

CLIENT ALERT

Cryptocurrency in Small Bytes: The SEC Turns its Attention to Trading Platforms

Mar.12.2018

The Securities Exchange Commission (SEC) has made clear its view that virtual tokens issued in “initial coin offerings” are securities and are thus subject to SEC regulation. Until now, most regulatory attention has been directed towards issuers, and companies have been attempting to comply with the securities laws through vehicles such as the SAFT. However, in a recent release, the SEC confirmed that it is also considering whether cryptocurrency trading platforms should fall within its jurisdiction.

Most cryptocurrency trading platforms only trade the so-called “major” cryptocurrencies – Bitcoin, Ether, XRP, and Litecoin. The SEC has never affirmatively stated that these cryptocurrencies are not securities – but the lack of SEC action with respect to these products has led most to believe that the SEC views them as commodities, not securities. Transactions in commodities are not required to be conducted on registered trading platforms unless they are contracts for future delivery or derivative contracts.

However, the SEC has authority over “spot” securities trades (*i.e.*, contracts for immediate as opposed to future delivery), and the Securities Exchange Act requires that entities that operate “exchanges” for securities be either registered with the SEC as national securities exchanges or be exempt from such registration.

Exempt exchanges include “alternative trading systems” (ATSs). An ATS is exempt from registration as a national securities exchange because it has only limited self-regulatory functions. While national securities exchanges regulate their participants’ activity both on and off-exchange, ATS platforms only regulate conduct on the exchange. ATS platform operators are required to register with the SEC and the Financial Industry Regulatory Authority as broker-dealers, and must also separately register as an ATS. National securities exchanges are generally viewed as having more clout and influence, and in the traditional securities world are more likely to attract issuers and have better market share. However, given the state of the cryptocurrency markets and the fact that many exchanges have become prominent without any registration at all, it’s likely that many cryptocurrency platforms will choose ATS registration rather than registration as a national securities exchange.

Of course, not every crypto trading platform is an “exchange” at all – the functionality of the platform determines whether it is required to register as such. So, for example, an “all to all” platform where buyers’ and sellers’ orders are matched and participants directly enter into trades with each other is most certainly an exchange. A platform which allows participants to buy and sell orders against the prices offered by a single dealer is not an exchange – although such a platform would likely be required to register as a broker-dealer if it is offering trades in securities. Even an individual acting as a matchmaker or finder for trades in securities tokens should consider whether broker-dealer registration is necessary.

The outcome of all of this regulatory guidance is that cryptocurrency market participants need to concern themselves with the regulatory implications of their businesses. It is possible to structure a cryptocurrency business in a manner that complies with applicable laws, but it is important to consider regulatory issues from the outset of a business plan.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.