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DISRUPTIVE TECHNOLOGIES IN INVESTMENT MANAGEMENT: THE REGULATORY LANDSCAPE FOR ASSET MANAGERS

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Overview



- Regulatory Overlay for Digital Assets
 - CFTC regulation of cryptocurrencies
 - SEC focus on digital assets and initial coin offerings
 - Applicability of New York's BitLicense
 - State and Federal Money Transmitter Laws
- Regulatory Initiatives

Cryptocurrency Innovation



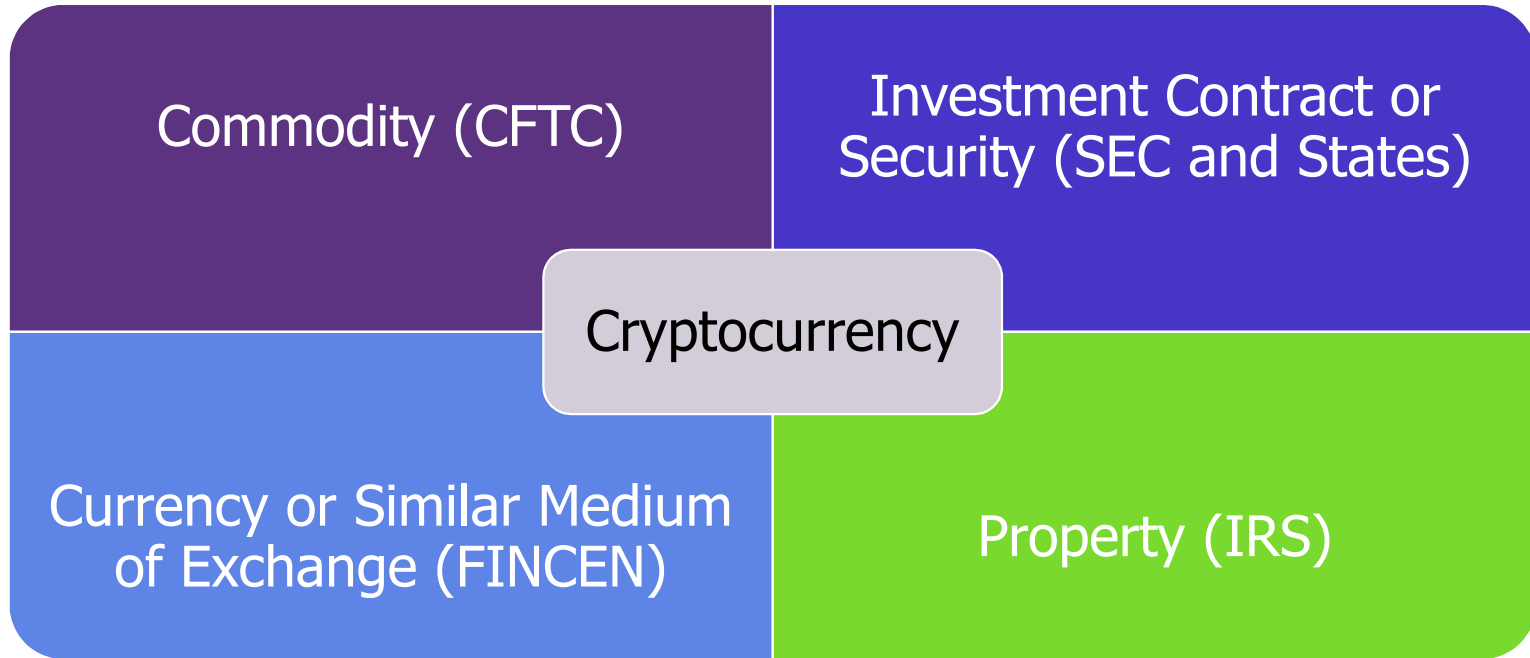
- Characteristics That Make Cryptocurrencies Useful
 - Quasi-Anonymous
 - Electronic
 - Fast
 - Cross-Border
 - No Intermediaries



The Imperative to Regulate Cryptocurrencies

- Criminal Uses
 - Money Laundering
 - Ransomware
 - Terror Financing
- Tax Evasion
- Investment Fraud
 - Ponzi Schemes
 - ICOs (unregistered offerings of securities)
- Market Manipulation
- Theft/Hacks

Regulators View of Cryptocurrency



CFTC Regulation



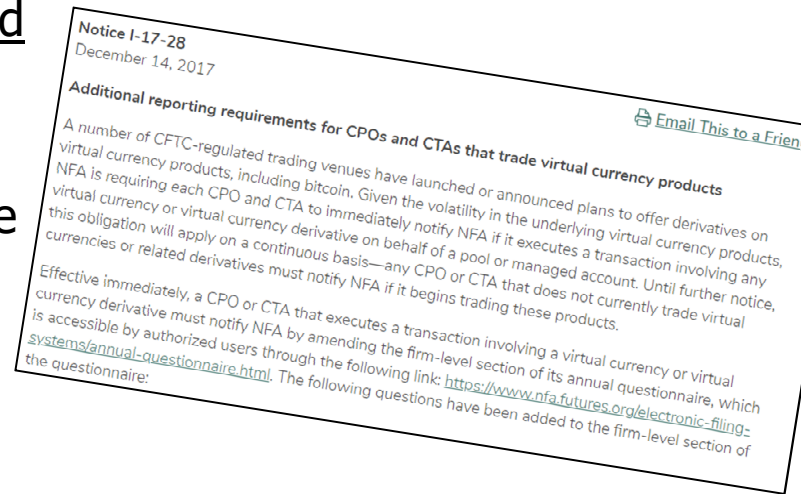
- CFTC has exclusive jurisdiction over:
 - Futures
 - Options
 - Swaps
- Section I a(9) of the Commodity Exchange Act defines "commodity" to include, among other things, "all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in."
- The CFTC takes the position that bitcoin and other cryptocurrencies are properly defined as commodities.

CFTC Regulation

- CFTC *Coinflip* Order
- CFTC *Bitfinex* Order
- TeraExchange-CFTC registered SEF for Bitcoin NDFs
- LedgerX-CFTC registered SEF and DCO for physically settled Bitcoin options
- CME/CFE-CFTC registered DCMs for cash-settled Bitcoin futures
- CFTC Intermediary registration implicated for futures, options, swaps and leveraged retail transactions—CPOs and CTAs, FCMs and IBs
- CFTC anti-manipulation and antifraud jurisdiction—not just derivatives!

NFA Requirements

- Registered CPOs and CTAs have initial and periodic cryptocurrency reporting requirements with NFA.
- Reporting requirements apply to derivatives and spot transactions in a cryptocurrency.
- Additionally, NFA members must have a cybersecurity policy and should consider unique cybersecurity challenges related to cryptocurrencies.



NFA Requirements



NFA guidance on risk disclosures is forthcoming.

A fund that trades cryptocurrency or invests in firms using Blockchain technology should include relevant risk disclosures in its offering memorandum, including risk disclosures related to:

- Legal and regulatory risk
- Market risk
- Custody risk
- Cybersecurity and hacking risks
- Trading risk
- Volatility

SEC Regulation

- Is the coin or token a security?
 - Howey Test
 - Under Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act, a security includes “an investment contract”
 - An investment contract is an (1) investment of money in a (2) common enterprise with a (3) reasonable expectation of profits to be derived from (4) the entrepreneurial or managerial efforts of others
 - Focus on substance and economic realities of the transaction
 - Tokens, coins or other digital assets issued on a blockchain may be securities under the federal securities laws
 - The DAO (July 25, 2017)
 - Munchee (December 11, 2017)

SEC Regulation



- Security registration
 - The security must be registered with the SEC (and states) or meet an exemption
- Offers and exchanges
 - Exchanges for digital tokens that are securities must be registered as a national securities exchange or be exempt from registration
 - Participants in securities transactions are generally subject to broker-dealer registration requirements
- Advice
 - Participants in the business of giving advice about securities for compensation are subject to investment adviser registration

SEC Regulation



- SEC Enforcement
 - Subpoenas and information requests relating to ICOs
 - All versions of white paper
 - Documents, communications and analysis relating to the status of the digital asset as a security
 - Application of securities laws to the offer, purchase, sale or trading of the digital assets
 - Secondary trading
 - Use of proceeds
 - Bank, brokerage or financial account or an location, wallet address or account holding tokens, coins or other digital assets and any persons with authority or control over each

CFTC and SEC Regulation – Custody

CFTC

- Bitcoin futures are cash-settled
- Spot cryptocurrency
 - Will the fund accept cryptocurrency from investors?
 - How will the fund hold cryptocurrency?
 - Will the fund possess a key to authenticate its cryptocurrency transactions?
 - Multi-signature authentication?
 - Access to the keys?

SEC

- Custody and customer protection (Rule 15c3-3)
- Qualified custodian (Rule 206(4)-2)
- Possession or control
- Client funds or securities
- Valuation of cryptocurrency for audit and financial reporting requirements, client statements and fee calculations, books and records



Federal and State Regulation



- FinCEN guidance on virtual currency activities
 - Exchanger or Administrator of virtual currency is a money services business
 - User of virtual currency is not acting as a money services business
- NYDFS BitLicense
- State money transmitter laws
- Uniform Regulation of Virtual Currency Businesses Act
 - Introduced in three states so far



FinCEN Guidance and NYDFS BitLicense

- FinCEN guidance on virtual currency activities
 - Exchanger or Administrator of virtual currency is a money services business
 - User of virtual currency is not acting as a money services business
 - ICO tokens can be “convertible virtual currency”
- NYDFS regulations contain a broad definition of “virtual currency business activity”
 - Activities involving New York or a New York resident
 - Includes “maintaining custody or control” of virtual currency

State Money Transmitter Laws

- If virtual currency is “money,” then the transmission of virtual currency might be money transmission
- A few states likely exempt virtual currency from the definition of “money,” or exempt virtual currency from money transmitter laws
 - Mostly guidance; only New Hampshire’s statute specifically excludes virtual currency
- A few states through statutes, regulation, or interpretation require money transmitter licensing for virtual currency transmission activities
- Around 30 states have neither modified money transmitter statutes to include or exclude virtual currency, or issued any public guidance

Regulatory Initiatives

- March 2018 GAO report: “Financial Technology: Additional Steps by Regulators Could Better Protect Consumers and Aid Regulatory Oversight”
- Upcoming Treasury Report on Non-Bank Financial Technology Companies
- State Regulatory Sandboxes
 - Arizona passed first regulatory sandbox law; awaiting regulations
 - Illinois proposed law
- Conference of State Bank Supervisors resulted in agreement among participating states to accept each other’s findings regarding key elements of money transmitter licensing
- NY AG inquiry/investigation of virtual currency trading platforms

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Jennifer L. Klass is a regulatory counseling lawyer with a broad background in investment management regulation. She advises clients on a wide range of investment advisory matters, including investment adviser registration and interpretive guidance, disclosure and internal controls, regulatory examinations, and enforcement actions. Her clients include major investment banks, investment advisers, broker-dealers, and the sponsors of private investment funds and mutual funds. Previously vice president and associate general counsel at Goldman, Sachs & Co., Jen's practice focuses on the convergence of investment advisory and brokerage services.

Advertising and communications with the public, social media, and fiduciary duty and disclosure are among the securities regulatory areas in which Jen counsels clients. She also advises them on investment adviser registration, internal controls, compliance policies and procedures, separately managed (or wrap fee) programs, regulatory examinations and enforcement actions, interpretive guidance, and no-action requests.

While at Goldman, Sachs, Jen counseled its private wealth management and asset management businesses. She was also previously an associate at Morgan Lewis.



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Melissa R. H. Hall represents US and overseas banks, nonbank financial services companies, investors in financial services, and technology companies in regulatory and corporate matters. She advises them on a wide range of state and federal financial regulatory laws and regulations. She provides counsel on financial regulatory compliance and enforcement, including state and federal licensing requirements, consumer financial products and compliance, payment systems, corporate and transactional matters, financial institution investment and acquisition, and the development of new financial services products.

Melissa provides counsel on complex, cross-discipline financial regulatory matters that require in-depth knowledge of regulations and business lines. Melissa focuses on a full range of more traditional federal and state bank regulatory matters, as well as emerging regulatory issues in connection with payment systems rules, credit cards and stored value cards, money services businesses, and consumer financial regulatory requirements.

Melissa advises banks and financial services companies, as well as their directors and officers, in connection with a range of corporate matters, including governance, management, business and operational, investment, and merger and acquisition (M&A) matters, as well as bank securities and fiduciary activities. Melissa also represents nonbank financial institutions and their investors regarding regulatory compliance and due diligence of state and federal bank and consumer financial laws.



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Michael M. Philipp counsels financial services clients in futures and securities transactions. He also advises them in derivatives regulation, legislation, compliance, and enforcement matters. United States and foreign exchanges and clearing organizations, banks, investment managers, proprietary trading firms, brokerage firms, and end users turn to Michael for guidance in connection with exchange-traded and over-the-counter derivative instruments. He also represents foreign exchanges and clearinghouses in their US offerings of futures and equity options products and derivatives clearing activities.

Michael has experience working with clients on issues related to the Dodd–Frank Wall Street Reform and Consumer Protection Act, as well as US Commodity Futures Trading Commission (CFTC) registration and compliance-related issues. These issues include trade practices, swap reporting and clearing, registration of swap execution facilities (SEFs), futures exchanges, clearing organizations, and swap data repositories (SDRs); retail and eligible contract participant forex (ECP FX) transactions; and futures commission merchant (FCM), swap dealer, commodity pool operator (CPO) and commodity trading advisor (CTA) registrations and compliance. Michael has experience in conducting internal compliance investigations, as well as representing clients in exchange and CFTC inquiries and proceedings, including matters involving allegations relating to disruptive trading practices, such as spoofing and market manipulation. He also provides assistance to firms that are negotiating bilateral and cleared swap documentation.



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Leveraging her experience as a lawyer at the US Commodity Futures Trading Commission (CFTC), Sarah V. Riddell advises domestic and foreign exchanges, derivatives clearing organizations, swap execution facilities, and other financial institutions on a broad range of regulatory matters, including CFTC registration and compliance. While at the CFTC, Sarah worked on Dodd-Frank-related rulemakings and participated in examinations of derivatives clearing organizations, including those designated as systemically important.

During law school, Sarah interned at the International Criminal Tribunal for the former Yugoslavia in The Hague where she worked on, among other things, policy matters related to detention. Sarah interned at the US Attorney's Office and for a federal judge in the Northern District of Illinois. Sarah has also worked on clearing issues for one of the world's largest derivatives exchanges.

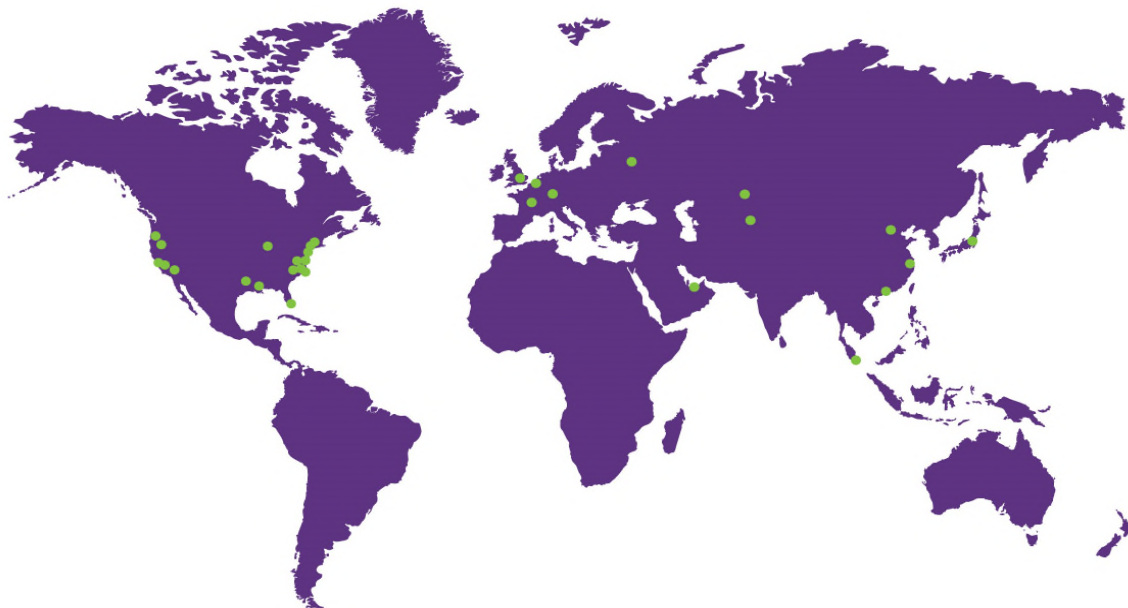


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