CFTC

COMMODITY FUTURES TRADING COMMISSION

Global Markets Advisory Committee November 21, 2024

Commissioner
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Opening Remarks

Recommendation from the GMAC Digital Asset Markets Subcommittee

RECOMMENDATIONS TO EXPAND USE OF NON-CASH COLLATERAL THROUGH USE OF DISTRIBUTED LEDGER TECHNOLOGY

REPORT TO THE COMMODITY FUTURES TRADING COMMISSION'S GLOBAL MARKETS ADVISORY COMMITTEE BY THE DIGITAL ASSET MARKETS SUBCOMMITTEE

AGENDA

- Introduction
- Current state of non-cash collateral adoption: Eligibility and limitations
- DLT potential use cases
- Benefits of DLT
- Recommendations

Introduction

- The Commodity Futures Trading Commission has consistently permitted the use of non-cash assets as collateral to satisfy regulatory margin requirements for both cleared and non-cleared derivatives
- Operational challenges have impeded the use of non-cash collateral
- Blockchain and distributed ledger technology (DLT) can help overcome these challenges
- Tokenization through DLT is simply another technological wrapper for existing assets
- The recommendations put forth do not require **any** regulatory action or changes to collateral eligibility rules
- Market participants can use existing policies, procedures, practices, and processes to identify, assess, and manage risks of using DLT

Current state of non-cash collateral: Eligibility and limitations

Non-cash collateral eligibility

- Non-cash collateral is expressly permitted under the CEA when assets share “fundamental characteristics:”
  - Liquid
  - Hold value
  - Lack correlation to counterparty or portfolio risk

Challenges to non-cash collateral use

- Transfer mechanisms inhibit firms from leveraging non-cash collateral to satisfy margin requirements:
  - Sequential involvement of multiple intermediaries
  - Limits on secondary transfers
  - No 24/7/365 capabilities

DLT benefits and use cases

- **Implementation types**
  - Books and records
    - Custody obligation is for the underlying securities
    - DLT is used as part of internal recordkeeping
  - Tokenization
    - Ownership represented on ledger
    - Transfer intermediated using the ledger

- **Assets**
  - Real world assets on ledger
    - Multilateral development bank debt securities
    - Government securities
    - Corporate debt
    - Money market funds
    - Gold
- **Benefits**
  - No change to the fundamental asset
  - Real-time 365/24/7 transfer of assets
  - Reduction of cost and complexity from existing transfer mechanism

Recommendations

Recommendation 1: Where DLT-based infrastructure is used solely as part of a financial institution's internal books and records, then a CFTC registrant should be able to rely on its normal processes to assess information security and other relevant operational risks, whether those risks arise from the registrant's own use of DLT-based infrastructure for its internal books and records or from the use of such infrastructure by a service provider, such as a custodian, for the service provider's internal books and records.

Recommendation 2: Where a CFTC registrant looks to accept eligible non-cash collateral in tokenized form, it should be able to satisfy relevant requirements by applying its existing policies, procedures, and practices in the following areas: legal enforceability; segregation and custody arrangements; credit and custodial risk; and operational risk.

Recommendation 3: Because use of DLT for these purposes need not affect the character of the relevant asset, and because registrants already have extensive policies, procedures, practices, and processes to address use of new technologies and infrastructures, no new rules or guidance should be necessary in order to permit such use.

Presentation on Utility Tokens

DAMS Workstream Update on Utility Token Recommendations

November 21, 2024

Digital Asset Markets Subcommittee

Background

- Over the past year, the utility token working group of the GMAC's digital market asset subcommittee assembled subject matter experts from traditional and digital asset industries and concluded that **U.S. digital asset market participants deserve to know who their regulator is and which regulatory regime applies.**

- At present, there is little clarity on which digital assets are considered to be commodities by the CFTC. This lack of clarity is undermining responsible innovation for digital assets in the U.S.

- Much of the industry's understanding comes from CFTC and SEC enforcement actions, which is to say that in many cases, market participants learn how a digital asset is classified **only after there is already a rule violation.**

- Together, these recommendations are an attempt to provide much-needed clarity to digital asset markets in the United States, and to allow for proactive compliance with applicable rules well before any given conduct leads to an investigation or enforcement.

Background (con’t)

- The Subcommittee working group recognizes that new legislation could further clarify jurisdictional boundaries and regulatory responsibilities. However, these recommendations are designed to deliver clarity to market participants and entrepreneurs **under the existing legislative framework i**n the United States.

- While the recommendations to follow provide a framework that if achieved, would clearly result in a utility token being considered a (non-security) commodity under U.S. law, it is important to note that tokens falling outside of this framework in many cases will still be commodities.

- The CFTC must continue to leverage its statutory authority to rigorously police commodity markets (including digital asset commodities) in cases of fraud, manipulation and abuse.

Recommendation 1: Utility Token Definition and Safe Harbor

- The working group proposes a definition of “Utility Token” based on six elements that, if satisfied, would assist market participants in determining whether a digital asset is subject to the CFTC’s jurisdiction as a commodity:

  The digital asset, whether in a primary or secondary sale, must convey an immediately available, non-incidental consumptive use to the buyer, whether that consumptive use is a tangible or intangible product, service, discount, special access or other benefit (collectively referred to as “utility”), which may include certain governance and voting abilities, nascent products and services not yet in existence or the ability to access or use of any of the foregoing in the future.

Recommendation 2: Publication on CFTC Website

- The definition of Utility Token set forth above should be published as a brochure, primer or other document on the CFTC's Digital Asset information page on the CFTC website (i.e. https://www.cftc.gov/digitalassets/index.htm).

Recommendation 3: Incorporation of the Utility Token definition in future rulemaking

- To the extent the CFTC undertakes rulemaking related to Utility Tokens, the working group recommends that it adopt this common definition and the criteria it sets forth.

Recommendation 4: Self Certification Process for Utility Tokens

- The CFTC will have 10 business days to review the submission before it is deemed certified, unless the CFTC notifies the market participant that it intends to issue a stay of the certification. In issuing a stay, the CFTC may notify the market participant that the digital asset presents novel or complex issues that require additional time to analyze, and the CFTC will have an additional 90 days to conduct the review. The CFTC would also be required to provide a 30-day comment period within the 90-day stay period in which the public may comment on the digital asset submission.

- The CFTC should consider a formal consultation with the SEC. In particular, the **agencies should consider reactivating the CFTC-SEC Joint Advisory Committee on Emerging Regulatory Issues**.

- A formal committee could encourage dialogue and coordination between the SEC and CFTC as they address jurisdictional issues related to digital assets, and utility tokens in particular.

Recommendation 5: Publication of an Official Approved List of Utility Tokens

- A list of the Utility Tokens that have been duly self-certified or that the CFTC otherwise deems to have satisfied the Utility Token Safe Harbor should be published on the CFTC's Digital Asset information page on the CFTC website.

- This transparency and predictability will help deliver transparency and regulatory predictability to industry participants.

Best Practices

- An interested party might demonstrate that a digital asset meets each of the criteria of the Utility Token Safe Harbor by publishing a white paper that specifies the expected or intended uses of the digital asset and how these benefits align with the “consumptive use” criteria.

Case Studies

- Ether ($ETH): the native token of the Ethereum blockchain that is used to 1) pay transaction “gas” fees, and 2) serving as collateral for network validation

- Avalanche ($AVAX): the native token in the Avalanche network that is used to pay for fees, secure the platform through staking and provides a wide suite of utility services

- Floki ($FLOKI): a token used in the Floki ecosystem, including its NFT gaming metaverse called Valhalla, that is used to pay for transaction fees solely within the Floki ecosystem.

- Geod ($GEOD): a token from the Geodnet decentralized physical infrastructure (DePin) ecosystem that can be used as an incentive method to build, explain and maintain the Geodnet network; tokens are exchangeable for Geodnet data services.

Conclusion

- Clear, transparent, and predictable regulation has been an important traditional characteristic of U.S. financial markets.
- It is important to extend this fundamental, bipartisan U.S. principle to digital asset markets.
- Adoption of the recommendations put forth by the working group of the Utility Tokens Workstream will be an important step forward for catalyzing responsible innovation in the U.S.

Appendix: Utility token factors to consider

- **Primary or Secondary:** the test applies equally to the primary and secondary sales
- **Immediately available**: the utility or the right to the utility must be conveyed to the buyer within a prompt, set period of time following the sale of the digital asset
- **Non-Incidental:** means the utility or utilities must be a material purpose of the digital asset
- **Consumptive Use:** means a product, service or other right or benefit, tangible or intangible that is conveyed to the digital asset holder and does not include an equity or ownership right in the underlying blockchain platform.
- **Nascent Products and Services**: a digital asset that conveys the right to the future access or use of a given utility that is not yet operational provided the seller has a commercially reasonable expectation that the future utility will come to fruition, not to exceed 2 years from the date the digital asset is generated
- **Future Ability to Access or Use:** means that a right to use the utility at a specified point in the future, so long as such right vests immediately upon conveyance

Disclaimer

These recommendations are being presented for purposes of a status update of the work done

Closing Remarks