



<https://poloniex.com>

October 18, 2016

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Division of Clearing and Risk

Mr. Aitan Goelman, Director
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Mr. Jonathan Marcus, General Counsel
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Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Request for No-Action Relief from Commodity Exchange Act Section 2(c)(2)(D)

Dear Sirs:

For the reasons set forth below, Poloniex, Inc. (‘‘Poloniex’’)¹ respectfully requests no-action relief pursuant to which Commodity Futures Trading Commission (‘‘Commission’’) staff will not recommend that the Commission take enforcement action against Poloniex for violation of Commodity Exchange Act (‘‘CEA’’) section 2(c)(2)(D)(iv) with respect to the margin and lending transactions in cryptocurrency described below.

Poloniex believes that the issues raised related to satisfying the ‘‘actual delivery’’ requirement (described below) in CEA section 2(c)(2)(D) in the context of cryptocurrency lending should be discussed and analyzed through an open, transparent process that allows for careful consideration of each of the relevant factors. We have significant concerns that, absent these procedural safeguards, the ‘‘technological changes that are reshaping our markets’’² will fall victim to inappropriate and harmful interpretation of the Commission’s laws and regulations.

We appreciate the work of the interdivisional staff working group on blockchain and virtual currency issues and would welcome the chance to meet with the group in the near future. Simply put, these novel questions of law and policy should be addressed in a manner consistent with the Commission’s longstanding practice of careful, empirically-driven analysis that considers the

¹ Poloniex is a U.S.-based cryptocurrency exchange that operates an online platform (‘‘Platform’’), which third-party subscribers use to hold, trade, and lend cryptocurrencies with other subscribers. For more information, please see www.poloniex.com.

² Keynote Remarks of Chairman Timothy Massad before the SIFMA Annual Meeting, September 27, 2016, available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-48> (‘‘SIFMA Keynote’’).

market impact for each of its decisions. As the Chairman has said when discussing complicated market policy issues, it is “sensible and responsible”³ to “study the issue”⁴ to make sure that the Commission “get[s] the framework right.”⁵

Background

Poloniex’s Cryptocurrency Platform

On Poloniex’s Platform, each subscriber holds its digital currency in a personal, individually-denominated separate account that is administered by Poloniex. The Platform functions “and subscribers’ personal accounts exist” within Poloniex’s deposit wallet on the blockchain. Subscribers open accounts by (1) completing an application, (2) agreeing to the Platform’s Terms of Use (which sets forth basic terms and conditions governing the holding, selling, and lending of cryptocurrency on the Platform), and (3) using a blockchain transaction to deposit their cryptocurrency into their Platform accounts. Each subscriber owns and retains the legal authority and control over all digital currency in its account. Subscribers effectuate sales (exchanges) and loans of their respective digital currency with other subscribers by entering into agreements for the same and directing Poloniex to transfer their digital currency between their separate accounts in accordance with their agreements. Poloniex does not act as a principal to any of the transactions that take place on or through the Platform.

Poloniex records and accounts for all digital currency held in each subscriber’s account and every transaction transferring digital currency into and out of a subscriber’s account and creates and maintains a separate record of every transaction involving a subscriber’s account. Subscribers can remove their digital currency from their Platform accounts by directing a blockchain transfer of their digital currency to whatever deposit wallet they direct.

Poloniex is not a party to any of the transactions on the Platform; it is not a seller, a buyer, a lender, or an offeror. In holding and handling subscribers’ cryptocurrency and effectuating subscribers’ transactions, Poloniex acts at the direction of the subscribers and has no legal authority to control or take action with respect to any subscriber’s digital currency except pursuant to a subscriber’s consent. Accordingly, Poloniex has no actual or beneficial financial or property interest in the cryptocurrency held, traded, and lent by subscribers.

Transaction Types Effectuated on the Platform

As further described below, a subscriber can enter into three types of transactions “spot, margin, and lending transactions” with other subscribers on the Platform. Each subscriber’s account has

³ Statement of Chairman Timothy Massad on Order Extending De Minimis Threshold Phase-In Termination Date, October 13, 2016, *available at* <http://www.cftc.gov/PressRoom/SpeechesTestimony/massadstatement101316> (“October 13 Statement”).

⁴ *See* SIFMA Keynote.

⁵ *See* October 13 Statement.

three subaccounts to manage these three types of transactions: an "Exchange" subaccount for spot transactions, a "Lending" subaccount for loan transactions, and a "Margin" subaccount for margin trading. With respect to the Platform's accounting of subscriber transactions, every transaction of digital currency in the subscribers' accounts is reflected in Poloniex's accounting system through debits and credits to the subscribers' accounts. Each transfer of digital currency is given a unique identification number. Each loan transaction is assigned a unique identification number, evidencing the borrower's receipt and ownership of the amount of digital currency borrowed.

Spot transactions involve the exchange of digital currency between two subscribers pursuant to which each subscriber agrees to the immediate transfer of a particular digital currency from the seller's account to the account of the buyer subscriber at full exchange value. In other words, neither subscriber is financing the other's receipt of digital currency in spot transactions.

In lending transactions, a subscriber agrees to transfer ownership of its digital currency to another subscriber pursuant to an agreement obligating the borrower to repay such amount with interest within an agreed upon time period. A subscriber seeking to borrow digital currency must first deposit sufficient cryptocurrency into its personal margin subaccount to serve as collateral for the repayment.⁶ Every lending offer posted by a subscriber is visible to all subscribers on the Platform.

When a borrower enters into a loan, the digital currency is transferred instantly to the borrower's account. Upon the transfer of the digital currency into the borrower's account, the borrower acquires rights of ownership, title, and legal control over the digital currency, and there is no limitation on the borrower's ownership, access to, or use of the borrowed digital currency. Each subscriber is required to maintain minimum collateral in its margin subaccount to satisfy the subscriber's loan obligations. After the digital currency is transferred to the borrower, the lender has no continuing interest in or lien on the digital currency. The lender's only source of recovery in the event of default on the loan is the collateral held in the borrower's account (and any other assets of the borrower).

Further, as a result of conversations with CFTC staff, policymakers, customers, and others, it would appear that the transfer of ownership, control and possession pursuant to a lending or margined transaction would be and should be reinforced where the recipient of cryptocurrency in a lending or margined transaction can withdraw the received funds from the Poloniex platform at any time. In addition, before entering into a lending transaction, every recipient of the transferred funds will be required to acknowledge that initial delivery of the funds will be into the recipient's Poloniex account.

Margin transactions occur when a subscriber trades digital currency held in its margin subaccount. The Platform enables a subscriber to track certain types of activity separately, *e.g.* trading with borrowed funds and trading with deposited funds, and to designate the amounts of

⁶ The initial margin collateral must be equal to at least 40% of the total value of the amount of digital currency borrowed. The minimum level of maintenance margin required after the loan is made is 20% of the loan amount.

which currencies may be considered collateral. For example, balances in a spot subaccount would not be drawn upon automatically to settle loans, and no borrowing occurs when a subscriber trades using balances in this subaccount. The counterparty subscriber to such trades, however, is not advised that the digital currency originates from a margin subaccount. Rather, the transaction is indistinguishable from any other spot trade to that subscriber.

In its August 23, 2013 interpretation,⁷ the Commission has cited an example of actual delivery not being made within 28 days. In Example 3, the Commission describes a scenario where only a book entry is made by the seller purporting to show delivery to the buyer. However, rather than actually making physical delivery, the seller merely has an enforceable obligation to do so. This transaction is not recognized as “actual delivery” because the seller has only made a record of his obligation to deliver the commodity, rather than delivering the commodity itself.⁸

To the contrary, on the Poloniex Platform, when spot, lending or margin trading occurs, the seller delivers the entire quantity of digital currency to the buyer. Once delivery of the digital currency has been made, it is Poloniex, and not the seller, who confirms delivery by debiting the account of the seller and crediting the account of the buyer. Upon delivery by the seller, the buyer has full use of the digital currency received.

CEA Exemption of the Platform’s Lending and Margin Transactions

Pursuant to the terms of CEA § 2(c)(2)(D)(ii)(III)(aa), the lending and margin transactions on the Platform are exempt from the CEA. In relevant part, CEA § 2(c)(2)(D)(iv) states that retail commodity transactions that are not exempt pursuant to the terms of CEA § 2(c)(2)(D)(ii)(III)(aa) should be regulated “as if” they were contracts for future delivery under CEA § 4(a) and 4d. CEA § 2(c)(2)(D)(ii)(III)(aa), however, exempts retail commodity transactions that result in “actual delivery” of a commodity within 28 days:

(D) Retail commodity transactions

(i) Applicability. Except as provided in clause (ii), this subparagraph shall apply to any agreement, contract, or transaction in any commodity that is

(I) entered into with, or offered to (even if not entered into with), a person that is not an eligible contract participant or eligible commercial entity; and

(II) entered into, or offered (even if not entered into), on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis.

⁷ Retail Commodity Transactions Under Commodity Exchange Act, 78 Fed. Reg. 52,426 (Aug. 23, 2013).

⁸ *Id.* at 52,428.

(ii) Exceptions. – This subparagraph shall not apply to

* * *

(III) a contract of sale that

(aa) results in actual delivery within 28 days or such other longer period as the Commission may determine by rule or regulation based upon the typical commercial practice in cash or spot markets for the commodity involved[.] [Emphasis added.]

The cryptocurrency loan transactions that observe the limitation clearly fall within the plain meaning of “actual delivery” in CEA § 2(c)(2)(D)(ii)(III)(aa) because, upon entering into the transaction, the recipient, whether purchaser or borrower: (1) immediately receives actual delivery of the digital currency into the subscriber’s personal Platform account; and (2) immediately acquires possession, ownership, title, and legal control over the digital currency within the subscriber’s Platform account. Poloniex has no ownership or other property interest in subscribers’ digital currency and is contractually bound to comply with the subscribers’ instructions with respect to executing subscriber transfers of their digital currency that comply with the Terms of Use. Poloniex in this regard not only provides a Platform for subscribers to hold, trade, and lend cryptocurrency, but also functions as subscribers’ agent with respect to executing their transactions and transferring digital currency as they direct consistent with the Terms of Use.

These transactional elements clearly satisfy the plain terms of the statute’s element of “actual delivery within 28 days.” Courts have long held that “words of common use are not to be given any but their natural, plain, and ordinary signification, unless the context shows an intention to use them in a different sense.”⁹ The immediate transfer of ownership, title, and possession of a commodity from one party to another, where the transferor retains no property or other legal interest in the delivered commodity, unambiguously constitutes “actual delivery” within the ordinary and traditional meaning of those words.

Lending and margin transactions on the Platform also satisfy the Commission’s “functional” interpretation of the term “actual delivery.”¹⁰ The Commission’s interpretation equates actual delivery with the receipt of ownership, title, and possession by the receiving party. The Commission opined that “actual delivery” would be satisfied, among other things, by “physical . . . delivery [of] the entire quantity of the commodity purchased by the buyer, including any portion of the purchase made using leverage, margin, or financing” into the possession of the buyer or a depository other than the seller’s.¹¹ Such actual delivery occurs with respect to every lending and margin transaction on the Platform.

⁹ See, e.g., *U.S. v. Chesbrough*, 176 F. 778 (1910).

¹⁰ 78 Fed. Reg. 52,426 (Aug. 23, 2013).

¹¹ *Id.* at 52,428.

Need for Commission Rulemaking

Poloniex respectfully submits that no-action relief at this time is warranted and salutary until the Commission promulgates a rule or further interprets the term “actual delivery” to make clear what transactional elements satisfy the condition of “actual delivery” with respect to cryptocurrency and blockchain transactions. To date, the Commission has not articulated the elements of “actual delivery” under CEA § 2(c)(2)(D)(ii)(III) with respect to the newly developing cryptocurrency and blockchain marketplaces, and the concepts it has expressed with respect to those marketplaces seem inconsistent with and antagonistic to the principles of its prior published interpretations.

The court opinions construing or discussing the term “actual delivery” do not provide any guidance for its application to virtual transactions of cryptocurrency that has no physical presence. The decisions in *Hunter Wise*¹² and *Monex*¹³ address the term only in the context of precious metals transactions and concepts of delivery of physical commodities. There is no precedent addressing the concept of actual delivery in the new world of virtual currency, and any declarations of law on the subject would be matters of first impression in the courts. Accordingly, until the Commission publicly announces clear standards for actual delivery of cryptocurrency and gives market participants reasonable time to comply, it is not an appropriate exercise of the Commission’s authority to attempt to establish such standards through ad hoc enforcement actions. The law is clear that the Constitution and the Administrative Procedure Act require that persons be afforded “fair notice” of legal standards before they may be prosecuted and sanctioned for violation of them.

The problems associated with the threat of enforcement where, as here, there is lack of fair notice in the context of cryptocurrency are exacerbated by the Commission’s potential departure from the principles announced in its published interpretations in its order in *In the Matter of BFXNA INC, d/b/a Bitfinex*.¹⁴ That order provides no legal precedent or statutory provisions or its legal conclusions. Furthermore, any Commission or staff private approval of a particular type of cryptocurrency transaction without publicly explaining the elements to satisfy any test suggests to the marketplace that there may exist secret rules in a manner inconsistent with traditional administrative and due process protections. In their totality, these factors introduce legal uncertainty regarding what the elements of “actual delivery” in cryptocurrency and blockchain transactions are or should be.

Recognizing the Commission’s significant workload and limited resources, no-action relief is appropriate at this time to remove legal uncertainty while the Commission carefully considers and defines the elements in the cryptocurrency market and related blockchain system of “actual delivery” under the CEA. By undertaking a formal rulemaking to consider these issues, the Commission would ensure that all market participants understand their compliance obligations

¹² *U.S. Commodity Futures Trading Comm’n v. Hunter Wise Commodities, LLC*, 749 F.3d 967 (11th Cir. 2014).

¹³ *U.S. Commodity Futures Trading Comm’n v. Monex Deposit Co.*, 824 F.3d 690 (7th Cir. 2016).

¹⁴ See *In the Matter of BFXNA INC, d/b/q Bitfinex*, Docket 16-19.

under the law, which, in turn, would facilitate fair competition among market participants in the nascent cryptocurrency marketplace.

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Poloniex appreciates your consideration of this request and welcomes the opportunity to further discuss the very important policy implications at your convenience. I can be reached at legal@poloniex.com.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Jules Kim', with a long horizontal flourish extending to the right.

Jules Kim
Chief Operating Officer

cc: The Honorable Timothy Massad, Chairman
The Honorable Sharon Bowen, Commissioner
The Honorable J. Christopher Giancarlo, Commissioner