

**ALERTS**

## **Reminder: NFA Member Managers and Virtual Currency Disclosures**

**August 4, 2021**

As an increasing number of investment managers are exploring virtual currency spot and derivative trading as part of their investment programs, managers who are members of the National Futures Association (“NFA”) should be reminded that NFA Interpretive Notice 9073[1] requires special disclosures to fund participants and managed account clients in connection with virtual currency trading activities (“Virtual Currency Disclosures”).

### **Who Must Deliver, and Receive, NFA Virtual Currency Disclosures?**

The NFA’s Virtual Currency Disclosures apply only to NFA-member managers. Commodity pool operators (“CPOs”) and commodity trading advisors (“CTAs”) who are not NFA members (for example, fully exempt managers relying on Rule 4.13(a)(3)) are not subject to these rules.[2]

For those firms that are NFA members, all pools and accounts are covered by the Virtual Currency Disclosure Rules, i.e., NFA-member CPOs and CTAs must provide Virtual Currency Disclosures to *all* fund participants and account clients of:

- Reportable commodity pools (e.g., commodity pools under Rule 4.7 relief);
- Exempt pools (e.g., those under Rule 4.13(a)(3)) relief; and
- Managed accounts;

that engage in either spot/underlier or virtual currency derivative trading (“Virtual Currency Trading”). Note that “funds of funds” that are exposed to Virtual Currency Trading by virtue of investing in funds with such exposure are also covered by the NFA’s Virtual Currency Disclosures requirement.[3]

Participants in an existing fund or separately managed account that will begin engaging in Virtual Currency Trading should be provided with Virtual Currency Disclosures at or before the time such fund or account engages in Virtual Currency Trading. Prospective investors should be provided with such disclosures prior to their participation in an investment vehicle or managed account that engages, or will engage, in Virtual Currency Trading.

## **What Materials Do the NFA’s Virtual Currency Disclosures Affect?**

The NFA’s rules require fulsome risk disclosures in fund offering memoranda and managed-account brochures where the investment program includes Virtual Currency Trading. Short-form virtual currency disclosures must also be included in any promotional materials for these funds or accounts. The exact content of these disclosures will differ depending on the specific course of investment.[4]

### *Spot trading in virtual currency*

NFA member CPOs and CTAs engaging in underlying or spot virtual currency transactions in a fund or managed account must “prominently” display a particular short-form “boilerplate” disclosure in *both* 1) promotional materials (such as investor marketing decks) and 2) offering memoranda or account brochures for this fund or account:

[Name of NFA member] is a member of NFA and is subject to NFA’s regulatory oversight and examinations. [Name of NFA member] has engaged or may engage in underlying or spot virtual currency transactions in a [commodity pool or managed account program]. Although NFA has jurisdiction over [name of NFA member] and its [commodity pool or managed account program], you should be aware that NFA does not have regulatory oversight authority for underlying or spot market virtual currency products or transactions or virtual currency exchanges, custodians or markets. You should also be aware that given certain material characteristics of these

products, including lack of a centralized pricing source and the opaque nature of the virtual currency market, there currently is no sound or acceptable practice for NFA to adequately verify the ownership and control of a virtual currency or the valuation attributed to a virtual currency by [name of NFA member].

In addition to the above boilerplate disclosure, each applicable offering memorandum or brochure must also include a full discussion of risk factors “that are applicable to their [spot/underlier Virtual Currency Trading] activities[.]” In particular, NFA Interpretive Notice 9073 highlights and discusses the following risk factors as topics to address[5]:

- Unique features of virtual currencies
- Price volatility issues
- Valuation and liquidity issues
- Cybersecurity considerations
- The opaqueness of the spot market
- Issues arising from virtual currency exchanges, intermediaries and custodians
- The regulatory landscape surrounding virtual currencies
- Technological considerations
- Transaction fees

#### *Trading in virtual currency derivatives*

NFA-member managers must also provide customized investor disclosures where a fund or managed account’s trading will involve virtual currency derivatives. This information would include a relevant short-form disclosure in promotional materials, and a fulsome discussion of relevant risks in applicable offering memoranda and account brochures. The NFA does not prescribe any “boilerplate” disclosure for promotional materials, offering memoranda or account brochures in the context of virtual currency derivatives trading, but does list several considerations for tailoring these disclosures. The NFA states that such disclosures should cover the “unique features” of these instruments and the potential impact

that these risks may have on a fund or account's investment program. By way of example, the NFA highlights several potential risks[6]:

- The potential for price volatility and potential initial margin increases;
- Potential futures commission merchant restrictions on trading in virtual currency derivatives, such as “requiring additional margin, imposing position limits, prohibiting naked shorting or prohibiting give-in transactions”; and
- The possibility of DCM trading halts or other restrictions on trading in virtual currency derivatives that may limit a manager's ability to exit a position when volatility is high.

Because virtual currency derivatives are at least indirectly exposed to many of the risks inherent in virtual currencies themselves, managers who trade exclusively in virtual currency derivatives should nonetheless consider each of the NFA's highlighted risks attendant to spot trading when crafting their disclosures.

## Action Steps

Managers should note that the NFA has recently increased its scrutiny of members' compliance with virtual currency disclosure obligations. Failure to comply with these requirements could subject a member to deficiencies, sanctions and a broader review of its promotional and offering materials. Accordingly, all NFA-member managers should take the time to:

- Assess whether any fund or managed account has, or will have, direct or indirect crypto asset exposure;
- Review NFA Interpretive Notice 9073; and
- Confirm that their promotional materials and offering documents comply with NFA rules.

Furthermore, while the NFA's Virtual Currency Disclosure rules apply only to NFA members, it is advisable for managers generally to seek counsel on the adequacy of their current investor disclosures if they plan to add cryptocurrency assets to their portfolios.

*Authored by Marc E. Elovitz, Heather N. Wyckoff and Joshua B. Wright.*

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

---

[1] See NFA Interpretive Notice 9073: Disclosure Requirements for NFA Members Engaging In Virtual Currency Activities (effective Oct. 31, 2018), available [here](#).

[2] However, managers who are not NFA members generally should ensure that disclosures to their investors and clients adequately describe their virtual currency spot or derivatives exposure and the considerations associated therewith.

[3] See NFA Virtual Currency Disclosure Requirements Webinar Transcript (Oct. 11, 2018), available [here](#).

[4] As a fallback, NFA-member managers engaged in virtual currency activities other than the spot or derivative trading addressed in this *Alert* must include a short, generic disclosure in any relevant marketing materials, as described in Interpretive Notice 9073 Section II.C.

[5] See Interpretive Notice 9073, Section II.A.

[6] See Interpretive Notice 9073, Section II.B.

---

*This communication is issued by Schulte Roth & Zabel LLP for informational purposes only and does not constitute legal advice or establish an attorney-client relationship. In some jurisdictions, this publication may be considered attorney advertising. ©2021 Schulte Roth & Zabel LLP.*

*All rights reserved. SCHULTE ROTH & ZABEL is the registered trademark of Schulte Roth & Zabel LLP.*

---

## Related People



**Marc  
Elovitz**

Partner  
New York



**Heather  
Wyckoff**

Partner  
New York



**Joshua  
Wright**

Associate  
New York

---

## Practices

**INVESTMENT MANAGEMENT**

**REGULATORY AND COMPLIANCE**

---

## Attachments

↓ Download Alert