Securities Regulation Daily Wrap Up, TOP STORY—Commissioner Quintenz provides roadmap for cryptocurrency self-regulation at DC summit, (Mar. 8, 2018)

Securities Regulation Daily Wrap Up

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In a keynote address before a sold-out crowd at the Digital Chamber of Commerce DC Summit, Commissioner Brian Quintenz set forth a detailed and compelling case for the cryptocurrency industry to promptly begin taking steps towards establishing a self-regulatory organization. In his remarks, the commissioner noted that with millions, if not billions, of dollars’ worth of products being transferred on a daily basis in the crypto space, some level of independent officiating is now required.

Quintenz observed that a new, private independent organization could perform an oversight function for U.S. cryptocurrency platforms by utilizing models similar to those employed by the National Futures Association (NFA) and the Financial Industry Regulatory Authority (FINRA) in the financial markets. Quintenz is closely followed by and considered a friend of the virtual currency community. The commissioner’s remarks at the DC summit follow and elaborate on comments he made in February about crypto industry self-regulation at another industry event.

The core elements of self-regulation. Acknowledging the current patchwork of state and federal regulation over the virtual currency industry, Quintenz noted his belief that the spot cryptocurrency market is the area with the greatest need for enhanced regulatory certainty and oversight. He stated, "As Congress works with federal and state regulators to determine the appropriate regulatory framework for cryptocurrencies, I believe an SRO-like entity could develop industry standards that could inform, or even serve as a blueprint for, future action."

According to Quintenz, an SRO-like independent regulatory body could establish best practices for spot platforms, including setting minimum standards of fitness for their employees. "Eventually, it could enforce rules on its own membership, supervise them for compliance, and provide a forum for customers to seek redress against member platforms, just like FINRA and NFA do for the securities and derivatives markets today. An SRO-like, independent regulatory body could create uniform standards for these trading platforms, reduce the possibility of regulatory arbitrage, and avoid duplicative regulation," he observed.

Advantages of self-regulation. The commissioner also noted that a private cryptocurrency oversight body has several advantages. First, as a private membership organization, it could begin providing oversight over spot platforms far more quickly than any federal regulatory regime, which could only be established following what would likely be a prolonged legislative process. Moreover, an SRO-like entity can also provide numerous efficiencies. Additionally, they are funded by their members, not by the federal government. They can also adopt and amend rules more quickly than a federal agency. Furthermore, the rules and best practices published by an SRO are informed by practical experience because the organization has input from industry participants. The commissioner emphasized this is especially beneficial in the case of a rapidly evolving industry, like cryptocurrency, where products and trading conventions are constantly changing.

A long history of SROs in the U.S. financial markets. The commissioner also pointed to the history of SROs in the U.S. futures industry, dating back to the mid-nineteenth century, and decades prior to the adoption of federal regulation. The Chicago Board of Trade (CBOT) began enforcing rules on its members in 1859 to prevent fraud and manipulation in its markets. He also noted that Congress has repeatedly called for self-regulation in conjunction with federal oversight of financial markets. When the CFTC was first created in 1974, its authorizing statute included provisions for a "registered futures association" or RFA to be supervised by the CFTC. The NFA
became the first RFA in 1981 and still serves this function today. FINRA traces its history to the Maloney Act of 1938, to promote oversight of the over-the-counter securities market, and the Municipal Services Rulemaking Board has served as the SRO for firms operating in the municipal securities markets since the Securities Acts Amendments of 1975.

IOSCO standards. The commissioner also referred to the International Organization of Securities Commissioners (IOSCO) and the internationally recognized Principles for Self-Regulation it has developed. Accordingly, any SRO-like independent regulatory body would not have to start from scratch. IOSCO principles call for an SRO to establish standards of corporate governance to effectively manage any conflicts of interest, and to observe standards of fairness and confidentiality when it’s exercising powers and responsibilities. Quintenz observed that “compliance with IOSCO’s robust set of protocols would lend credibility to any SRO-like body for cryptocurrency spot platforms.”

International developments. Quintenz also observed an emerging movement toward self-regulation in the cryptocurrency sector internationally. A cryptocurrency trade association called “CryptoUK” was recently established in the United Kingdom. That organization has established a code of conduct for its members which includes guidelines around due diligence checks, customer protections, and pricing transparency. Similarly, the heads of two cryptocurrency trade groups in Japan, together with the country’s 16 spot exchanges, have committed to establishing a new self-regulating body.

The time is now. Commissioner Quintenz concluded his remarks by urging the cryptocurrency industry to begin its journey towards self-regulation, noting, “I believe that while Congress considers what, if any, further federal action in this area is appropriate, an SRO-like entity could begin to develop ideas and standards that would strengthen the integrity of the spot markets.” He continued, “I think we’ve come to the point with cryptocurrencies where an independent body must step up, establish, and enforce the rules of play.”

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