



How to Launch a Cryptocurrency Hedge Fund: Manager Registration Considerations

Unlike other private funds, complex analysis is required to determine registration considerations for the manager of a crypto fund. This is because, unlike other asset categories such as securities and futures, cryptocurrency investments are not their own asset class. Rather, such investments are currently regulated by the asset class that a particular instrument most closely resembles – such as a security, commodity, commodity interest, cash or consumer item. Consequently, launching a crypto fund requires an in-depth understanding of securities and commodities laws, as well as an ongoing review of regulatory developments in the crypto space. Below is a sampling of registration-related considerations in relation to the fund's manager. International regulations and additional crypto investment types are not addressed herein. If a fund invests in a combination of the investment types discussed below or in other investment types, registration considerations must be understood with respect to each investment type prior to the time of the investment.

Direct Cryptocurrency Investments: If the fund will only invest in the most common cryptocurrencies, such as Bitcoin or Ether, investment adviser registration with the SEC and states is not likely required. This is because the U.S. Securities and Exchange Commission (SEC) has determined that such instruments are more akin to a non-security than a security, and thus investment adviser registration is not triggered. However, this begs the question of when a cryptocurrency is deemed to be more akin to a non-security than a security. Complex analysis is required in this regard, including application of the Supreme Court's 1946 Howey Test to determine whether an investment contract exists. Moreover, a token's regulatory status can shift over time depending on how it is being offered and the reasonable expectations of investors. Managers must therefore proceed with caution if they do not wish to trigger investment adviser registration in connection with their direct cryptocurrency investments. A separate legal analysis needs to be conducted in connection with each token desired to be invested in prior to such investment. In-depth disclosures are also required to apprise investors of the various risks applicable to these investments. In addition, a prominent crypto platform (Gemini) has proposed the creation of a self-regulatory organization (SRO) called the Virtual Commodity Association, which would seek to regulate the crypto spot markets. More updates on this to come, as they become available.

ICO and Blockchain Investments: Investments in initial coin offerings (ICOs) and private investments in blockchain initiatives would almost certainly be deemed investments in securities (per the SEC) and thus trigger either SEC or state investment adviser registration. Certain exemptions may be available, however, such as the private fund adviser exemption (up to certain asset thresholds). If investment adviser registration is triggered, particularly with the SEC, special care needs to be taken in situations where the rules do not easily apply to crypto funds, such as in the case of custody and valuation. As for custody, if the adviser is registered with the SEC, there remains the issue of whether there currently exist “qualified custodians” to oversee the fund’s assets. Valuation issues also exist, particularly with hard-to-value digital assets such as ICOs. In-depth disclosures are likewise required to apprise investors of the various risks particular to these investments. Unique compliance procedures must also be prepared for crypto funds. In addition, state laws vary widely in this area.

Crypto Futures: Registration with the Commodity Futures Trading Commission (CFTC) as a commodity pool operator (CPO) and/or commodity trading adviser (CTA) may be required if the fund trades “commodity interests” (such as Bitcoin futures). Certain exemptions may be available, however, such as under CFTC Rule 4.13(a)(3) or Rule 4.7 (registration light). Under Rule 4.13(a)(3), in-depth monitoring may be required to ensure that the fund stays below applicable *de minimis* thresholds. Under Rule 4.7, CPO registration is required, albeit not a full registration, and thus various CFTC regulations apply. If the fund operator is distinct from the investment manager, CTA registration and exemption considerations also apply. Finally, unique CFTC compliance procedures should be adopted in the case of crypto funds. Even if the fund is not registered with the CFTC, the CFTC has claimed jurisdiction to monitor fraud and manipulation with respect to commodities (as opposed to commodity interests), which term, the CFTC purports, includes crypto-related assets. Finally, in-depth disclosures are required to apprise investors of the various risks particular to trading in commodity interests, particularly with regard to crypto-related investments.

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