The Surge in Cryptocurrencies Begs the Question: Add Them to Your Code of Ethics?

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You can call them virtual, digital or alternative currencies but more and more people refer to them as cryptocurrencies and see them as one thing: money.

What started with bitcoins during the financial crisis of 2009 has blossomed to more than 1,200 cryptocurrencies, according to a website that tracks them. That same site claims bitcoin's total market capitalization now tops $137 billion.

"Cryptocurrencies will not go away. Ever," said **Adam Ludwin**, CEO of the San Francisco-based start-up technology firm **Chain**. He spoke last month before the **SEC**'s Investor Advisory Committee. "You shouldn't bet against cryptocurrencies," he continued. They will "only increase in value over time."

A bubble ready to pop?

Skepticism, however, has been voiced by the likes of committee member **Damon Silvers**. The director of policy and special counsel at the **AFL-CIO** said he worries bitcoin's exploding value may pre-tell a bubble. The value of a bitcoin now exceeds $8,200.

That same committee meeting heard from **Jeff Bandman**, a principal at **Bandman Advisors** and a former FinTech adviser to the **CFTC**. He warned that "fraudsters abound" and initial coin offerings and cryptocurrencies carry a huge potential for losses due to cybercrimes (see the box below and this related story).

Bandman also said blockchain, initial coin offerings and bitcoins are all interrelated (**IA Watch**, Aug. 31, 2017). They're financial services on the cutting edge of technology.

All of these developments have compliance officers contemplating whether they should revise their codes of ethics to include cryptocurrencies.

A CCO at a southern California RIA didn't revise her COE but did notify staff that cryptocurrencies would be deemed to be currencies under the firm's code. This means a staffer investing in cryptocurrencies would have to disclose this to the firm and share duplicate confirmations and statements.

"They can't do [the investing] in some random, online account that we don't know about," says the CCO, who asked for anonymity.

Giving it some thought

"The regulators are thinking about it," says **Steven Felsenthal**, general counsel/CCO at **Millburn Ridgefield Corporation** ($1.7B in AUM) in Greenwich, Conn., "so we should be thinking about it."

Felsenthal's current thinking has him treating initial coin offerings like IPOs. This means staff investments in them must be pre-approved and they must complete quarterly attestations. His firm bans staff from investing in currencies because the firm does. The RIA doesn't invest in bitcoins, however.

But he admits his policy could change as quickly as regulators' take on this topic. He also says an informal poll he took of other CCOs found nearly all inclined to follow his lead on a policy toward cryptocurrencies.

In July, the SEC released its first views of initial coin offerings in a report that states they could be seen as securities (**IA Watch**, July 27,2017). If this view sticks, it would seem to steer a CCO's hands because Advisers Act rule 204A-1 (code of ethics) requires the firm to review an "access person's current securities holdings" as well as quarterly transactions.

However, the code of ethics rule – which was last revised in 2011 – didn't contemplate the evolution of cryptocurrencies.

Dueling regulators?

And regulators don't seem to agree on the topic. CFTC Chairman **J. Christopher Giancarlo** recently told Congress that his agency interprets these new currencies as commodities that fall under its purview within the Commodity Exchange Act (**CPO/CTA Watch**, Oct. 12, 2017).

It follows then, argues **Ben Anderson**, principal with **Anderson PLC** in Minneapolis, that a CCO would want to ensure that the firm's personal trading policy extends to employees trading in commodities and futures.

Major cryptocurrencies, such as bitcoins and ethereum, are so ubiquitous that your policy could permit staff to trade them while requiring more esoteric currencies to be pre-approved, says a Washington, D.C. attorney who requested anonymity. But permitting the trading in even common cryptocurrencies like bitcoins presents the challenge that there are no electronic feeds that you could subscribe to that could verify such trades, he adds.

Given this difficulty, it could be safer to ban staff from investing in cryptocurrencies until the industry gets a better handle on them, the attorney suggests.