initial margin for long positions, potential futures commission merchant ("FCM") restrictions on customer trading activity, and the potential impact of designated contract market trading halts.

- ***Any Other Activities in Underlying or Spot Virtual Currencies***: Because a CPO or CTA member may also engage in spot virtual currency transactions with customers or counterparties other than through a pool, exempt pool, or managed account program, the Interpretive Notice also would require the same standardized disclosure required of an FCM or introducing broker member 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, exempt pool, or managed account program) engaged in by a CPO or CTA member.

Conclusion:

Notably, the Interpretive Notice states that failure to follow the disclosure guidelines set forth therein 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 regarding communications with the public and promotional material. As a result, given that the Interpretive Notice will become effective shortly, to the extent that NFA member CPOs or CTAs engage in, or intend to engage in, virtual currency activities, they should review their disclosure documents, offering documents, advisory agreements, and promotional materials to ensure that they are compliant with these new guidelines.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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