

The Banking Law Journal

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Cryptocurrency Trading Agreements

*By Richard J. Lee**

This article highlights the primary legal concerns arising under digital asset trading agreements.

Institutional investors trading cryptocurrencies generally engage cryptocurrency brokerage firms to manage trade execution, clearing and settlement logistics in the digital asset marketplace, where trading infrastructure remains highly fragmented.

CRYPTOCURRENCY TRADING AGREEMENTS

When evaluating a cryptocurrency broker, an investor's business concerns—like the broker's technological capacities, fees, security protocols and familiarity with applicable regulatory regimes—should be front and center. But involving legal counsel is also critical, particularly when negotiating an “account agreement,” “brokerage services agreement,” “master purchase and sale” or other similarly titled agreement that governs the broker's provision of cryptocurrency trading services and allocation of operational, economic and legal risks between the parties.

Cryptocurrency brokers provide their own trading agreement forms—there are no industry-standard templates—and the terms of these forms heavily favor the broker. These trading agreements are normally modeled on traditional securities trading agreements, but securities documentation is not a perfect fit because cryptocurrency assets have novel features and considerations that are not addressed under traditional securities trading frameworks.

If utilizing multiple brokers to trade cryptocurrencies, investors typically encounter a variety of idiosyncratic drafting styles, operational mechanics and trading terms. Moreover, given the quickly evolving nature of the digital assets industry, investors often face difficulty identifying “off-market” terms that should be corrected before signing. Cryptocurrency documentation is in a state of flux, and trading agreements likely will continue to evolve to address new issues and risks specific to this new asset class.

When reviewing these agreements, we recommend that investors identify “must have” and “nice to have” terms, while being sensitive to the technological

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practicalities of digital asset trading and the parties' relative bargaining power. Due to the nature of the digital asset class, many features that would be standard in trading agreements for more evolved or regulated markets are often not present or applicable.

Despite the multitude of forms, cryptocurrency brokers' agreements tend to address a core set of fundamental trading issues. Below are questions and issues that investors should be especially attuned to when vetting these agreements:

- *Scope of Responsibilities.* What is the explicit scope of the broker's operational duties (or lack thereof) set forth in the agreement? In particular, those duties that could cause material harm to the investor if breached should be spelled out, including with respect to:
 - The broker's promised trade execution times;
 - Available hours and/or maintenance windows for the trading platform; and
 - Obligations to settle trades with an investor's designated custodian.
- *Counterparty Credit Risk.* Under what circumstances is the investor exposed to credit risk of the broker and can this risk be mitigated? In particular, how would the investor's assets be treated in a bankruptcy or insolvency of the broker?
 - Is the broker holding the assets in custody as a fiduciary for the investor, or are assets held in omnibus accounts with the broker, its affiliates, or with the relevant exchange(s)?
 - Are the investor's assets otherwise segregated and/or traceable?
- *Dispute Rights and Dispute Resolution.* Provisions should exist to help ensure that the various day-to-day determinations made by a broker are derived in a commercially reasonable manner and yield commercially reasonable results.
 - There are countless approaches for "keeping the broker honest," including building in "verification rights" (where the investor may request to review records or calculations supporting a broker's determination) and various types of "dispute rights" (where a broker's determination may be compared against, and potentially substituted for, quotes or other determinations provided by third-party reference sources).
 - If all else fails, a dispute may require adjudication by an outside authority. Some investors have a strong institutional preference for litigating disputes in court, in which case any arbitration

clauses should be reviewed, modified or deleted, as need be.

- *Indemnities, Waivers and Limitations of Liability.* Trading agreements typically provide broad waivers of broker liability and lopsided indemnity provisions. These should be scaled back and include exceptions for broker malfeasance, where possible.
 - On the other hand, if a brokerage client is a managed fund, there should be no ambiguity that the broker may recover damages only against fund assets and not those of the manager or other funds.
- *Termination.* Brokers customarily have wide latitude to terminate a trading relationship, often without “cause” and sometimes with little advance notice.
 - Investors should ensure, however, that broker termination rights will not disrupt executed trades that are pending settlement and that positions will not be liquidated abruptly before ameliorative actions can be taken.
 - Early termination language that could be interpreted as inappropriately triggering cross-default provisions in an investor’s trading or loan documentation executed with third parties should be excised.
- *Security Interests.* If any grant of a security interest over investor property is contemplated, the scope of the lien should be narrowly tailored. This type of lien arises most commonly in the context of trading on margin or using other synthetic leverage products, like over-the-counter derivatives.
- *Broker Affiliates.* Depending on the suite of services provided, certain affiliates of a broker may be party to or beneficiaries of the trading documentation. In this case, contractual relationships between the multiple parties should be scrutinized—particularly if custodial services for digital or fiat assets of the investor are contemplated or if contractual “set-off” provisions exist.

This article highlighted the primary legal concerns arising under digital asset trading agreements, but there are myriad other related and nuanced drafting issues that will undoubtedly surface when reviewing cryptocurrency trading agreements.