

**WHY CONGRESS NEEDS TO ACT:
LESSONS LEARNED FROM THE FTX COLLAPSE**

HEARING

BEFORE THE

**COMMITTEE ON AGRICULTURE,
NUTRITION, AND FORESTRY**

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WHY CONGRESS NEEDS TO ACT: LESSONS LEARNED FROM THE FTX COLLAPSE

Thursday, December 1, 2022

U.S. SENATE
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY
Washington, DC.

The Committee met, pursuant to notice, at 10 a.m., in room G50, Dirksen Senate Office Building, Hon. Debbie Stabenow, Chairwoman of the Committee, presiding.

Present: Senators Stabenow [presiding], Brown, Klobuchar, Bennet, Gillibrand, Smith, Durbin, Booker, Luján, Boozman, Hoeven, Ernst, Marshall, Tuberville, Grassley, Fischer, and Braun.

STATEMENT OF HON. DEBBIE STABENOW, U.S. SENATOR FROM THE STATE OF MICHIGAN, CHAIRWOMAN, U.S. COM- MITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Chairwoman STABENOW. Good morning. I call the Committee to order. We appreciate Chairman Behnam being with us this morning.

One month ago, the crypto market was rocked by reports that Alameda Research, a trading firm affiliated with crypto exchange FTX, was in financial trouble. Alameda's balance sheet was propped up by a crypto token that FTX had created. In a matter of days, FTX and most of its affiliated companies collapsed into bankruptcy. At best, these events uncovered an alarming lack of internal controls and egregious governance failures. At worst, Sam Bankman-Fried and his inner circle lied to and stole from over one million customers, some of whom have lost their life savings.

Meanwhile, the fallout continues across the crypto ecosystem. For over a year, this Committee has been examining the risks posed by the lack of Federal oversight of the crypto industry. The Chairman of the Commodity Futures Trading Commission (CFTC), with us today, Russ Behnam, spoke about this issue at his confirmation hearing. At that hearing, Mr. Behnam discussed the agency's enforcement actions against crypto firms but warned that they were just "the tip of the iceberg." Since that time, members of this Committee have been working on a bipartisan basis to advance legislation that would give the CFTC regulatory authority over the trading of crypto tokens that are not securities.

To be clear, there currently is no Federal market regulation of spot crypto assets that are not securities. These include Bitcoin and Ether, the two most heavily traded crypto assets. The White House and the Financial Stability Oversight Council have urged Congress to close this gap. The Digital Commodities Consumer Protection

Act (DCCPA) does exactly that, and I want to thank Senator Boozman as my partner, and I want to thank our co-sponsors as well.

I have said this before and I will say it again: the Digital Commodities Consumer Protection Act does not take authority away from other financial regulators, nor does it make the CFTC the “primary” crypto regulator. Because crypto assets can be used in many different ways, no single financial regulator has the expertise or the authority to regulate the entire industry.

We continue to work with our colleagues on the Senate Banking Committee, and at the Securities and Exchange Commission and other financial regulators, to bring greater protections to this market, regardless of whether the asset is a security or a commodity.

The crisis created by FTX further confirms the need for a whole-of-government approach to regulating this market. The risks of trading crypto have come into sharp focus in the past few weeks, but we have known about them for years. The lack of clear, consistent rules has allowed crypto to flourish, despite harmful conflicts of interest, an absence of responsible governance and risk management, and a failure to safeguard customer assets. This is the very conduct our legislation is designed to prevent.

Where Federal regulators, including the SEC, already have authority to register and oversee crypto firms, they must use that authority. Fraud prosecutions are a critical tool, but far too often, they are brought after customers’ money has been lost, with little recourse for those affected. Senator Boozman and I have called today’s hearing to do two things. First, to understand what went wrong at FTX. We will not have all the answers today because the story is just beginning to unfold, but the Committee will hear from Chairman Behnam about what may have triggered such a staggering collapse in such a short period of time. Second, we want to ensure that the Digital Commodities Consumer Protection Act sufficiently addresses these risks.

One thing is already apparent: the crypto industry lacks the customer protections that Americans expect and deserve when trading in U.S. markets. When exchanges accept customer funds for trading, they must not be allowed to gamble with those funds. They must not be allowed to invent products that have little to no intrinsic value and accept them as collateral for loans. They must not be allowed to self-deal.

FTX did all of those things, emboldened by a lack of Federal oversight. Let me just conclude by saying that there is one exception in this story. One exception is LedgerX, a derivatives exchange and clearinghouse purchased by FTX and registered with the CFTC. John Ray, the CEO appointed to navigate the FTX companies through bankruptcy, said that LedgerX has a “solvent balance sheet” and “responsible management.” Customer money was safeguarded and is accounted for. The DCCPA replicates these protections for digital commodity markets. If our bill had been law, FTX’s conduct would have been illegal and could have been prevented.

Congress must act to pass legislation that will hold this industry to the same rules as traditional financial institutions and close gaping holes in our regulations. If we fail to meet this responsibility, consumers will continue to be harmed, and hardworking Americans

will continue to lose billions of dollars at the hands of bad actors, like FTX.

That is why we are here, and I am going to turn now to my colleague and partner in this effort, Senator Boozman.

**STATEMENT OF HON. JOHN BOOZMAN, U.S. SENATOR FROM
THE STATE OF ARKANSAS**

Senator BOOZMAN. Thank you, Madam Chair, for calling today's very, very important hearing.

The sudden bankruptcy of FTX, a Bahamas-based cryptocurrency exchange that, at its peak, was the world's third-largest crypto exchange by volume, has been truly shocking. Public reports suggest a complete lack of risk management, conflicts of interest, and misuse of customer funds. There is simply no place for such behavior, especially in our financial markets.

A failure of this magnitude requires Congress to analyze a number of things: what happened, the scope and scale of the impact to U.S. consumers and investors, what could have prevented this, and what the potential market effects are or systemic risks were.

This hearing will allow the public to learn what happened from the perspective of the CFTC, a frontline regulator, the agency's response, and the tools the agency needs to protect U.S. customers and investors in the future.

Many have asked, why is the Ag Committee involved in this? The Ag Committee is involved because this Committee, and no other Committee in the Senate is responsible for the oversight of the Nation's commodity markets. Bitcoin, although a cryptocurrency, is a commodity. It is a commodity in the eyes of the Federal courts and the opinion of the SEC Chairman. There is no dispute about this. If there are exchanges where commodities are traded, be it wheat, oil, or Bitcoin, then they must be regulated. It is simply that simple. The choice not to regulate leaves consumers at the mercy of those who would prey upon them.

The FTX failure is an unacceptable recurrence. A foreign entity fails and U.S. consumers and businesses get hurt as a result. The choice not to regulate, or opting for a regulation by enforcement approach, drives entities offshore and out of the U.S. regulators' purview. When these offshore entities fail, U.S. consumers still get hurt, but U.S. regulators can only watch from afar.

The CFTC is the right agency to regulate digital commodities. When given the necessary authorities, the CFTC has consistently demonstrated its willingness to protect consumers via enforcement actions against bad actors. It also has a pragmatic, principles-based agency approach that enhances consumer protection by building and implementing constructive, workable regulatory structures for markets to function in. There is no better example of this than the CFTC's regulation of the futures market, which has proven to be one of the most resilient markets, in large part because of the CFTC's tried and trusted principles-based regulatory regime. The CFTC regulates markets through core principles that prevent conflicts of interest, prohibits abusive trade practices, protects customer funds and informs investors about market risk.

Chairman Stabenow and I have drawn from these consumer protection-based principles and the agency's expertise in regulating

evolving and complex markets and applied them to digital commodity spot markets. I welcome today's hearing to explore how the CFTC would have used the Digital Commodities Consumer Protection Act in this situation and to flesh out what regulatory gaps we need to fill to prevent such occurrences from happening again.

Long before the FTX's collapse, the Chairwoman and I began working, drafting legislation to address the need for regulation in digital commodity spot markets. Speaking for myself, I can tell you that between my staff and I, we have had a transparent process, taking at least 240 meetings this year, with a wide variety of stakeholders that informed the legislation that was introduced in August and continues to inform my thinking as Chairwoman Stabenow and I refine the DCCPA.

A lot of hard work has gone into the Digital Commodities Consumer Protection Act. It is the result of a bipartisan coordination and widespread stakeholder engagement encompassing nearly the entire digital asset and financial services ecosystem. It also incorporates consumer advocacy and academic input and regulatory technical assistance. The bill is a good-faith effort to establish a constructive regulatory framework that provides the CFTC with the resources and the authority necessary to protect consumers and retail investors while promoting industry innovation in digital commodity spot or cash markets.

I am confident that CFTC is the right agency for an expanded regulatory role in the digital commodity spot market and I remain committed to advancing a final version of the bill that will allow for the creation of safeguards the market desperately needs, and certainly even more so in the wake of the FTX collapse.

I look forward to Chairman Behnam weighing in on the events of the FTX collapse, giving the perspective on the state of the industry, the role the CFTC is playing in protecting U.S. consumers, and ensuring efficient derivatives markets. I welcome his insight on the bill.

With that I yield back.

Chairwoman STABENOW. Thank you so much, Senator Boozman.

Russ Behnam is Chairman of the Commodities Futures Trading Commission, well known to the Committee. We welcome you today and we appreciate hearing from you on this really important topic. Please proceed.

STATEMENT OF HON. ROSTIN BEHNAM, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, DC

Mr. BEHNAM. Thank you, Chairwoman Stabenow, Ranking Member Boozman, and members of the Committee, for the opportunity to appear before you today.

The events of the past few weeks embody, in the most regrettable way, the perilous state of the digital asset market. For years many have recognized that a patchwork of Federal-and State-based regulation is an unsuitable substitute for a comprehensive approach. We are here today because many Americans invested in a novel product and will likely lose money because digital asset markets lack the basic protections that we have all come to expect and have made American financial markets the envy of the world.

In the absence of stringent and uniform standards, the digital asset market rapidly expanded. With nominal barriers to entry for new products and new consumers, massive speculative interest has taken the place of legitimate market forces, putting the American public at significant risk. We are here today because the latest events involving FTX lay bare the consequences and demand accountability. As I have stated publicly many times before, I strongly believe that we need to move quickly on a thoughtful regulatory approach to establish guardrails in these fast-growing markets of evolving risk, or they will remain an unsafe venture for customers and could present a growing risk to the broader financial system.

Failure to act will leave consumers who have made investments in digital commodities largely unprotected. Unlike other Federal financial regulators, the CFTC lacks the necessary and direct authority to write rules and to oversee this marketplace. Instead, we may only reach it through more limited authority activated when fraud or manipulation has already occurred. While we can and do hold perpetrators accountable when we find fraud or manipulation, for the victims of the scheme it is already too late.

The CFTC does not have direct statutory authority to comprehensively regulate cash digital commodity markets. Instead, the Commission's jurisdiction resides with its more limited fraud and manipulation enforcement authority. In the absence of direct regulatory and surveillance authority in the underlying cash market, CFTC enforcement activity begins with a referral or whistleblower tip from an external source. Despite this limitation, the CFTC has brought more than 60 enforcement cases in the digital asset space since 2014, with total penalties of just over \$820 million. Alone, in Fiscal Year 2022, more than 20 percent of our total 82 enforcement actions involved digital assets.

As I suggested over a year ago, the fraud that we are able to prosecute is likely a fraction of what exists in the shadows. Limited enforcement authority is no substitute for comprehensive regulation in which trading platforms, dealers, custodians, and other critical infrastructure participants are required to be registered and subject to direct oversight by a regulator such as the CFTC. By the time the CFTC is able to exercise its fraud and manipulation authority, it is already too late for defrauded customers.

Identifying unique elements of the digital asset commodity markets that distinguish it from other cash markets, I have asked Congress for clear authority to impose our traditional regulatory regime over the digital asset commodity market. I have been greatly encouraged by the efforts from Congress to date.

I have not been shy about my encouragement of bills that contemplate shared responsibility for the CFTC and the Securities and Exchange Commission, where the SEC would utilize its existing authority and reporting regime requirements for all security tokens, while the CFTC would apply its market-based rules for the more limited subset of commodity tokens which do not have the same characteristics of security tokens.

In September, I appeared before you in support of the Digital Commodities Consumer Protection Act, which benefited from the expertise of CFTC staff who worked closely with some members of this Committee to establish a framework similar to the CFTC's cur-

rent and effective regulatory framework over the derivatives markets. I have been encouraged by the bipartisan and bicameral support that recognizes the need for guardrails around the burgeoning digital asset economy and calls for regulation to impart transparency, accountability, stability, customer protections, and oversight across digital assets.

In light of recent events, the CFTC stands ready to continue working with this Committee and other Members of Congress in revisiting existing proposals to ensure every known weakness, risk, and failure is addressed in legislation.

It has been easy to fall into analysis paralysis, compelled to endlessly debate the utility of the underlying technology, how to ensure responsible innovation, and how flexible or restrictive regulation should be, both exclusively around digital assets and inclusively amongst traditional financial instruments. Our highest priorities must be the protection of customer property and promotion of fair, stable, and resilient markets. If we are going to ensure that FTX and other firms that are subjecting customers to billions of dollars in losses are appropriately regulated and held accountable, we need to act promptly to apply a comprehensive regulatory regime.

Most of the coverage about FTX in the past weeks has focused on the over 130 different entities that filed for bankruptcy, which includes an offshore-based exchange for trading digital assets and digital asset-based derivatives, a highly leveraged market making firm trading throughout the digital asset market, and a U.S.-based spot exchange. Of significantly less focus is the entity registered with and overseen by the CFTC, a derivatives exchange and clearinghouse called LedgerX LLC.

Since 2017, LedgerX has been registered with the CFTC as a designated contract market, swap execution facility, and derivatives clearing organization. LedgerX is one of the few FTX entities to not file for bankruptcy. The CFTC has been in near daily contact with LedgerX as well as the third-party custodians it uses to hold both cash and digital assets. Based on the information presented to us at this time, LedgerX customer property remains secure and LedgerX has the financial resources to continue operating for the foreseeable future.

We are continuing to closely monitor LedgerX, but the initial evidence suggests that in the collapse of the broader FTX universe, CFTC regulations are working to ensure that those registered with the CFTC are in a position to protect customers and continue market operations. The lesson here is clear: thoughtful, comprehensive regulation works to protect customers and prevent the type of events that have befallen the other FTX entities.

Invariably, the questions we are all obligated to answer as regulators are, “How did you let this happen?” and “How will you prevent this from happening again?” In the pivotal moment we find ourselves in, the answer to both questions is: comprehensive, market regulation. At the CFTC we lacked the authority to comprehensively regulate the digital commodity market and to prevent this from happening again. We must be provided appropriate authority by Congress, and without new authority for the CFTC there will remain gaps in a Federal regulatory framework, even if other regu-

lators act within their existing authority. In fact, the recent Financial Stability Oversight Council Report concludes that, “A regulatory gap exists in spot markets for crypto assets that are commodities and not securities.”

The CFTC will remain vigilant with respect to our registered entities, using our existing fraud and manipulation authority to the fullest extent of the law, and engage with this Committee to ensure you have as much information as needed.

I look forward to answering your questions and thank you for the invitation today.

[The prepared statement of Mr. Behnam can be found on page 48 in the appendix.]

Chairwoman STABENOW. Thank you very much, Mr. Chairman. We will have seven-minute rounds because of the importance of this issue and having our one witness today.

Chairman, you testified that CFTC has a limited window into FTX operations apart from the one entity that you talked about, LedgerX, which is registered with the CFTC. Based on the visibility that you have into LedgerX and the information that you learned from discussions with other regulators or FTX, what can you tell us about the cause of the FTX collapse?

Mr. BEHNAM. Thank you, Senator, for the question. I say at the beginning very clearly the LedgerX relationship was essentially walled off from other affiliates and other entities in the FTX family. We had a lens into FTX, and as I have stated and as you have recognized, the entity is healthy, it is solvent, it is operational, and we know where customer money is. The limitations of our authority stopped at that entity, and the sort of reciprocal relationship is for those same reasons that we were walled off from going past the regulated entity, the other FTX entities were not able to pierce through LedgerX and potentially take customer money, which obviously, as a regulator, that is the priority.

In terms of what happened and what we are learning, obviously a lot of information continues to come in. As we look at what we have learned thus far, it seems like a classic liquidity crunch that really forced a run on the institution. Over a series of days there were concerns about the health of the FTX entity and all of the affiliates, and at that point, as we have learned, a number of the customers and investors started to withdraw their funds, which really cascaded into a massive withdrawal of funds, which at some point FTX had to stop those withdrawals and then ultimately file for bankruptcy. A lot of indications about comingling and not using custody to protect customer property, and a series of conflicts of interest which you also pointed out.

These are the things that we have learned so far but continue to monitor the situation. Ultimately it looks like a classic run based on a liquidity crunch.

Chairwoman STABENOW. Thank you. FTX had requested that CFTC amend LedgerX’s clearinghouse license, and the agency was reviewing that proposal at the time of their bankruptcy. Could you please describe for the Committee the agency’s interactions with FTX and its former CEO regarding this request, as well as the status of the request before it was withdrawn?

Mr. BEHNAM. Thank you, Senator. I will try to be as concise and comprehensive as possible. It is an important question.

FTX was dogged in their pursuit of getting an approval for this application for the clearinghouse. Certainly I cannot speak to the number of meetings necessarily that Mr. Bankman-Fried and his team had with staff. I do know they were in the building quite a bit, talking with staff about the details of the application.

I can, though, share with this Committee with respect to me. My team and I have taken an initial review of my calendar, and what we have observed is that my team and I met with Mr. Bankman-Fried and his team. Over the past 14 months we met 10 times in the CFTC office, at their request, all in relation to Derivative Clearing Organizations (DCO), this clearinghouse application. Nine out of the 10 times we were in Washington. One was at a widely held conference in Florida earlier this year.

In addition, there were two phone calls, I believe, and a number of messages, all in relation to the DCO application, providing us updates, suggesting that they were answering questions from different divisions, and trying, as I said, to doggedly move the application along and to get it approved.

I would say it is really important to understand that by law, by statute, we needed to address and respond to the application. We did not have flexibility to put it on the side of the desk or disregard it. We had to respond to it. Knowing the importance of the issue and the very strong feelings on both sides of the application, both in support and opposition, I made a decision very early to be as transparent as possible with the process. In March of this year we put out a request for information, a series of questions to the public, trying to get as much stakeholder input. We received 1,500 responses to that request for information.

In May of this year we had a public roundtable on non-intermediation, specifically on non-intermediation and not the FTX application because this application was not the first of its kind, and I will tell this Committee it is not going to be the last of its kind either. This will continue to be an issue for the CFTC.

All that said, this application had the potential impact far beyond FTX itself. It had the potential impact across market structure, across derivatives markets, and potentially across all financial markets. It was for that reason that I decided, me, as Chairman, to be personally engaged as much as possible. There were very, very strong feelings about this application, and I felt I needed to be engaged as the Chairman of the agency. That meant directly with FTX and Mr. Bankman-Fried, but that meant with other CEOs of public interest groups, of clearinghouses, of exchanges, of academics and regulators as well.

In many respects this is consistent with what I have done in the past, but it is also consistent with recognizing the importance of the issue. I want to be responsive to stakeholders, I want to be respectful to stakeholders, and I want to have an open-door policy so that my team and I can learn as much possible.

With regard to the last question, and I know there has been a number of reporting lately about the status of the application and where it was, the application was applied or submitted in December of last year. As of the withdrawal date, which was, I believe,

November 11th of this year, there was no decision. There were more questions than answered. There was no decision or recommendation from staff. There was no pressure from any outside sources. As I said, we were doing what we were obligated to do by law. We were being very careful and surgical in examining the issue, and including as many people and stakeholders as possible to better inform our decision.

Chairwoman STABENOW. Thank you very much. Last question before turning to my colleagues, would the conduct that led to FTX failure have been prohibited under the Digital Commodities Consumer Protection Act? If you could speak briefly.

Mr. BEHNAM. Sure, Senator. Based on what we know thus far, a lot of the issues that have arisen and sort of come to light are significant conflicts of interest, significant allegations of comingling customer money and house money, lack of books and records, lack of corporate governance and risk controls, just to name a few. These are, from our understanding in working with you on the DCCPA, core elements of the DCCPA.

I certainly think given the events of the recent past we should take a fresh look, but the DCCPA does address these issues and would have prohibited those actions from occurring at FTX.

Chairwoman STABENOW. Thank you. Senator Boozman.

Senator BOOZMAN. Thank you, Madam Chair, and thank you again, Mr. Chairman, for being with us to testify about what has happened, and so importantly about the potential for future bad things happening to consumers if Congress does not act and get some authority to both you and the SEC so we can prevent these things from happening in the future.

While this is not my view, over the past week I have read multiple articles that suggest the CFTC is a soft-touch regulator. Do you have a response to that?

Mr. BEHNAM. Senator, I just patently reject that suggestion. I think you and I have talked about this before. I have talked about this to this Committee. Again, I think it is just a lack of insight into the CFTC and what we do, and I think if individuals took a harder look at our record, both from a regulatory perspective and an enforcement perspective, they would understand that we are the farthest thing from a light-touch regulator. We are one of the strongest, most respected regulators in the world, especially around derivatives markets.

You know, I have been thinking about this a lot, given the narrative that has been building, and my response comes with a few thoughts about what we do and what we have done historically.

First, as we have discussed, let us think about LedgerX and the entity that we regulate. Of all the 130 entities in the FTX family, the few that survived, one is the CFTC-regulated entity. Solvent, operational, and customer money is where it is supposed to be.

I would also point to our enforcement record. Since the last time I was with this Committee we closed out our Fiscal Year 2022 enforcement record. Over \$2.5 billion in assessed penalties on a \$320 million budget. Of those cases, 82 cases, 20 percent digital asset cases, and strong cases, precedential cases across all digital asset markets, including DeFi. These are not sham cases just looking for a headline.

The third thing I would say, and Senator, you sort of alluded to this in your opening statement. Looking back to 2008 and the financial crisis, the tsunami that wiped the financial markets and the economy across the globe, the one area that was sort of a beacon of financial market regulation were cleared derivatives. Futures markets were able to know where customer money was and return customer money to its owners. That regulatory framework served as a model for the swaps reform that this Committee enacted in Dodd-Frank, and ongoing right now there is a discussion about Treasury market reform in clearing Treasury markets. Cleared derivatives are the model for that market as well.

Just a couple of indications of the importance, the efficacy, and the strength of derivatives markets that are implemented and enforced by the CFTC.

Senator BOOZMAN. Very good. I think you have answered this but I think we need to be very, very clear about it. If FTX.com had been a registered U.S. exchange, would the CFTC have been able to mitigate what happened?

Mr. BEHNAM. Senator, you know, with our current authority the answer is no. We need the authority to get into a CFTC-registered exchange. As you point out, if we have that authority and they were registered, given what we know from the facts about conflicts of interest, comingling funds, books and records, we would have been able to prohibit it.

I would point to what we are doing with LedgerX. On a daily basis, our staff is in direct communication not only with LedgerX but the custodians themselves, able to identify customer property and customer money. Imagine that scenario with FTX US. If we had a daily lens into the location of customer money and customer property, you can imagine given what we have learned about what has happened with FTX, we could have certainly prohibited many of the actions that we are hearing about.

Senator BOOZMAN. Do you agree that the FTX collapse shows the need to, No. 1, bring entities into the U.S. to enable regulatory oversight into them, and No. 2, create a framework focused on regulating custodians, exchanges, and scrutinizing conflicts of interest relating to common ownership and control of exchanges and on-venue trading firms?

Mr. BEHNAM. Absolutely, Senator. You know, I think naturally if there was a regulatory framework in the U.S. you would see a number of entities, perhaps, migrate to the U.S. and register, and this would bring the transparency that is direly needed around all the issues you stated.

These are core fundamentals of market regulation. These are core fundamentals of CFTC regulation, ensuring that there are no conflicts of interest, and that an individual entity cannot wear multiple hats, offering different services to the same customer, making sure that money is not comingled between house and customers as well. Having books and records to examine, being able to audit financial statements, having disclosures for customers. These are core elements that have served U.S. markets, U.S. derivatives markets so well for decades.

As we continue to see this digital asset market exist and interest from retail speculative investors, we need to bring these principles

into this market in order to protect customers. There are gaps, gaps, gaps in this regime, and we have to fill this gap in order to protect customer money.

Senator BOOZMAN. Very good. I want to take a moment to focus on a specific DCCPA provision, the dealer definition. My concern is that if we require CFTC registration in the digital asset context for U.S. entities who do not trade with any retail counterparties and do not offer trading with margin leverage or custody, we set a precedent for future Congresses to call for these same requirements in traditional commodity markets, which would be wholly inappropriate. Even though the activity is the same, I am also concerned with diluting the CFTC's resources away from protecting retail participants by overreaching on who is required to register.

Do you agree that the priority focus should be protecting retail from fraudulent leveraged selling practices, similar to the way the CEA currently requires registration of retail foreign exchange dealers?

Mr. BEHNAM. Senator, I think absolutely the priority should be retail customers and retail investors. I have said that many times. Given the risks and the knowledge gap and the education gap, the focus certainly should be on retail investors.

Senator BOOZMAN. Good. Thank you, Madam Chair.

Chairwoman STABENOW. Thank you very much. Senator Klobuchar.

Senator KLOBUCHAR. Thank you very much, Madam Chair. Thank you for joining us, Chairman.

As has been explained by my colleagues, at its peak FTX was revealed to have been a shell game in which the company gambled with customer money through its hedge fund. The \$8 billion hole in FTX's balance sheet not only raises questions about regulatory oversight and transparency but also about market structure and how centralized and interconnected much of the digital asset market is. I am going to start with something that kind of leads off of what Senator Stabenow was asking about.

When retail investors purchase traditional financial assets like stocks through cash markets, the transaction is typically carried out through several different entities, including a broker, an exchange, and a clearing and settlement company. FTX, like many other digital asset companies, consolidated several of these processes under one roof. To what extent did centralization and vertical integration of FTX play into its ability to conceal operational risk and fraud from regulators, auditors, and investors? Would rules about conflicts of interest requiring transparency and disclosure make a difference to manage risks in the future?

Maybe answer the centralization question and then how you fix it.

Mr. BEHNAM. Yes. Senator, this question about vertical integration is a key question. It is one that we were dealing with, with the application that FTX had before us. I said this earlier in my opening statement. We have to be mindful of this structure because the FTX application was not the first to the CFTC and it is not going to be the last. It is a very important issue that we need to think about.

The Financial Stability Oversight Council mentioned vertical integration as a risk or a potential risk. You know, on one hand it is a product of technology and the ability to have direct execution to a trading platform or a clearinghouse, and there may be merit there. As you point out rightfully, there are a lot of potential risks, and that ability to consolidate control over multiple parts of a trade execution or a trade as sort of evolution.

It may have made it easier for FTX. I do not know exactly because really this goes to the point of a lack of regulation and a lack of insight into FTX and what was happening within the entity, and whether or not anyone was identifying these issues. Obviously conflicts of interest, which you have identified, is a serious issue.

Senator KLOBUCHAR. Something that clearly contributed to the collapse is the fact that the exchange took customer funds that it was supposed to safeguard and then lent it to its sister company, Alameda Research, that made reckless gambles, it appears, with that money.

My colleagues already asked about the requirement to register. What should be done? Could you talk about what you think the role of the SEC should be in this balancing with what role you should be? In a perfect world, how do you think this would work, because we clearly are living in an imperfect world when you look at the collapse that we just saw.

Mr. BEHNAM. Well, I think the responsibilities would largely be the same, but they would be drawn on the line of what is a security token and what is a commodity token. Much of the market structure that both the SEC and the CFTC implement is similar in terms of overseeing trading platforms, the exchanges, the clearinghouses, and the broker-dealers or the intermediaries. In addition, the investment advisors and the market makers which is, as you mentioned, the Alameda institution.

If we have regulatory authority and regulatory insight into these institutions then we can impose the requirements around conflicts of interest, about separation of customer money and house money, about disclosure requirements for investors, about books and records that regulators can frequently, or even at will, examine when needed, having an auditing function. These are all again core elements that both the CFTC and SEC impose on regulated entities, and I think at its fundamental foundation nothing needs to change in terms of what we do now with what we should do with digital asset markets.

Senator KLOBUCHAR. Okay. The cash market is dominated, you know, for digital assets by retail investors who may not understand the differences in protections offered by digital asset market platforms and traditional financial service companies. Consumers have been inundated with crypto advertising—anybody that watches Superbowl knows what I mean—aimed at stirring feelings of urgency, stoking fears of missing out. For the securities market, brokers must follow the SEC's best interest rule and FINRA's suitability standard which sets rules of the road for the types of instruments brokers can recommend to clients.

Do you believe there should be parallel investor protections between digital commodity companies acting as brokers and prospec-

tive investors? What additional practices should be required of digital commodity brokers?

Mr. BEHNAM. Absolutely. In terms of disclosures to investors, the best interest rule, and similar rules are absolutely needed to ensure that investors understand the risks of the underlying asset. I have said this many times about the distinguishing factors between commodities and securities and what an ongoing disclosure about the underlying asset would be.

In terms of disclosures to investors before they invest, knowing what they are investing in, and how they are doing it, those types of requirements are critically important, and we are doing what we can with what we have right now to provide as much information to investors who are using our markets for Bitcoin, futures, and other similar products.

Senator KLOBUCHAR. You believe more must be done.

Mr. BEHNAM. One hundred percent.

Senator KLOBUCHAR. As soon as possible.

Mr. BEHNAM. Yes.

Senator KLOBUCHAR. Okay. Last question. In many cases, cryptocurrency companies have utilized social media platforms, including the accounts of influencers and celebrities, to create hype for digital asset products. Last month, the SEC fined Kim Kardashian \$1.26 million for failing to disclose she was paid \$250,000 to promote a cryptocurrency token on her Instagram account. The FTC has called the blend of social media and cryptocurrency, quote, “a combustible combination for fraud,” and found that—this is a quote—“Since the start of 2021, more than 46,000 people have reported losing over \$1 billion in crypto to scams.”

How does the CFTC plan to work with the SEC, FTC, or any other alphabet agency to combat the growing nexus of fraud between digital commodities and social media?

Mr. BEHNAM. Senator, we work with both agencies, all agencies, actively right now. We are in close collaboration on enforcement matters. We are in close collaboration on getting advisories out and word out in terms of customer protections.

This is not new or not different than what we have done historically, in the swaps market or the futures market. We will continue to do that. We have a shared interest in protecting customers and filling gaps in the marketplace. There is no doubt in my mind that Chairman Gensler and I will continue to do that to the extent that authorities provide it.

Senator KLOBUCHAR. Thank you very much.

Chairwoman STABENOW. Thank you very much. Senator Marshall.

Senator MARSHALL. Thank you, Madam Chair. I wish we were here today to talk about Michigan football and Ohio State.

Chairwoman STABENOW. Me too. Go Blue.

Senator MARSHALL. We have a real serious subject here. Chairman, thank you for joining us.

Where we are with cryptocurrency today reminds me of where we were with nuclear physics in the late 1940's and the early 1950's. Two weeks ago, a nuclear bomb went off in the financial world. We know that nuclear physics can be good. There can be bad

from it. Just like as we try to understand and think about the uses of digital currency, we all understand there is an upside to it. There is definitely a downside to it.

Where my question is with this is, No. 1, do you think that crypto should be held to the same standards as banking, and No. 2, even if we were to pass legislation today, I think it will take six months to years to really get our hands around it. Do you ever consider that there should just be a pause in this cryptocurrency digital world until we get our arms around it?

Mr. BEHNAM. Senator, thanks for the question. My concern is, and I have said this many times, as a market regulator, as someone who has observed these markets for years, going back to 2017, their growth, the intersection with the CFTC, I do not have the luxury to sit back. I think no matter what, whether it is in the U.S. or offshore, these markets are going to exist. There is going to be participation by institutional and retail investors.

Senator MARSHALL. You agree our arms are not around this. They are not close. Even with this legislation, would our arms be around the potential problems to the American public?

Mr. BEHNAM. Fully, I would say probably not, but it would be a significant step and a significant improvement to provide disclosures, to provide—

Senator MARSHALL. Do you think that they should be held—crypto should be held to the same standard as a bank?

Mr. BEHNAM. I think our banking and market regulations are sound. They have worked well, and they have proven to be efficient and effective. As the DCCPA does, we should essentially model any regulation around crypto off of what has worked in the past.

Senator MARSHALL. What would be the impact on our Nation's economy if digital replaced the U.S. dollar as the world currency?

Mr. BEHNAM. Senator, I do not know for sure, but given, you know, obviously, a lot of movement overseas by China and other countries, I think it is important, and I think you and I have had this discussion. The Federal Reserve is taking this very seriously and understanding that technology is going to disrupt a lot of things, including financial markets and financial systems, and potentially our existing currency system. At least investigating and seeing what the potential is and what the risks are is critically important for both our economy, our labor market, and potentially national security.

Senator MARSHALL. That is a great segue to my questions about national security. I am sure the other members of the dais would agree. When we travel abroad and sit down with the national security officials, if not their first, their second concern is about how digital currency is being used, specifically ransomware—\$600 million paid in ransomware last year, that we know of. That is certainly an underestimate.

Anybody in the financial world understands the cyberattacks that are going on and how ransomware has basically sprung its own little economy, that you have to purchase ransomware insurance now, \$1,500 per million dollars of coverage, on average.

When we talk about human trafficking, drug trafficking, again, crypto is the major currency being used. How can we ever get our

arms around that in those worlds when there are bad actors out there?

Mr. BEHNAM. Senator, I will say Treasury does a fantastic job through Financial Crimes Enforcement Network (FinCEN) and The Office of Foreign Assets Control (OFAC) doing what it can with what it has, but a more comprehensive regime and regulatory oversight over all of these markets I think would be a huge step in the right direction. We will never be able to comprehensively cover every element and fraud and people who are going to just intentionally break the law. You are right. I agree with you. Much illicit activity is happening right now using this technology and these assets as the sort of foundation and base.

Sitting back, in my mind, is not an option. We have to use every tool we have and create new tools—

Senator MARSHALL. I agree with you, but I just do not see the tools yet. No one has shown me, in a laboratory, on paper, what those tools look like. Again, this feels like a nuclear bomb is going off and we are not getting our arms around it. That is why we should be considering a pause.

Ninety percent of the Dark Web drug sales are done with cryptocurrency. Would you agree with me that cryptocurrency is a threat to our national security?

Mr. BEHNAM. Potentially it is a threat to our national security.

Senator MARSHALL. Potentially. I mean, we have 200 Americans dying every day from fentanyl poisoning, and I assume most of those drug—the money laundering going on is done with crypto. Human trafficking. I do not think it is theoretical. I think it is happening every day.

Mr. BEHNAM. Senator, I do not know the statistics, but yes, if it is in fact true then yes, it is a national security threat and it is something that we have to take very seriously. Again, I do not see how we put a pause on it. From a U.S. perspective we could try to ring-fence the country from crypto, but it is going to exist offshore.

We learned yesterday from the existing CEO of FTX that two percent of the customers' exposure were from the U.S. That is not supposed to happen. Somehow two percent of U.S. customers have exposure to FTX. Folks will find a way to get exposure to offshore entities or activities, even if it is prohibited in the U.S., and we have to do something about that.

Senator MARSHALL. Okay. This next one is more of a technical question. Under the current provisions of the Commodity Exchange Act and CFTC regulations, any bank or trust company in the U.S. is a good location for customer money, securities, and property. Senate Bill 4760, the Digital Commodities Consumer Protection Act (DCCPA), pushed by FTX, restricts to insured depository institutions, insured credit unions, and any digital commodity platform.

Would you support the expansion of good locations to include any bank or trust company, and if so, why or why not?

Mr. BEHNAM. I think given what we have learned and certainly what has happened in the past few weeks, we have to take a fresh look to ensure that whatever happened at FTX cannot happen again and that the DCCPA is tightened up to ensure that there are

no holes and no gaps in the regulation and that we ensure customer money is safe and that no illicit activity or fraud could occur.

Senator MARSHALL. Thank you so much, Chairman. It is a tough job, and whatever we need to do to put wind beneath your sails is what we need to be doing.

Thank you so much. I yield back.

Chairwoman STABENOW. Thank you. Senator Smith.

Senator SMITH. Thank you, Madam Chair. Thank you very much to both you and Ranking Member Boozman for holding this hearing today, and thank you for being here, Mr. Chair.

The collapse of FTX has been shocking, but I think it would be hard to say it is surprising. There is still a lot that we need to learn about what has happened, but it looks like this crypto exchange and its related trading firm, Alameda Research, completely failed to safeguard the money that people entrusted them with. We should not lose sight of the fact that billions of dollars essentially evaporated overnight, and that was real money, including the retirements and savings of Americans who had no idea that their savings were at such risk.

The fact is that these crypto assets are highly volatile and risky, and that risk is made worse by a lack of basic consumer protections. This is why I have joined Senator Durbin and Senator Warren to call on investment firms like Fidelity to keep crypto out of retirement plans.

Look, people can invest or bet or gamble or risk their money on anything that they choose to, but in a free and fair market, as you have been saying, Mr. Chair, they should at least be able to count on a fair playing field so they do not get gamed or scammed.

Chair Behnam, I would like to look at FTX and the crypto world generally and just sort of make clear what is happening and what is not happening today. Exchanges and firms that buy and sell stocks and commodities are required to keep their company money separate from their customers' money. They cannot gamble with their customers' money like it is their own. That is correct.

Mr. BEHNAM. Correct.

Senator SMITH. Is that required of crypto exchanges right now?

Mr. BEHNAM. No.

Senator SMITH. Does any Federal agency have enforcement authority to require that?

Mr. BEHNAM. I believe the Securities Exchange Commission has authority.

Senator SMITH. Okay. When a firm is being paid by their customers to give advice on how to invest their money they are required to put their customers' interests first, not their own business interests. That is their fiduciary responsibility. That is correct, right?

Mr. BEHNAM. Correct.

Senator SMITH. Is that required of crypto exchanges right now?

Mr. BEHNAM. No.

Senator SMITH. Does any Federal agency have enforcement authority to require that?

Mr. BEHNAM. Again, in clarifying my previous response with respect to the SEC, over security tokens, not commodity tokens—

Senator SMITH. Right.

Mr. BEHNAM [continuing]. is where the gap exists between us and the SEC. Based on my understanding and hearing from the Chairman himself that they do have the authority to police this market.

Senator SMITH. Okay. All right.

Mr. BEHNAM. The security market.

Senator SMITH. Right. Right. Because your distinction is what kind of a thing this is. Is it a commodity thing or is it a stock thing.

Mr. BEHNAM. Correct.

Senator SMITH. Right. Companies that are investing other people's money are required to get the best possible price, by looking at the best deal across multiple markets. Right? That is called best execution. Is that required for crypto trading right now?

Mr. BEHNAM. No.

Senator SMITH. Okay. Is there any enforcement authority anywhere in the Federal Government that would require that?

Mr. BEHNAM. Again, if my assumption based on the authority the SEC has over security tokens, that they can impose the same requirements that they impose on traditional securities, then based on that sort of logic they would have that authority over security tokens.

Senator SMITH. Okay. Okay. I have one last question. Banks and other financial services firms have a duty to know who their customers are. That is how we protect against money laundering and keeping crooks and criminals from using legitimate businesses to wash their dirty money. Is that the case for crypto-related enterprises?

Mr. BEHNAM. I think this is a little bit distinguishable from your previous questions because this goes to some of the State money transmitter licenses that exist for these crypto exchanges on a State-by-State basis. There are registration requirements with FinCEN, which would have AML and KYC requirements. With that in mind I think there might be some element of what your concern and issues are, but maybe not as comprehensive as a Federal regulatory regime over the marketplace that we have with traditional markets.

Senator SMITH. Thank you. Thank you.

I appreciate the brevity of your answers because I think that what this shows us, the crypto world of FTX shows us what can happen when there are not basic consumer protections. You know, I do not care whether you are buying wheat or stocks or FTT, which is the digital coin that was created by FTX, or whether you are buying some derivatives of those assets, the market should be fair and not rigged, and that is the problem.

I would also argue that we know how to do this. Crypto is a new thing, but the rules of the road for how to ensure that markets are fair and that financial institutions, you know, know what is happen, I mean, those rules are not new. It seems, Madam Chair, that our job is to figure out how we can enforce the laws that we have and then plug the holes where those holes exist or we are going to see more disasters like FTX.

Mr. BEHNAM. Agree.

Senator SMITH. Thank you.

Let me just ask one last question because I have a bit more time. There are obviously real concerns about the FTX collapse and future swings in crypto markets as this instability has unfolded. Since you serve also, Chair Behnam, on the Financial Stability Oversight Council (FSOC), and I am sure that this is something that you think about as well, the impact of crypto on general financial stability, could you comment on that and how you see that issue?

Mr. BEHNAM. I think thus far it has not been of huge concern, and if you look back to the spring when we had the Terra Luna collapse and now with the FTX collapse, the banking system and the market system have been largely siloed from the crypto system, and I think that is a testament to the value of our banking regulatory system and our market system, and keeping that crypto market out.

At this point, given its current size—and I was here a year ago and I think we were talking about \$3 trillion in market cap and now it is well under \$1 trillion itself—there is no direct impact to financial stability. It is not something that I think we can rest our laurels on. We have to think about what-ifs and what may happen in the future.

These are the types of things that concern me is we cannot just assume things will remain the same and things will be safe. We have to be aggressive. We have to be thoughtful of different scenarios, and we have to assume, with gaps in the system, as you pointed out, future crises will continue to occur.

Senator SMITH. Thank you very much. Thank you, Madam Chair.

Chairwoman STABENOW. Thank you very much. Senator Tuberville.

Senator TUBERVILLE. Thank you, Madam Chair. Thank you, Chairman, for being here. It kind of reminds me of sitting in a chair after I got the heck beat out of me in the football game and knowing the other team did not go by the rules and I had to explain why. There is really no way around it. We have screwed this up. You have got to have rules. We have all seen this coming.

I have invested in crypto. I did not get as deep as some of these people have gotten but it is a mess and it is going to get worse if we do not get control of it. We have got confidence that you will, with our help. We have been trying to help.

You know, this country needs to be the leader in the world in financial regulation, you know, all the innovation, and if we do not we are going to be in trouble. China has got their own digital currency that is cranking up. You know, it is a huge problem. I have got people calling me from everywhere going, “What are we going to do? What are we going to do about this?” Well, it is new. It is totally new, and you go through some hard times, and unfortunately you have got a lot of people that have lost money in this. We have got to get control of it so people get confidence in digital currency. Bottom line.

I have got just a couple of questions here. First of all, you said you met with Sam, and, of course, we have had him in hearings before. Have you gotten any texts or emails with him over the years?

Mr. BEHNAM. Yes. In addition to I pointed out to Senator Stabenow's question, I mentioned there was this sort of dogged desire to get this application approved, and my approach to that application given the issues and the strong feelings was that I needed to be as transparent and open with him and FTX as well as other CEOs who felt the same.

There were a number of emails and messages back and forth, all about the application, about the status of the application. Some of the messages were about scheduling the ten meetings I mentioned. It was about updates, giving us, again, this dogged approach to we submitted answers to the questions from the division, or we have more data, to just support their advocacy of this application, all in relation to the application.

Senator TUBERVILLE. Okay. Good. Thank you.

Chairman Gensler is using this collapse to argue that the SEC should run point on crypto regulation, but he has repeatedly cutoff pathways for crypto firms to register at his agency. What have you done at the CFTC to encourage digital asset firms to register and enter the regulatory fold?

Mr. BEHNAM. Senator, that is a great question but this is at the heart of the problem. We have had, since really 2016 and 2017, we have seen an influx of these crypto firms coming to the CFTC to list derivatives products, whether on incumbent or existing registered exchanges, but also crypto firms buying existing derivatives exchanges and starting to list crypto derivatives. New products emerging and new ways that the crypto community can get into derivatives exchanges.

Ultimately—and this is the reference I think you are making—in terms of regulation of cash markets, right, the spot market, we simply do not have authority to register cash market exchanges or any intermediary broker-dealer or entity within that structure, and that is what concerns me. This is the gap. This is the gap that exists. This is the gap that FSOC pointed out, and ultimately, again to your point, if we do not do something customers are going to continue to lose money and we are going to be right back here again in a couple of months.

Senator TUBERVILLE. Exactly. On another point here, going back to FTX, you know, these major environmental social governance, ESG, ratings companies gave FTX high marks, very high marks, for corporate governance. We have since learned that the exact opposite was true.

What Federal agency is responsible for auditing these ESG rating reports? What needs to be done to protect investors from inaccurate reporting by ESG rating companies? Can these people be sued when they do something like this?

Mr. BEHNAM. Senator, you know, I think it would depend on if these are products that are being traded and there is an ESG rating on it, then naturally I think if it was as security financial product it would be the SEC that would have to come up with some sort of rating mechanism. I do not know for sure that it would necessarily be the SEC or potentially another department that might have the authority.

You point out a potential gap in who are the rating agencies. This was an issue in 2008, with the financial crisis. Who was over-

seeing rating agencies and what are the conflicts of interest there, and what actions are they taking, and it is truly an objective rating to give consumers and investors the information that they need?

Senator TUBERVILLE. Should this be in some kind of bill that we do with crypto?

Mr. BEHNAM. To the extent that the issue you raise is a significant problem and one that crypto firms are getting ESG-related ratings, then I think it is something that we should talk about further. This goes to the heart of disclosures and customer information, which is, I think, a part of at least the DCCPA and the bills that are being proposed. Investors need information. We need to bridge the gap between an issuer, a rating agency, and an investor so they know exactly what information they have and they can make the most informed decision.

Certainly I would welcome the opportunity to work with you and see if we can do something in this space.

Senator TUBERVILLE. Well, as we go through this investigation hopefully if we look into some of these investors into FTX we find out did you look at this ESG report, did you look at their credence? Did you invest because of that? Somebody could get in trouble over this, and we need to really look into this. We have got people out there doing things they should not be doing, especially when it comes to finances and people losing millions and millions of dollars.

I look forward to working with you. I know you will get control of it. I look forward to people having the opportunity to continue to invest in crypto but also understand that there are rules and regulations.

Thank you, Madam Chair.

Chairwoman STABENOW. Thank you very much. Senator Brown.

Senator BROWN. Thank you, Madam Chair. I welcome Chair Behnam. Nice to see you again. Thanks for serving in so many capacities in our country, and thank you, Chair Stabenow, for holding this hearing. We just briefly, quietly, talked about his important this is, so thank you.

The failure of FTX is shocking to all of us, not only for the misconduct but also for the speed of the collapse. Many critical questions have emerged about the abuse of customer funds and also about the business model in conflicts of many other crypto firms also. It is troubling the contagious effect as FTX's connections across the crypto markets have pushed other firms into failure. You know all that, of course.

We must make sure we learn the right lessons from this failure. It means creating a framework that safeguards a traditional financial system, that protects consumers, that does not put the crypto companies first. Yesterday I wrote to Secretary Yellen. I look forward to working with her and all the financial regulators to achieve that.

Chair Behnam, one of the more troubling issues related to crypto is its role in illicit finance and the threat it poses to national security. While I did not hear his comments, Senator Marshall's comments, I was told he spoke eloquently and directly about the importance of safeguarding our national security in light of some of the crypto abuses.

The Banking, Housing, and Urban Affairs Committee, which I chair, held a hearing in March about cryptocurrencies, how they provide hackers and scammers anonymity and immediate transferability, facilitating cybercrimes like ransomware attacks. That month, a North Korea State-sponsored cyber group carried out one of the largest virtual asset heists ever, worth over \$600 million, and then laundered the proceeds. We need to be vigilant about that.

FinCEN recently reported that Bank Secrecy Act filings related to ransomware reached over \$1 billion in 2021, more than double what they were in 2020. We do not know what 2022 will show, but we need to be concerned.

My questions, first question. Do we need to make combatting the use of crypto and illicit finance more of a priority across all of the Federal regulators?

Mr. BEHNAM. Yes, Senator, thank you for the question. Thank you for the letter also to Secretary Yellen. We did see it, and certainly look forward to working with you and Treasury Department.

This is an enormously important issue you pointed out. Senator Marshall raised it as well. There is so much opacity and potential activity in the shadows around illicit activity using cryptocurrency and digital assets. You know, as you pointed out, Treasury is doing an excellent job with the tools they have. I think there is a technology curve that we are all learning and trying to climb right now to understand how this technology works and to identify illicit activity. We will certainly, to the extent we have within our enforcement authority, work with Treasury, work with OFAC, FinCEN, as you said, under the Bank Secrecy Act and other authorities, to make sure we are rooting out any illicit activities possible.

I would say comprehensive regulation, as you suggested and proposed, is going to be an important and critical tool to take a step in the right direction and identify all of this illegal activity.

Senator BROWN. Thank you. You play an important role in this. I appreciate you acknowledging Treasury and their action plan to mitigate the illicit finance risk of digital assets, what they issued in September. That is a key step, and the fact that you all understand how this is cross-agency, so thank you.

The FTX collapse demonstrates the inherent conflicts, and even worse, self-dealing in some crypto business models. We know it is important to avoid dangerous incentives in the financial service industry. For example, banks have restrictions on proprietary trading and transactions with affiliates, as do registered investment companies. Would not safe, similar safeguards make sense for crypto firms?

Mr. BEHNAM. Absolutely. The idea that we have, as you pointed out—and just thinking about the markets that the SEC oversees, that we oversee—the idea that an exchange can act as a dealer, can act as a lender, can act as a custodian, just does not work. It does not exist in our existing traditional financial system, and I think those same principles and regulations should apply to crypto.

Senator BROWN. Are there other conflicts that should be addressed or prevented? Have you thought about looking at that?

Mr. BEHNAM. Based on what we know with what happened to FTX and then certainly what we know with other traditional crypto

firms and the services that they offer to clients, it seems to be the exchange-traded function, the market-making function, the broker-dealer function, lending function, and a custodian. That is a long list of things that typically do not occur by a single institution.

There may be other things certainly worth looking into. We would work with you and your staff. Those are core elements that we see the services being provided and certainly could never be allowed in traditional financial systems.

Senator BROWN. Thank you, and I appreciate working with Chair Stabenow, your focus on your jurisdiction here that crypto products understanding touch not only commodities markets, what you work on, but also securities and banking. Your comments have already indicated what you think about that, but one more last question to expand on that.

Would you commit to continue working with the other regulatory agencies to minimize these gaps and to make sure consumers in the financial markets are fully protected?

Mr. BEHNAM. Senator, it is the absolute, most important priority. There has been a narrative about a power grab. This the farthest thing from it. It is about filling a gap and doing what we can do as a commodity market regulator to fill the gap, the protect customers, and to prevent us from having to be here again talking about another bankruptcy.

Senator BROWN. Thank you, and I have had individual conversations, one-on-one and through the committee process, with a number of the other regulators, especially SEC, and even the Fed, a little more distantly the Fed, and Treasury and FDIC and all of them. Of course, I understand your sincerity here and your genuineness and how important that is.

Last point, Madam Chair, I ask the Chair's consent to enter into the hearing record a letter from the North American Securities Administrators Association, highlighting considerations for Congress.

Chairwoman STABENOW. So ordered, without objection.

[The following letter can be found on page 54 in the appendix.]

Senator BROWN. Thank you. I yield back. Thank you.

Chairwoman STABENOW. Thank you. Senator Grassley.

Senator GRASSLEY. Thank you, Madam Chairman. When I bring up the word whistleblower I do not do it in legal sense of the word, whistleblower, but I always try to get people like you to listen to what is going on in the department and take action on it, so people do not have to become what you call official whistleblowers.

We have heard many reports that people involved with FTX had concerns about its business practices. Unfortunately, it does not appear that anyone stepped forward to report on what was going on. Did your office receive any reports of wrongdoing involving FTX, and if not, do you believe employees would have stepped forward if the program was better publicized?

Mr. BEHNAM. Senator, we did not receive any tips or whistleblowing activity about FTX, and we looked at that very thoroughly over the past few months to ensure that was the case, and that is, in fact, the case. We did not receive anything.

I certainly appreciate your support of our whistleblower program. It has been extremely effective in supporting our enforcement division and the enforcement actions we have brought at record-break-

ing numbers. We do everything we can at the agency, but I will commit to do more than we are doing to ensure that whistleblowers feel safe and protected and that they come to us without fear of retribution.

Senator GRASSLEY. Since we got my bill passed, do you have the money to pay the whistleblowers?

Mr. BEHNAM. We are currently in a good place, but I think we do need to continue to work on making sure that the program is effective. The reason that we have had a challenge is not a bad reason. It is because we have awarded so much money to whistleblowers, and the cases we have brought have been so significant. I hope that continues because we have a huge participant pool and a lot of fraud that we need to police. I appreciate your support in working with us and will ensure that your bill is passed and it supports the program and that we can continue making these significant payments to whistleblowers.

Senator GRASSLEY. You told us in previous testimony how many times you met with representatives of FTX. Sam Bankman said that he has spent tens of thousands of hours with the CFTC. In regard to you personally, have you made your calendar public, and if not, when could we expect that that happens?

Mr. BEHNAM. Thanks, Senator. As I mentioned to Senator Stabenow, we have taken an initial look at my calendar, and as I said we have had, over the past 14 months, 10 meetings with Mr. Bankman-Friend and his team. There were two phone calls and a few messages all related to either scheduling the meetings or giving us information about an application. I would just emphasize that to you. The relationship that the CFTC had with FTX was about the regulated clearinghouse, LedgerX. It had nothing to do with the activity that was happening offshore or the spot exchange, which we do not regulate.

As I said, they were dogged in their approach to getting this clearinghouse application approved, which meant Mr. Bankman-Friend and his team meeting a lot of CFTC staff over the course of many, many weeks and months, and many meetings, as I said, 10 meetings with me and other communications to just share information with us, update information about the application, and doggedly give us as much information in advocacy of their application.

That said, we will take a fresh look, given the initial review, and get that up to the Committee as soon as possible.

Senator GRASSLEY. In regard to just what you said about LedgerX, and I think you have answered some of my questions, but did the CFTC ask for any financial information or organizational charts, and can you provide the Committee what FTX shared with your Commission?

Mr. BEHNAM. Senator, it is an important question and unfortunately our legal limitation, in terms of authority to ask questions or to examine entities, stopped at the regulated entity. We, at the CFTC, do not have legal authority to police, to examine, or to ask questions about an unregulated entity. The only circumstance is if we get a whistleblower tip, if we get a referral, or if we have information that is going to meet the test to get a subpoena in court after passing the Commission vote. That is the only way we could

then start asking questions and use subpoena authority to start investigating or examining a non-registered entity.

This really goes to the heart of an issue that we have right now. I will say in contrast, that legal limitation is the same reason that customer money in the LedgerX entity is safe and it is where it is supposed to be. I certainly look forward to working with you, if you would like, to see if there can be a change to that authority, but it is a delicate balance that we have to approach. To repeat myself, there is no existing authority to ask questions beyond the regulated entity.

Senator GRASSLEY. You know, the guy that is now CEO of FTX, he was involved with the Enron liquidation. He said he has never seen such a complete failure of corporate controls and complete absence of trustworthy financial information. Getting back to what Bankman-Fried said about FTX spending tens of thousands of hours with the CFTC, I would like to know how did the CFTC miss this complete lack of corporate control?

Mr. BEHNAM. Senator, John Ray, who is the individual you are referencing, when he talks about complete lack of controls he is talking about the non-CFTC companies. Chairwoman Stabenow mentioned, in her statement, that John Ray made a statement about LedgerX, the CFTC entity, and he said there is good governance, there is liquidity, there is capital, and it is fully operational, and it is in good shape. John Ray was very clear that the CFTC-regulated entity is healthy, capitalized, and operational, and that is in stark contrast to the non-regulated entities.

It is for that reason exactly, and the limitation that I shared with you earlier, that we do not have legal authority to go beyond the regulated entity. Since the regulated entity was fully in compliance, fully operational, and met all of the legal requirements of the CFTC, we had no basis or reason to sort of pierce through the entity and start fishing or asking questions about affiliate entities or non-CFTC-registered entities.

Senator GRASSLEY. In regard to the bill that was introduced in August, or sometime this summer, and have you been working with people on that legislation, is there anything in that legislation that ought to be rewritten, from what we know now from FTX?

Mr. BEHNAM. Senator, thanks for the question. Certainly given the circumstances of the past few weeks I think we should take a pause and look at the bill and make sure there are no gaps or no holes. We are going to learn more information about FTX in the coming weeks, and we will certainly take that information and share it with the Committee.

Two things that have come to mind in terms of what we have learned thus far and where the bill may be strengthened: disclosures around financial information of the entity, the crypto entity, and the conflicts of interest. Obviously, an issue that many members have talked about today, given the brazen conflicts that occurred at the non-regulated entity. I think there should be an effort, both by the Committee, and we certainly look forward to supporting you, in tightening and strengthening the conflicts of interest provisions.

Senator GRASSLEY. Thank you.

Chairwoman STABENOW. Thank you very much. I am going to turn now to someone who has spent a whole lot of time on this, and thank you for your leadership and co-sponsorship of the bill, Senator Gillibrand.

Senator GILLIBRAND. Thank you. thank you, Chairman Behnam, for being here, and thank you for taking the Committee through what happened here and what role the CFTC has played and could play in the future. I want to drill down on a couple of areas where I still see risks that are coming ahead.

I think you have made it very clear to the Committee that comprehensive legislation is necessary. Senator Lummis and I wrote a very broad bill for all committees of jurisdiction, including the Banking Committee, including the Finance Committee, including the Intelligence Committee.

What the Ag Committee has done is focused on your jurisdiction, and this bill that the Chairman and Ranking Member have put together is quite comprehensive. I will be very grateful for you to give us the guidance about how to improve that as well as the framework bill that Cynthia Lummis and I put together.

I am very concerned about the issues that you have talked about today, and I am very concerned specifically with the potential of future problems. Responsible governance is something that we have talked a lot about today, and the absence of which really contributed to the FTX's debacle, especially its foreign-registered entity. For Senator Grassley, the difference between the foreign entity and the U.S.-based entity is not necessarily clear.

I am on the Intelligence Committee, and so I am very concerned about who owns and who controls our critical infrastructure, such as platforms engaging in financial exchange and custodial services. My concerns is particularly acute where foreign interests may conflict with those of the United States, and of course, the FTX debacle has shown bad actors, foreign and domestic, can contribute to global digital asset markets' nefarious ends, harming United States consumers.

The CFTC's current rules, I understand, provide that where ownership of the CFTC-licensed exchanges changes at the holding company's level, as when FTX US purchased the CFTC-registered LedgerX digital asset derivatives exchange last year, the registrant has to notify the CFTC of the change of control. The Commission's current rules do not require detailed information about purchase of the entity or its beneficial owners, nor do the current rules allow the Commission, where appropriate, to require conditions to the transaction to manage risk or to block the sale in exceptional circumstances.

For example, if a hypothetical Chinese actor wants to acquire this entity who has questionable background and perhaps criminal activity undisclosed, this is something that the CFTC should be able to inquire about.

Specifically, please tell us how you would address these issues under our legislation for digital asset platforms, particularly those that actually serve retail markets.

Mr. BEHNAM. Thanks, Senator Gillibrand. An extremely important question, and you rightfully point out the existing authority for the Commission to ask questions about an acquisition or some

sort of corporate combination is limited. It is essentially a notice filing, at best. Given the circumstances of the recent weeks, this is not an issue that is infrequent for the CFTC. We see a lot of consolidation and M&A activity in the derivatives space. I think it is an important issue, particularly with your interest around cyber and critical infrastructure.

This is not unlike the CFIUS process in some respects, which this Committee has been very focused on over the years. What can we do to strengthen that authority for the CFTC to be able to ask questions, to be able to demand books and records, to be able to demand information about personnel, management, system safeguards, going to your cyber issue, so that we can better screen and evaluate the acquiring company, and what role or impact it might have on the CFTC-regulated entity.

Senator GILLIBRAND. Mm-hmm. Then to follow on Senator Grassley's line of questioning about the undisclosed conflicts of interest, obviously Sam Beckman-Fried had several other entities that were double-dealing or using assets that should have been not located in an area where he could have used them. We had allegations of inadequate books and records. We have allegations of how FTX's own tokens were reportedly used as collateral by customers and affiliated entities for massive loans. These are just enormous numbers of conflicts of interest that will be investigated.

Please describe, under the proposed legislation by both Senator Boozman and Senator Stabenow, as well as the more framework-oriented bill with Cynthia Lummis, how the CFTC would address these conflicts, and does that legislation provide the Commission with sufficient leeway to ensure identification, mitigation, disclosure, and where appropriate, prohibition of these conflicts?

Mr. BEHNAM. Senator, you know, this goes to the heart of market regulation, I mentioned this before, these issues that you rightfully point out around conflicts of interest, about custody of funds, about books and records to examine, about financial resources, to make sure that an entity has financial resources to be a going concern over a period of time.

I think that current bill is very effective in addressing nearly all of these issues. As I said to Senator Grassley, I think it is important that we tighten the conflicts of interest provisions because of the egregious nature of what we learned with FTX, and I think there is a way to do that. Disclosures to customers about financial resources also will be an important issue to address, and I certainly look forward to working with you on that.

In terms of authority, and our experience at the CFTC, when we are able to impose these requirements on a regulated entity it is quite workable and effective. I will use the LedgerX entity as an example. On a daily basis, we know where the customer money is, and we do not have to go through LedgerX. We go directly to the custodian with direct access to know and identify the customer money. Books and records, on demand we are able to examine books and records. These are just some examples of the direct relationship that regulation provides, and I think in the case of crypto and the bill, DCCPA, and your bill with Senator Lummis, these would be the authorities we have, and we could impose them and bring much more transparency to these unregulated entities.

Senator GILLIBRAND. Okay. I have one last question that you may not know the answer to. In your testimony you just said that you thought that approximately two percent of FTX's customers of the international entity were U.S. persons. That would lead me to understand that either FTX lied or was untruthful about their business, and they actually should have been registered with the CFTC or the SEC under current rules and subject to CFTC's fraud and manipulation authority.

How can the CFTC investigate more aggressively to deploy its current enforcement authority where overseas exchanges in fact have such significant and actual business within the U.S., putting U.S. persons and the U.S. economy and other entities at risk?

Mr. BEHNAM. Thank you, Senator. I am happy to share this with the Committee, but this was a disclosure document made by John Ray yesterday. It is a pie chart, and it says where the lost customer money is across the globe. There are huge amounts of money in some sort of island jurisdictions, two percent there is a sliver from the U.S. I feel fairly confident there are a number of U.S.-based entities that have entities registered offshore that were trading that will have exposure, and that is a huge issue. We should always think about institutions that have offshore entities that could potentially bring risk back to the U.S.

From a retail perspective, and this is just my understanding, I have heard this for a number of years, some savvy retail investors are able to go around the virtual private networks, these VPNs that essentially act as the firewall in an activity that happens offshore. That is an area that we could potentially look at. I do not know if it is an area that the CFTC has the expertise to look at, but perhaps we can work with other Federal agencies to see how we can protect those firewalls and prohibit U.S. customers from getting around those prohibitions.

Senator GILLIBRAND. I think this issue is one that the Committee needs to understand. When you have a foreign-registered entity there are limitations about what we can actually regulate and how we can provide the oversight and accountability. The examples that I brought up today are examples that could impact other businesses.

That is why I would like you to do some deep thinking about in this particular market of digital assets, where there are always these workarounds and these abilities to get access to different markets, and then the related lack of registration where there should be, it is going to be something that you will have to wrestle with, and I am certain this Committee wants to help. Because if you heard from every person's testimony here so far, their constituents are very nervous about how this impacts U.S. markets and how it impacts U.S. persons. That is why I think the bill that the Chairwoman and Ranking Member have put together for this Committee is so essential.

If we do not regulate this industry we are going to see more collapses, more bankruptcies, and a head-in-the-sand approach is absolutely unacceptable. We are very eager to work with you on solutions.

Mr. BEHNAM. Thank you, Senator.

Chairwoman STABENOW. Thank you very much. Senator Fischer.

Senator FISCHER. Thank you, Madam Chairman. Thank you, Mr. Chairman, for being here today.

There are a lot of questions that are around FTX's self-minted exchange token, FTT, and it seems clear that FTX and Alameda Research used FTT and the token—I think it is pronounced Solana—to inflate their own valuations, and then misused it as collateral in their risky business investments and their ventures.

Mr. Chairman, would the Digital Commodities Consumer Protection Act provide the CFTC or the SEC regulatory authority over transactions in FTX's exchange token, the FTT?

Mr. BEHNAM. From my understanding there was a sort of compensation mechanism with the FTT token. There was an incentive mechanism. I am just sort of talking in real time here. Based on that incentive mechanism it probably suggests characteristics that are more like a security and not a commodity. If that is the case—this entity you are talking about is offshore, but let us assume it is onshore, onshore being in the U.S.—then there would be authority within the SEC to oversee that organization.

Senator FISCHER. Under the DCCPA would the CFTC or the SEC have regulatory oversight over the Solana token?

Mr. BEHNAM. I do not want to opine on the Solana. I think either way, if we consider Solana a commodity under the DCCPA, that authority would be provided to the CFTC. If Solana—and work needs to be done, sort of analysis needs to be done—if Solana is a security then the SEC has existing authority to police the Solana token.

Senator FISCHER. How many of tokens are traded on the FTX US platform? Would the CFTC have spot market oversight under the proposed legislation?

Mr. BEHNAM. Under the proposed legislation the CFTC would have authority to register spot exchanges. In that scenario then the FTX US entity would have been required to register with the CFTC. We would have had to go through a process to figure out which tokens are commodities and which are securities. The commodity tokens would have been listed on the CFTC registered exchange. I think we have talked about this—there is likely going to be dual registration, which is not uncommon in our financial markets, between securities and commodities, and with that registration and that lens into the registered entity we would be able to prohibit conflicts of interest.

Senator FISCHER. That is going to be helpful in the future.

Mr. BEHNAM. Senator, it goes to the core of the issue. It is critically important. It is the gap that exists that provides and presents customer protection risks.

Senator FISCHER. Okay. With the Digital Commodities Consumer Protection Act it instructs the CFTC to write rules and guidelines for all aspects of the legislation, including rules related to customer protection, margin, or leverage trading of digital commodities, conflict of interest, lending activity, reporting of trades, and other information, and stablecoins.

Mr. Chairman, what kind of timeline and rulemaking process do you expect to take place if this would become law?

Mr. BEHNAM. Senator, a tough question.

Senator FISCHER. It takes you guys forever. Let us be honest.

Mr. BEHNAM. We would work vigorously and hard to get this done. I have obviously been a huge advocate for authority and understanding the risk that exists every day that goes by without action. As the Chairman, I am not willing to accept that responsibility.

Quickly, just for 20 seconds, using the post-financial crisis experience as an example, the CFTC was able to implement over 60 rules, significant rules, over the swaps market, in a period of about three years. If we can cut that 60 number, and it would be cut significantly with the DCCPA, probably down to single digits, I am confident that we would do everything in our power to get the rules done as soon as possible, and hopefully within a 12-month to 18-month basis.

Senator FISCHER. Would it be helpful if Congress would provide more guidelines?

Mr. BEHNAM. Around the statutory provisions?

Senator FISCHER. Yes.

Mr. BEHNAM. Well, it is a difficult balance because as drafted now—and again, we need to take a fresh look at the bill, given the circumstances of the past few weeks—but it is a balance between providing sufficient statutory authority and direction but not too much, not too prescriptive such that the agency cannot evolve with the marketplace through the rulemaking process.

Obviously, as you know, the statutory process, the legislative process is a key critical component, but the rulemaking process, which goes through the APA, the public comment and reporting period, this is a critical element of the process, and I think as drafted now, notwithstanding some changes that we may need to make given the circumstances of the past few weeks, it is drafted in a very good way that balances prescription and direction with enough flexibility to evolve with changing technology.

Senator FISCHER. Mr. Chairman, when you were here last before the Committee you and I had what I thought was a really good exchange on the important role that State security regulators play in the patchwork of financial regulatory systems that we have. As a former State securities regulator yourself you know that State security regulators have a strong record of protecting and educating investors in matters involving those digital assets. I do worry that communication between the Federal and State regulators is lacking, specifically as it comes to these digital assets.

Do you support inviting State security regulators to have a seat at the table and be more involved in in the Federal advisory boards and working groups related to these assets?

Mr. BEHNAM. Senator, absolutely. I was talking to Senator Tuberville about this before the hearing started, and mentioning Senator Brown submitted for the record the letter from NASAA which was submitted yesterday. I spoke to the head of NASAA, Joe Borg, a few weeks ago, just to share notes with what is going on with FTX. As you and I discussed the last time I was here, and in my experience as a State regulator, this is boots on the ground at the local level. It could not be more important to have State security regulators working with local officials, working with local investors and local communities to make sure people understand the

risks and understand information that they need in order to invest their money appropriately.

Senator FISCHER. Thank you, and thank you for the work you do.
Mr. BEHNAM. Thank you.

Chairwoman STABENOW. Thank you very much. I will turn now to Senator Luján, and thank you for being a co-sponsor of this legislation.

Senator LUJÁN. Well, thank you, Madam Chair, and to our Ranking Member as well, for bringing us together yet again but for your leadership on this issue as well. Mr. Chairman, thank you for being with us again.

When FTX acquired LedgerX it acquired an entity that was fully licensed and regulated by the CFTC. Despite this fact, widespread accounts at FTX and FTX US were mismanaged at the highest levels. Mr. John Ray, who is overseeing the bankruptcy filing, highlighted the scope of corporate negligence in the Chapter 11 filing for FTX when he said, quote, “Never in my career have I seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here,” from the guy that oversaw the liquidation of Enron. It is pretty startling.

My question, Mr. Chairman, and if you can answer this yes or no, did the CFTC have legal authority to examine the governance structure, balance sheet, or other financial documents for any entity other than LedgerX that was associated with this acquisition?

Mr. BEHNAM. No.

Senator LUJÁN. Are there other instances where unregulated entities have acquired CFTC-regulated products being legally offered to U.S. consumers and what risks does this pose to American consumers?

Mr. BEHNAM. Senator, and this, I think, goes to the conversation I had with Senator Gillibrand, it is important as a lesson learned about what conflicts and what relationship a CFTC-regulated entity has with other affiliates, both in the U.S. and across the globe. Currently the authority is limited to essentially a notice filing, where the registered entity would only have to give notice to the CFTC that they are being acquired or they are in some sort of consolidation or combination with another entity. Obviously, as we are learning now, this has huge potential impacts on U.S. investors.

I would say this. For the same reasons that we, the CFTC, were not able to look into the other affiliates, which John Ray described as essentially a disaster, it was those same legal reasons that the FTX affiliates, while all of this illegal activity was happening, were not able to pierce through the LedgerX entity and potentially steal or use U.S. customer money out of LedgerX. That is a tough balance. It is something we should think about collectively. My job is to protect U.S. customer money in CFTC-regulated entities, and knowing what we did with LedgerX and what we are currently doing, that is what I am focused on.

Certainly what we are learning, we should think about whether the policy is appropriate, whether it needs to change, and whether or not there are risk offsets to allowing us to go past the registered entity and what those risks are and what that cost benefit is between the registered entity and the non-registered entities.

Senator LUJÁN. What is the CFTC currently doing to ensure customer funds on LedgerX are safe?

Mr. BEHNAM. Thanks, Senator, for the question. We are in communication on a daily basis with both LedgerX and also the custodian, and we have a more direct relationship with the custodian to ensure that customer property, customer money is at the custodian. This is both digital assets and also fiat money. We continue to have that relationship. The entity is operational. It is well capitalized. It has financial resources for 12 months on a rolling basis. It has books and records that we can examine. We are ensuring all conflicts of interest and every requirement under CFTC law is met today and in the future.

Senator LUJÁN. I appreciate that. I will be asking you to submit an answer to this in the record, so I will make sure I get it to you and I will submit it to the Committee. What corporate governance standards should be required for exchanges like FTX US? I know that is a long answer but I am very interested in hearing from you directly on that.

Mr. Chairman, the last time you appeared before the Committee you stressed that on issues like conflicts of interest you would regulate spot digital assets similarly to how the derivatives market is currently regulated. Digital assets, however, are very different from traditional commodities and stocks. Since these assets are not tied to equity in a company, tangible good, or hard currency there is more volatility. Entities and tokens can be deeply interconnected through smart contracts, and when the asset itself is digital the risk from security vulnerabilities and hacks are much higher.

My question is what special considerations are necessary when setting rules for digital commodity platforms?

Mr. BEHNAM. Senator, thank you for the question. I stand by what I said probably a few months ago and I probably said many times in the past and even today. The core fundamental of market structure are what we should rely on and lean on and anchor ourselves in as we think about what a regulatory structure would look like for digital assets. However, you make an extremely important point that there are distinguishing factors between traditional assets, whether it is a commodity or a security, and digital tokens, whether they are securities or commodities.

I think the two key elements, or essentially what you raise is custody and cybersecurity, and how are we going to utilize the tools we have in terms of custody and how we custody digital assets and what do we need to do, from a CFTC perspective it is called system safeguards, to protect the entity and the institutions from potential cyber hacks and cyberattacks.

Those are things that would come through the rulemaking process, but I certainly would welcome a rethink of the current DCCPA to strengthen those guidelines around cybersecurity through system safeguards, and that is a core principle, or what the custodian relationship is and what minimum requirements a custodian of digital assets should have in order to protect those assets and appreciate some of the fluctuations and the volatility that these assets have, because they are intertwined with a much larger system of financial resources.

Senator LUJÁN. I appreciate that. Madam Chair, I have a few other questions. I will submit them into the record, and I yield back.

Chairwoman STABENOW. Thank you very much, Senator Luján. Senator Thune, who is also a co-sponsor of the bill.

Senator THUNE. Yes indeed. Thank you, Madam Chair and Ranking Member Boozman, for having today's hearing and giving us the opportunity to examine this recent collapse. Chairman, thank you for appearing in front of the Committee today.

My dad, who was born before the stock market crash, and then went through the Great Depression, always said, "If it seems too good to be true, it probably is." I think it looks like this whole thing, there just was not any there, there. I mean, I do not know how they were able to pull this off for as long as they did. Obviously being offshore and not being subject to the visibility that regulators might otherwise have. It is just really pretty stunning. I am, as I think everybody is here, I think, deeply troubled by all the information that has come to light as it relates to what appears to be, at the very least, some incredibly serious wrongdoing on the part of FTX.

I think that whole collapse, again, underscores the need for greater oversight and transparency of the digital asset marketplace. I think that is why we need a comprehensive, regulatory approach for digital assets that ensures that Federal regulators have the proper tools to oversee this market, and it is increasingly clear that Congress needs to act, and needs to act soon.

Could you describe what enforcement actions the CFTC has taken or is considering to take following the collapse of FTX?

Mr. BEHNAM. Senator, unfortunately I cannot talk about ongoing investigations. As I have said before in the past, we will utilize every tool we have to the fullest extent of the law to bring wrongdoers to account. As I have said this before, and we have probably talked about this, it is an extremely powerful tool we have, enforcement over digital assets, but given this limited authority, which you just referenced, unfortunately when we act it is often after the fact because the information that allows us to bring an enforcement action in digital asset cash commodity markets is only because information is coming to us from outsiders, from referrals, from tips, from whistleblowers. This is in stark contrast to some of the surveillance tools and examination tools that we would have if we had a comprehensive regulatory framework over digital asset commodities.

Senator THUNE. Is your full Commission engaged on this, on this issue?

Mr. BEHNAM. Absolutely.

Senator THUNE. Are the CFTC and SEC collaborating on this investigation?

Mr. BEHNAM. Yes.

Senator THUNE. Is CFTC currently considering—and I know we are talking about a statutory legislative, some guidance on this—currently considering changes to its approach for oversight enforcement activity of other digital commodity platforms since the collapse, absent the legislative framework we are talking about?

Mr. BEHNAM. I think if we think about—it really comes down to the limited authority. We have a number of incumbent exchanges that have a wide variety of financial assets in the commodities space that also list Bitcoin and Ether futures contracts. There are a number of sort of new, startup trading platforms that are listing similarly situated futures contracts in Bitcoin and Ether. As I mentioned earlier, we have had incumbent or native crypto firms buy existing licensed CFTC exchanges and start listing contracts.

The authority for us to go beyond that registered entity is limited. We have limited lens into the cash market, and this is no different in agricultural complex or energy or metals complex. Essentially it is when we get information about potential fraud or manipulation in a cash market is really the only time we have that ability to go through the futures market and start scoping around the cash market, and that is the handcuff we have. That is the gap that we have, that we are not able to fill right now.

Senator THUNE. You did discuss—I know it has been talked about some here already—LedgerX in your testimony. What would you say, in terms of the characteristics of the two, what sets LedgerX apart from FTX?

Mr. BEHNAM. Senator, just quite simply it is a CFTC regulatory regime.

Senator THUNE. They are registered.

Mr. BEHNAM. I mean, it is a forceful, strong, transparent regime that they have to comply with, and if they did not comply with it there would have been consequences.

Senator THUNE. Are there, I mean obviously, learned from their registration with CFTC that we ought to consider?

Mr. BEHNAM. I think, as I mentioned to Senator Gillibrand and Senator Luján as well, this question about our ability to pierce through—I use that word—the regulated entity. In this case, the questions that I am getting today we have gotten in the past. There have been some suggestions which are just false that we had some authority to go into the FTX entities. We simply did not. It is a limitation. It is a wall-off of our authority, and I think that might be something to consider.

I would say it comes with risks, and that is what we need to balance, because what are those risks? Those risks are I could not come before this Committee today and tell you I know exactly where customer money is in the LedgerX entity, and that is what worries me, right? If we had that reciprocal relationship with non-registered entities, these other FTX affiliates, would that have given the FTX affiliates an opportunity to fish around LedgerX and potentially take that customer money, in which case that is not a message I want to be sharing with you.

Senator THUNE. Right. In terms of sort of the global situation—these are traded globally—regulatory structure in other places around the world, are there some that can act as sort of a model for how we might do things here, and does the lack of regulation other places create the kind of systemic risk that seems like could be very real in this industry, absent that?

Mr. BEHNAM. Senator, it is an important question because I think right now, in the regulatory community, and having conversations with my colleagues here in the U.S. and overseas, it is

this balance between validation and risk management and customer protections, and I err on the side of customer protections and risk management. I am not suggesting my colleagues do not care about that. That is the No. 1 priority. You could see how this concern of if we regulate it you are going to validate it, and why are we validating? Because a lot of people think that, you know, not unlike what your father told you, like if it is not there, what is the there, there, and if it is too good to be true.

From my perspective as a market regulator I do not think we can regulate this out of existence, and even if we tried to regulate it outside the borders of our country it would still exist elsewhere, and that risk would inevitably come back to us through retail or institutional. I do not want to keep coming back to this Committee after another bankruptcy or after another failure. It is just too important to take action. I will remain agnostic on the success or failure of the technology. That is not my job. My job is to protect customers, to fill gaps, and to tell this Committee what I think is important to do so that your constituents do not lose money and do not have the information they need to arm themselves when they are making investment decisions.

Senator THUNE. Yes. Very good. All right. Thank you. Thanks, Madam Chair.

Chairwoman STABENOW. Thank you very much. Senator Durbin.

Senator DURBIN. Thank you, Madam Chair, and thank you, Chairman Behnam, for being with us today.

I am glad that we are having this hearing. I know that we have thought about it a few weeks back. The world has changed pretty dramatically, and it really became more compelling for us to move forward on this. I am glad that you are here.

I know a little bit more about your agency than some because the CFTC is a major regulatory agency when it comes to a massive investment industry in the city of Chicago. I have watched it through the years as a member of the House, as a member of the Senate, and have a great deal of respect for it. I have always felt that you are a legitimate cop on the beat, and that is one of the reasons why the integrity of the process in Chicago is respected, not just State-wide and nationwide but worldwide. I want you to be strong and appropriately funded to regulate an industry which is very important to the State that I represent. That is my intro. That is not bad, right?

Mr. BEHNAM. Senator, I could not be more happy and thankful for that statement.

Senator DURBIN. Let us talk about FTX for a minute. Less than three years old, supposedly worth \$32 billion, one million users, and it collapsed overnight. I saw where Mr. Bankman-Fried was tweeting—I suppose that is where his users get their information—and he led them right up to the edge of the cliff and then they fell off and could not recover what they had invested in the process.

I just might add, I think it should be noted by all the members on this Committee there will be a reporter waiting in the hall—I have already talked to her this morning—who will ask you, “Did he ever contribute to your campaign?” I said, “Oh, no. I never heard of the man.” She said, “You are wrong, Senator. He contributed to you.” The cryptocurrency people are active politically, and

they are trying to achieve a political end here. It is their right as citizens of this country to do that. It really calls on us to make sure that whatever we do is credible under those circumstances.

How long will it take to unpack the FTX mess, to be able to understand exactly what happened and where it stands today?

Mr. BEHNAM. Senator, I think, you know, we have a cursory understanding of what happened. We mentioned this today, the comingling of funds, the conflicts of interest, the lack of a custodian to separate those funds, the lack of books and records. As John Ray has said, just the sort of complete disaster from risk controls. I think that is fine at a cursory level. I think it is going to take months, probably, before we truly understand the extent and scope of the failure.

Senator DURBIN. Who is going to do that investigation?

Mr. BEHNAM. Senator, as I mentioned to Senator Thune, you know, we are a civil enforcement agency. We are using the full extent of our power under the law to police any infraction or violation of the law. I know our sister agencies across the U.S. and the globe are doing that as well. Enforcement cases take time but we are moving expeditiously and we understand the importance of this.

Senator DURBIN. This legislation, which is before the Committee to consider, is to enhance or improve your authority in this area. Is that correct?

Mr. BEHNAM. It is to fill a gap over commodity spot tokens. Correct.

Senator DURBIN. All right. I find this interesting and I want to put it in this perspective. It seems to me there is a competition, at least at the Capitol Hill level, between those who believe there should be no regulation, that this is the new world order. You do not need the faith and credit of any nation or known entity as long as your computer program is sophisticated enough. I am skeptical of that, personally, but that seems to be one point of view.

The second point of view is CFTC is a nice agency but it is a small agency, and this is a big, big problem and challenge. If it is going to take you months to figure out what happened to one of the larger players when they collapsed overnight, how are you going to maintain the daily regulation of this industry that is, at least until the recent collapse, was mushrooming in size? There are some who say you have got a fundamental problem that you are facing here. When you want to fund the CFTC's activities you come hat-in-hand to Members of Congress because you need an appropriation. The SEC is largely funded by fees charged to those who are using the regulated entities.

Now I know that you ask for a user fee as part of this, but as I understand it your general appropriation is in the \$300 million range for CFTC. Is that correct?

Mr. BEHNAM. \$320 million.

Senator DURBIN. You believe that the user fees you are asking for from this digital industry will generate how much?

Mr. BEHNAM. Senator, it depends on how much appropriators at the low end, and that would obviously require collaboration with us. What we would have to do if the DCCPA passed, at the agency level, is determine what funds we needed to implement the rules and to enforce and impose the rules, and then provide a request to

you and you would set the level, not unlike the SEC, and then we would collect those fees requisite with what you set the level at.

Senator DURBIN. Ultimately Congress has something to say about the user fees.

Mr. BEHNAM. You have all to say.

Senator DURBIN. The reason I am doing this is to put it in the context. Mr. Bankman-Fried, my contributor, and people just like him, are going to be spending a lot of money to make sure there is as little regulation as possible. Unfortunately, you are a captive of a process that is driven by politicians like myself. What assurance do we have that you are going to have adequate resources—the staff, the technology, the people—over and above the authority to execute any kind of meaningful regulation of an industry which is almost impossible to describe, let alone regulate?

Mr. BEHNAM. Senator, a couple of things. I want to agree with you on your point about regulation versus nonregulation. This area needs to be regulated. All components of it need to be regulated, without a question.

Second, in terms of responsibilities and, you know, this narrative of small or weak agency could not be farther from the truth. I shared that with Senator Boozman, and I could give you reasons why.

We have a separation of duty and a separation of responsibilities at the agency in terms of months-long enforcement action that is done by the enforcement team. They are best-in-class in the world, and they are laser-focused on this right now, and they will get the job done. That is completely separate than our policy divisions and those that regulate entities and do the day-to-day work of examinations and regulation of our institutions, including the institutions in your State.

In terms of why I am going to be honest and be very forthright about what I need to do, what I need to do, I am always happy to come before this Committee and tell you what I think and tell you what I need, but I would much rather be at the CFTC doing my job right now. I am going to tell you what I need because I need to do my job, and I need to fulfill the mandate that you provide to me. If you provide me authority to oversee cash market commodity digital tokens I will be very transparent with you about what I need to fulfill that responsibility, 110 percent.

Senator DURBIN. I do not question your commitment to this, your honesty, or your experience. You are going to go through a political process to determine whether you have dollar one to deal with this.

The last thing I will say is I have heard some of my colleagues say, “We have got to move on this, fast. We have got to be the leader in the world when it comes to cryptocurrency.” I do not know if they are saying that now as they did a month ago, the notion that some people have actually articulated to me, “Do you realize Malta is on the march in terms of becoming a major factor in cryptocurrency? How about Portugal? How about El Salvador?”

Well, I am just telling you, I happen to believe, reflecting on Chicago, your agency and the SEC for a moment, there is a hell of a lot more credibility when the United States says this is properly regulated and the world can respect it, and we ought to take the

time to make sure we not only salve our consciences but make sure that we provide the resources to get that kind of regulation.

Thank you very much for being here.

Mr. BEHNAM. Thank you, Senator.

Chairwoman STABENOW. Thank you very much. Senator Hoeven.

Senator HOEVEN. Thank you, Madam Chairman.

Mr. Chairman, you talked a little bit about LedgerX, but is LedgerX the only part of FTX that you actually have regulatory authority over? Are there other aspects of the company that you have regulatory authority over, or just LedgerX?

Mr. BEHNAM. Senator, in terms of direct authority, LedgerX is the only entity that we have direct oversight over. There is a commodity pool operator, I believe, that is called Ledger—it might be LedgerPrime, and it is mainly regulated by the National Futures Association, which is a self-regulatory organization, an SRO. There is an indirect relationship, but I did want to mention that to you, in full transparency.

To answer your question directly, the single entity that we regulate and have the most direct relationship with is LedgerX.

Senator HOEVEN. What is the status, financially, of LedgerX at this point in terms of assets and obligations, and in terms of your ability to make sure that it retains those assets to cover its obligations?

Mr. BEHNAM. It is solvent. It is operational. I know where the customer money is on a daily basis, through direct communications with both LedgerX and the custodian which holds the digital assets and the money, the fiat money. The company has financial resources for up to 12 months on a rolling basis. There are books and records that we can examine on a daily basis.

Senator HOEVEN. Are you able to, with the authorities you have, make sure that dollars, resources, assets, are not siphoned off away from LedgerX? I mean, you are telling us that LedgerX is your responsibility, based on the authorities you have for this larger company, FTX. Right?

Mr. BEHNAM. Correct.

Senator HOEVEN. You are saying that it is solvent, it is operating, it has assets to meet its obligations.

Mr. BEHNAM. Correct.

Senator HOEVEN. Are you able to make sure it stays that way so that those resources are not dissipated to these other entities of the larger company?

Mr. BEHNAM. I would say absent fraud, we are able to do that, and I think particularly in this moment in time, where the majority of the 130 entities are going through bankruptcy, and there is a laser-focus from John Ray, the current CEO of FTX, and there is a lot of scrutiny about LedgerX and the other entities, it would require a significant, significant act to have money move out of that entity without approval or that would violate our laws and take them out of compliance and put that entity in any jeopardy.

Senator HOEVEN. You feel you are doing everything you need right now to try to maintain the solvency of LedgerX.

Mr. BEHNAM. It has been the No. 1 focus since we learned about the potential for the bankruptcy is to make sure customer property at the LedgerX entity, the CFTC-registered entity, stays exactly

where it is. That is why we are having daily communications with both the custodian and the registered entity.

Senator HOEVEN. Well, and those goes to my broader question is okay, then to properly regulate crypto you have to start with defining, are you regulating the commodity aspect of it, the securities aspect of it, or the currency aspect. Correct? First, how do you define it, and then how do you determine who regulates or has that jurisdiction, and then third, how do you coordinate it between yourself, the SEC, the Federal Reserve, Treasury, and so forth?

Mr. BEHNAM. Senator, I will first say, from a potential currency or payments element—and this probably goes to stablecoins—if it is, in fact, or a product is used as more of a payments or currency element, it would be outside of the CFTC's remit. In terms of the security or commodity question, you and I, I think, maybe have had this discussion before, but it really goes to the heart, at least today, of the traditional legal analysis of what a security is and what a commodity is.

That said, there are unique characteristics of these digital commodities. It will require hard work and collaboration between us and the SEC to further define what characteristics make up a digital commodity and a digital security.

The DCCPA exempts securities. I have said this before. The DCCPA and other similar bills are not a power grab. It is filling a gap in the commodity cash market. If we do not fill the gap, there will be fraud and there will be customer losses in the future. I am confident the CFTC, the SEC, I am committing to you that we will work together, we will figure out a path forward to have a reasonable, productive, and effective means to figure out what is a security token and what is a commodity token, and who should regulate.

Senator HOEVEN. How do you do that? How do you do that with all those other agencies, make that determination and sort out the jurisdiction, and make sure that you have the authorities, and then apply that not only from the standpoint that you are dealing domestically, in a global market, with all these different products? How do you do that?

Mr. BEHNAM. Senator, you know, we have done it historically with futures products and swaps products. Just to give you a hypothetical in how we play this out, if the DCCPA or a similar bill were passed into law and I had authority to oversee these cash markets, I think the first steps that would happen is I would speak with my counterpart, Chairman Gensler. We would have our teams get together and start to flesh out a framework for what are the main characteristics of security tokens, what are the main characteristics of commodity tokens, and then just work through more granular details of what unique characteristics are. You know, we have, I think, on the biggest exchange in the U.S. 200-plus tokens being traded. We would have to go through each token and figure out what are the characteristics and is it a security or a commodity. That sets precedent. That is the benchmark and the foundation for the future. It is a process we have done in the past, and we can continue to do it in the future.

Senator HOEVEN. Should this legislation, whether it comes out of this Committee or Banking or one of the other committees of juris-

diction, have some kind of clearinghouse mechanism, like you often have in financial markets, to sort that out, in order for all this to work?

Mr. BEHNAM. I will say this, is I want to impart on you that we can do this, but if that is something you are interested in I would certainly welcome the opportunity to work with you. The balance that we always have to strike with statute versus regulations, especially in an industry like this, I need a steer and a direction from you. I need prescription to give me a clear path forward of what my mandate is. It should not be too prescriptive to the extent that the technology can outrun the law, because it is going to be a lot easier for me to change rules through the public comment process than obviously you to change the law.

Senator HOEVEN. It does go to exactly what we have been talking about here, and that is looking at the legislation before this Committee to make sure that it does all the things it needs to do, not only so you can enforce the crypto aspects under your jurisdiction but so that you can coordinate with the other financial agencies that are going to need to be involved to deal with crypto on a broad basis, not only in this country but globally.

Mr. BEHNAM. Absolutely, Senator, and I think especially given the circumstances that we are in today and what happened in the past few weeks, that elevates the need to just take a fresh look and to see where there may be gaps, where we can strengthen the bill. I would say this: strengthening the bill and filling the gaps is one thing. We need to move forward as soon as possible. We do not want this to happen again in the next few months and have the risk of customers losing money because of these gaps.

Senator HOEVEN. Thank you.

Mr. BEHNAM. Thank you.

Chairwoman STABENOW. Thank you very much. I will indicate there is a vote going on. I will be stepping away to vote. Hopefully our members who are here have already done that. We have members that are left. I am going to leave the gavel in Senator Boozman's hands, and I told him I would be watching him.

Senator BOOZMAN. I get a little bit of responsibility here.

Chairwoman STABENOW. That is right. Thank you, Mr. Chairman, for being here, but I apologize that I need to step away. Thank you.

Senator BOOZMAN.

[Presiding.] Senator Bennet.

Senator BENNET. Thank you, Mr. Chairman. I have been waiting to be called on all morning, and obviously it was new leadership that was required in the Committee in order to be called on. Thank you. I am grateful for that. Thank you, Mr. Chairman, for being here today.

One question I have and something that has given me pause is just thinking about why FTX would have lobbied so hard for a bill that it could never comply with. Do you have any insight into that at all?

Mr. BEHNAM. Senator——

Senator BENNET. I am sure you have thought about that.

Mr. BEHNAM [continuing]. I have thought about that myself, and you kind of hit the nail on the head, right, because I cannot speak

to what Mr. Bankman-Fried or anyone at FTX was thinking when they were advocating for regulation. The remarkable thing is to think about it in the context of compliance, right, and what we have learned about the FTX entities. Just thinking about the bill that Senators Stabenow and Boozman introduced, you know, they would have been so far out of compliance that it would not have even been possible.

Senator BENNET. I was happy to hear you say earlier to Senator Grassley that you thought in the wake of what has just happened that we need to keep an open mind about what this legislation ultimately is going to look like, and you have already suggested a couple of provisions that you think we ought to add. I think probably everybody on the Committee would share that view—I hope that they would—and the need to act urgently at the same time.

One of the things that worries me is we have to regulate here. We have to do it. One of the things that worries me is that we might inadvertently be giving the seal of approval to, you described it as—

Mr. BEHNAM. Validation.

Senator BENNET [continuing]. validation, to Senator Thune, but the seal approval to a global enterprise that we do not know enough about to say to Colorado's teachers and firefighters, you know, this is stuff you should invest your pension money in. I mean, can you talk about some of the risks here? You said that you would err on the side of accountability and err on the side of consumer protection. That is the right impulse to have. It does not make it any less complex, the balance there that we have got to strike.

Mr. BEHNAM. No, it does not. I have had these conversations with my colleagues in the regulatory space about, you know, what does this mean in terms of systemic risk, what does it mean? We have been now through two major crises, if you think about the spring and Terra Luna and now FTX, and the traditional, regulated banking system is safe.

Senator BENNET. No contagion.

Mr. BEHNAM. No contagion. No even market resiliency issues. Let's keep it that way. Why would we even dabble in the idea of changing? What I always come back to is, you know, especially since 2008, after the crisis, we have been through a lot of bumps in the past two years with COVID and then the Russia-Ukraine war and the impact on volatility in commodity markets and markets generally. Our regulations work. They work very well. Our markets are resilient. The improvements we made after 2008 are very impactful and effective.

My thought process is, yes, I understand that there has been no contagion, but I have to think about that risk to customers and this idea that gaps exist and that future crises might happen. I cannot just sit back and not do anything. I always lean back on the fact that our regulations work. If we did bring this into the regulatory fold then what are we essentially accomplishing? We are eliminating the probability of these FTX-type implosions occurring.

Senator BENNET. How do we eliminate or prevent contagion from happening as a result of one of these? I am not arguing that there

shouldn't be regulation. I am arguing that we need to do it in as intelligent a way as we possibly can.

Mr. BEHNAM. We eliminate contagion by applying the same principles of financial regulation that we apply to traditional finance to the digital asset space.

Senator BENNET. Let me ask you about that. I am not an expert in digital assets, but if there were not an existing regulatory structure here, if we did not have an SEC and we did not have a CFTC, why would it make sense to lodge the responsibility to make these determinations about whether it is a security or a commodity and all the other determinations you were just talking about with Senator Hoeven in two agencies versus one? Are there bad things that could happen as a result of having that disparate oversight?

Mr. BEHNAM. You know, we have very different missions. The SEC is a capital formation and an investor disclosure-based agency. We are a risk management and price discovery agency.

One thing that I have been very cognizant of since becoming Chair, and I was a commissioner since 2017, you know, there is this debate about the two market regulators is not new. It has been going on in this body for years. Standing alone, as I have conversations with my colleagues across the globe, the CFTC and the SEC are two of the largest regulators, and regulate the largest markets in the world, by far. Standing alone we are immensely impactful and have huge remits, far greater than any other regulator in the world. It is for those reasons, I think, where it is effectively separate and each agency accomplishes its goals.

To your point about do we miss anything, I would just point to the markets we oversee. This issue about securities versus commodities really first came up in the early 1980's, with futures products. There are security futures and there are commodity futures. Both of them are commodity futures but they are security futures. This came up after the financial crisis, security-based swaps and commodity swaps. We have done, the two agencies, a very comprehensive job in filling all the gaps. There are essentially no gaps, and I feel very confident today telling you that we could do the same thing in the digital asset space.

Senator BENNET. Just with the last 40 seconds I have, can you please—you have said it already today once or twice—define the gap for us as you understand it.

Mr. BEHNAM. There, based on the SEC's statement, authority to regulate security tokens. The CFTC, the authority stops right now at derivatives markets. We only regulate financial products whose price is based on an underlying commodity. The gap that exists is what is called cash commodity digital tokens. The Securities and Exchange Commission does not have authority to regulate or oversee any commodity, and we, the CFTC, do not have any authority to regulate cash commodity markets.

Senator BENNET. Thank you. Thank you, Mr. Chairman.

Senator BOOZMAN. Senator Braun.

Senator BRAUN. Thank you, Mr. Chairman. I have been watching and it has been an interesting conversation. Let's talk about currency itself. That seems to be the most important part of the discussion.

Do you think anything with the volatility that crypto has shown can ever become a medium of exchange in the sense that fiat and sovereign currencies have become? You look at that analog, you do not have near as many exchanges. I just looked to see how many exchanges are out there. I mean, it is a couple of pages full.

Do you think, in the long run, we will get through with this interesting technology that has so much to offer, not only on the provenance of stuff but to be kind of that foundation for currencies? Will volatility, the way we have seen it, do you think that is just the early stages of it, or do you think it will be inherent to cryptocurrency going forward?

Mr. BEHNAM. Senator, I think, one, you can never predict what is going to happen, but I would say if we look in the past, say, 12 months, from the beginning of 2022 to where we are right now, and especially focusing on the events in the crypto digital asset space in April and May, when Terra Luna and some of these bankruptcies at these large lenders and hedge funds occurred, the price movement of—and I am going to use Bitcoin as the most prominent example—moved significantly downward from a much more elevated price, and then the spread or the volatility has really narrowed, more so than it ever has historically. We have largely been in a \$5,000—which is a huge move, right, relative to what you are saying—but relative to the history of the Bitcoin volatility. In the past six months it has been very narrow relative to its past.

Is that a sign of things to come? Possibly. Could we end up in a situation where Bitcoin or other digital currencies really start to narrow and you have that pressure from buyers and sellers where that range is much more narrow? It is possible.

I would say also, quickly, the foundation of the technology is really an issue. The costs, from a payments perspective, which I am sure you have read about, those are issues that I think have to be figured out in order for the application of these tools in traditional finance and payment systems to be applied.

Senator BRAUN. The other thing we can kind of turn the page back to, the dot-com explosion had a lot of these characteristics. Many of those stocks went up ten times on public issue, and ended up maybe either being of no value or selling way under, and kind of the same dynamic there. We will see over time.

Security or commodity? Would you not think that the entities within, the exchanges, maybe ought to be regulated by the SEC, and whatever we end up with that has more characteristics of a commodity, the currencies, end up being regulated by your agency? Is there any need that it would have to be regulated all by one or the other?

Mr. BEHNAM. I made this comment before, Senator, and I appreciate the question that, you know, under existing authority, for the SEC they cannot oversee a commodity, right, any commodity class, whether it is—

Senator BRAUN. We are still trying to define what they are and what all the elements are within it.

Mr. BEHNAM. We are. I think many of the characteristics should really be driven by historical precedent about what a commodity is and what a security is. I said this before. If we look at the Howey test from 1946, it is an investment money in a common enterprise

with the expectation of profit from the work of others. Those are the core characteristics of a security, and those same fundamental characteristics should be applied to a digital commodity. There probably will likely be different things that we have to add and think about, but fundamentally that is what we are thinking about. Because the SEC was created to bridge information gaps between issuers and investors. The CFTC was created to create a market-based structure so that commodities can be traded in a transparent, fair, and resilient way.

Senator BRAUN. That is probably a pretty good paradigm. At least now a lot of it is structure simply because those are the existing guidelines as well.

Here, I think is the biggest issue. This is a fledgling concept. It is arcane to many. It also looks like it has got huge potential, because when you look at sovereign currencies, those have not, in terms of a medium of exchange, it a hostage to whatever your fiscal policies and your central banking policies are as well.

You know, I think we really need to err on the side of making sure that we do not smother it, overregulate it. It definitely needs some regulation so that we do not take what might be the salvation for many places that do not even have a country that performs in a sovereign way, let alone a currency.

How aware are you of the fact that—I look at Bernie Madoff. You know, he was a guy that was a crook involved in retirement. We are going to have some of that here now, and we might be looking at that being litigated as well. You still do not want to take the exception, the outliers, and take something this new, this unknown, and put a wet blanket on it for all the future potential it has. Just give me your general thoughts on that.

Mr. BEHNAM. Senator, you know, I am going to focus on my responsibility as a market regulator and coming to you and telling you what I am seeing in markets and the risks to customers and where the regulatory—

Senator BRAUN. Do you want to make an opinion on that, outside of bailiwick?

Mr. BEHNAM. Maybe in the hallway but probably not right now. [Laughter.]

Senator BRAUN. Fair enough. Good conversation.

Mr. BEHNAM. Thank you, Senator.

Senator BOOZMAN. Senator Booker.

Senator BOOKER. Mr. Chairman, thank you very much.

Senator BOOZMAN. Best for last.

Senator BOOKER. Thank you, sir, for that, and thanks for the work that you have done. It has been a really bipartisan effort to try to create a regulatory regime that would protect against many of the issues we have discussed. It is good to see you, and you have been extraordinarily available to me and my team as we have been trying to forge a path forward to protect consumers, create more transparency, and I just have a lot of respect for you, not only because you are from New Jersey but because you do a heck of a good job, so I am grateful.

We know millions of Americans now have been scammed by this colossal FTX failure. Their exposure has lost a lot of folks their resources, and for some people their hopes and dreams and security.

We have the responsibility, as you know, and a lot of my colleagues have expressed already, to really understand the impacts of this deception, what are the real regulatory gaps to help to inform our regulatory actions, and how we can work to create a new space with a lot of abuse, how we can make sure that there are actually opportunities within it for the future.

Chairman, when you and I last spoke in the Committee I communicated that I actually had a lot of optimism, not in these coins or any particular commodities but the underlying technology that there could be hope that we could see, often for lower-income folks who are dealing with banks that overcharge or have ridiculous fees, that we could begin to create more expanded opportunity for people that are often either abused by the banking system as it stands right now or who do not have access to a lot of the conveniences and opportunities within the banking system. I am still hopeful that this technology can provide economic opportunities for the underbanked and folks who have been left behind by traditional financial institutions. That said, without legislation like the DCCPA, we are leaving these same groups of people, that I am most concerned with, really vulnerable, as we have just seen.

We know that there are issues in the industry, and have been said by my fellow Committee members, from the scams, fraudsters, risky, over-leveraged projects, inadequate disclosure, and more that are really causing these difficulties. I think that FTX blowup is actually indicative of other things that have happened that maybe not have captured as much attention.

I am a supporter of the Digital Commodities Consumer Protection Act and still believe that the provisions within it would have solved many of the problems we have seen recently, had FTX been registered in the United States, which is a big issue we are not really focusing on. Many of the actions that have been allegedly perpetrated actually have been crimes in this country for over a century. The legislation is not going to solve everything, but I think it is important that we move forward with providing a regulatory framework that can protect consumers.

The first question, I just want to set some things straight, and you have touched on them a bit, but it has been widely discussed in the media that the Stabenow-Boozman bill, of which I am a proud co-sponsor, is an SBF bill, or an FTX bill. This does not match any of the experience I have had with the legislative process. Sam Bankman-Fried did give a lot of feedback, as did many others, from industry, from academia, from the policy community, from your shop, and beyond. Everyone's feedback was considered by the Chair and the Ranking Member, who I think did an extraordinary job in getting input from lots of folks.

Can you speak a little bit more to this allegation or this idea of the involvement of FTX? You talked about your calendar and what they were talking about, but can you speak to the involvement of FTX in the process of developing the piece of legislation that you have been such a principal advisor to us on?

Mr. BEHNAM. Thank you, Senator. As far as I know, given conversations that we have had with the Committee—because as you pointed out we were very engaged in providing technical assistance and legal analysis, which is, you know, typical process for an au-

thorizing committee and the agency it oversees, and we are continuing to look forward to doing that with you as we think about the bill going forward. As I noted, the Chairwoman and Ranking Member were very inclusive in their exercise of inviting folks in.

We took a lot of meetings. You know, I mentioned that I met with Mr. Bankman-Fried and his team ten times, and we had some message exchanges, mostly about this application for the clearinghouse. Certainly as meetings go and conversations go we were talking about meetings he was having with other regulators or discussions he was having—

Senator BOOKER. I am going to cut you off. I think you made my point for me. You met with me a handful of times on this, and I am just a junior Senator from New Jersey. I imagine collectively you have met with us dozens and dozens of times, members of this Committee, including testifying. In the private conversations we had your mission is not about the wealth of individuals. It is about the protection of consumers and financial security for Americans. Is that correct?

Mr. BEHNAM. Yes, 100 percent.

Senator BOOKER. 100 percent. Okay. Financial criminality is just not new, as I have said. We know that FTX is accused of crimes, of things that have been crimes for a long time. In those cases, enforcement and transparency appear to be the most important issues. We know, in the financial world, your agency, as well as the FTC, have done a lot of work in enforcement.

The Digital Commodities Consumer Protection Act, among other things, was written to bring more resources to Commodity Futures Trading Commission's ability to create enforcement in this space.

Would you, in my remaining seconds, expand upon the authority and resources enumerated in the bill that have given you the ability to prevent something like what recently happened with FTX—again, if FTX had been registered in the United States—what are the tools that this bill would give you to protect consumers and prevent some of the things alleged with FTX?

Mr. BEHNAM. Senator, thank you. Just quick context is right now—I have said this before—every enforcement action we bring in the digital asset space is because someone comes to us, and that is not healthy, and that is not good. It touches—as the Chairwoman said, I said this—the tip of the iceberg, right? There is a whole area in the shadows.

We need registration of exchanges. We need surveillance of market activity. We need direct relationship with custodians who are holding customer money so that we can prohibit and prevent money moving around that is not house money. There are so many tools in a comprehensive, regulatory framework that will put us, as boots on the ground, in the entity to prevent all of these illegal activities.

Senator BOOKER. Thank you very much. Mr. Chairman-slash-Ranking Member, I really want to thank you. This has been one of the better bipartisan experiences I have had, to try to do what is necessary to bring transparency, bring accountability, bring regulation, and create a real enforcement agency that has the resources to go after people doing bad things. Thank you.

Senator BOOZMAN. Well, thank you so much for being here. As Senator Booker just alluded to, this really has been a very helpful hearing. What we want to try and do is just give you the tools in your toolbox to protect consumers.

I was the Chairman of the Financial Services Subcommittee on Appropriations a couple of Congresses ago. I had the opportunity to work with Chairman Gensler in his role that you have right now, and I really enjoyed working with him. He is a very talented guy. I have really enjoyed getting to know you and your staff and the great job that you all are doing, again, you all being a very talented team.

You have got a portion of this. The SEC has got a portion of it. I know that you all have the ability and the want-to to get this done. A lot of this is going to depend on you all getting together and just helping us figure out a path forward. We do have to find that path in an expeditious way or we are going to wind up talking about the new FTX in the not-too-distant future.

With that the meeting is adjourned. Thank you.

[Whereupon, at 12:33 p.m., the hearing was adjourned.]

A P P E N D I X

DECEMBER 1, 2022

Testimony of Rostin Behnam**Chairman, Commodity Futures Trading Commission****Why Congress Needs to Act: Lessons Learned from the FTX Collapse****U.S. Senate Committee on Agriculture, Nutrition, and Forestry****December 1, 2022**

Thank you, Chairwoman Stabenow, Ranking Member Boozman and members of the committee for the opportunity to appear before you today.

The events of the past few weeks embody—in the most regrettable way—the perilous state of the digital asset market. For years many have recognized that a patchwork of federal and state-based regulation is an unsuitable substitute for a comprehensive approach. We are here today because many Americans invested in a novel product and will likely lose money because digital asset markets lack the basic protections that we have all come to expect and have made American financial markets the envy of the world.

In the absence of stringent and uniform standards, the digital asset market rapidly expanded. With nominal barriers to entry for new products and new consumers, massive speculative interest has taken the place of legitimate market forces, putting the American public at significant risk. We are here today because the latest events involving FTX lay bare the consequences, and demand accountability. As I have stated publicly many times before, I strongly believe that we need to move quickly on a thoughtful regulatory approach to establish guardrails in these fast-growing markets of evolving risk, or they will remain an unsafe venture for customers and could present a growing risk to the broader financial system.

Failure to act will leave consumers who have made investments in digital commodities largely unprotected. Unlike other federal financial regulators, the CFTC lacks the necessary and direct authority to write rules and to oversee this marketplace. Instead, we may only reach it through more limited authority activated when fraud or manipulation has already occurred. While we can and do hold perpetrators accountable when we find fraud or manipulation, for the victims of the scheme, it is already too late.

Dating back to when the first bitcoin futures contracts and binary options self-certified in 2017,¹ I warned that market regulators and policymakers too often find ourselves at the tail end of technological advancement. Acknowledging that the certification of derivatives in a new asset class would solidify the CFTC's regulatory interest in the underlying cash market, which was nascent, opaque, and unregulated, I urged for greater involvement by regulators with respect to the adoption of new technologies that make new products, new relationships, and new forms of

¹ See Press Release Number 7654-17, CFTC, Statement on Self-Certification of Bitcoin Products by CME, CFE and Cantor Exchange (Dec. 1, 2017), [CFTC Statement on Self-Certification of Bitcoin Products by CME, CFE and Cantor Exchange | CFTC](#).

conduct possible.² Specifically, I called for: (1) industry engagement in assessing risk; (2) legal and regulatory certainty; (3) education for the general public; and (4) questioning and challenging the status quo, in the market and within regulatory structures.

As anticipated, the swift adoption of digital asset derivatives signaled that scaling in the underlying cash or spot digital asset market would be quick. Our vigilance was necessary, but our regulatory authority beyond the bounds of the U.S. derivatives market was, and remains nonexistent.

The CFTC does not have direct statutory authority to comprehensively regulate cash digital commodity markets; instead, the Commission's jurisdiction resides with its more limited fraud and manipulation enforcement authority. In the absence of direct regulatory and surveillance authority in an underlying cash market, CFTC enforcement activity begins with a referral or whistleblower tip from an external source. Despite this limitation, the CFTC has brought more than 60 enforcement cases in the digital asset space since 2014, with total penalties of just over \$820 million. In fiscal year 2022, more than 20% of our 82 enforcement actions involved digital assets.³

But as I suggested over a year ago, the fraud that we are able to prosecute is likely a fraction of what exists in the shadows. Limited enforcement authority is no substitute for comprehensive regulation in which trading platforms, dealers, custodians, and other critical infrastructure participants are required to be registered and subject to direct oversight by a regulator such as the CFTC. By the time the CFTC is able to exercise its fraud and manipulation authority, it is already too late for defrauded customers. The CFTC has many tools at its disposal to try to make defrauded customers whole, but the process is long and arduous, and sometimes there is no way to return all of what was lost. Comprehensive regulation protects customers on the front end by stopping fraud *before* it occurs.

Identifying unique elements of the digital asset commodity markets that distinguish it from other cash markets, I have asked Congress directly for clear authority to impose our traditional regulatory regime over the digital asset commodity market.⁴ I have been greatly encouraged by the efforts from Congress to date.

I have not been shy about my encouragement of bills that contemplate shared responsibility for the CFTC and the Securities and Exchange Commission (SEC), where the SEC would utilize its existing authority and reporting regime requirements for all security tokens, while the CFTC would apply its market-based rules for the more limited subset of commodity tokens, which do not have

² See Rostin Behnam, Commissioner, CFTC, Opening Statement of Commissioner Rostin Behnam before the Market Risk Advisory Committee (Jan 31, 2018), [Opening Statement of Commissioner Rostin Behnam before the Market Risk Advisory Committee | CFTC](#).

³ See Press Release Number 8613-22, CFTC, CFTC Releases Annual Enforcement Results (Oct. 20, 2022), [CFTC Releases Annual Enforcement Results | CFTC](#).

⁴ See, e.g., Rostin Behnam, Chairman, CFTC, Testimony of Chairman Rostin Behnam Regarding "Examining Digital Assets: Risks, Regulation, and Innovation" before the U.S. Senate Committee on Agriculture, Nutrition, and Forestry (Feb. 9, 2022), [Testimony of Chairman Rostin Behnam Regarding "Examining Digital Assets: Risks, Regulation, and Innovation" | CFTC](#); Rostin Behnam, Chairman, CFTC, Testimony of Chairman Rostin Behnam Regarding the Legislative Hearing to Review S.4760, the Digital Commodities Consumer Protection Act at the U.S. Senate Committee on Agriculture, Nutrition, and Forestry (Sept. 15, 2022), [Testimony of Chairman Rostin Behnam Regarding the Legislative Hearing to Review S.4760, the Digital Commodities Consumer Protection Act at the U.S. Senate Committee on Agriculture, Nutrition, and Forestry | CFTC](#).

the same characteristics as security tokens. In September, I appeared before you in support of the Digital Commodities Consumer Protection Act (DCCPA), which benefited from the expertise of CFTC staff who worked closely with some members of this Committee to establish a framework similar to the CFTC's current and effective regulatory framework over the derivatives markets. I have been encouraged by the bipartisan and bicameral support that recognizes the need for guardrails around the burgeoning digital asset economy and calls for regulation to impart transparency, accountability, stability, customer protections, and oversight across digital assets.⁵ In light of recent events, the CFTC stands ready to continue working with this Committee and other members of Congress and revisiting existing proposals to ensure every known weakness, risk, and failure is addressed in legislation.

It has been easy to fall into analysis paralysis, compelled to endlessly debate the utility of the underlying technology, how to ensure responsible innovation, and how flexible or restrictive regulation should be both exclusively around digital assets and inclusively amongst traditional financial instruments. Our highest priorities must be the protection of customer property and promotion of fair, stable, and resilient markets. If we are going to ensure that FTX and the other firms that are subjecting customers to billions in losses are appropriately regulated and held accountable, we need to act promptly to apply a comprehensive regulatory regime.

To understand why comprehensive regulation of trading platforms is critically important to protect the largely retail customer base of these speculative digital commodity markets, one need look no further than where the CFTC's regime intersected with FTX. Most of the coverage about FTX in the past weeks has focused on the over 130 different entities that filed for bankruptcy, which includes an offshore-based exchange for trading digital assets and digital asset-based derivatives, a highly leveraged market making firm trading throughout the digital asset market, and a US-based spot exchange. Of significantly less focus is the entity registered with and overseen by the CFTC – a derivatives exchange and clearinghouse called LedgerX LLC (“LedgerX”).

Since 2017, LedgerX has been registered with the CFTC as a designated contract market (DCM), swap execution facility (SEF), and derivatives clearing organization (DCO).⁶ LedgerX is one of the few FTX entities to *not* file for bankruptcy. The CFTC has been in near-daily contact with LedgerX as well as the third-party custodians it uses to hold cash and digital assets. Based on the information presented to us, at this time, LedgerX customer property remains secure and LedgerX has the financial resources to continue operating for the foreseeable future.

In compliance with applicable core principles for DCOs under the Commodity Exchange Act,⁷ LedgerX is required by CFTC regulations to ensure segregation and security of customer property

⁵See, e.g., Rostin Behnam, Chairman, CFTC, Keynote Address of Rostin Behnam at the Brookings Institution Webcast on the Future of Crypto Regulation (July 25, 2022), [Keynote Address of Chairman Rostin Behnam at the Brookings Institution Webcast on The Future of Crypto Regulation | CFTC](#).

⁶See Press Release Number 7945-19, CFTC, CFTC Approves LedgerX LLC as a Designated Contract Market (June 25, 2019), [CFTC Approves LedgerX LLC as a Designated Contract Market | CFTC](#); Press Release Number 7592-17, CFTC, CFTC Grants DCO Registration to LedgerX LLC (July 24, 2017), [CFTC Grants DCO Registration to LedgerX LLC | CFTC](#); Press Release Number 7584-17 CFTC, CFTC Grants SEF Registration to LedgerX LLC (July 6, 2017), [CFTC Grants SEF Registration to LedgerX LLC | CFTC](#).

⁷See Commodity Exchange Act § 5b(c)(2), 7 U.S.C. § 7a-1(e)(2).

(including digital assets), maintain capital to cover up to a year's worth of projected operating costs on a rolling basis, and maintain accurate books and records, in addition to numerous other important requirements. Among other things unique to LedgerX's DCO registration order as required by the Commission, LedgerX must engage an independent certified public accountant to audit its digital asset balances and issue an opinion on accounting treatment of digital assets held by LedgerX annually.⁸ Many public reports indicate that segregation and customer security failures at the bankrupt FTX entities resulted in huge amounts of FTX customer funds being misappropriated by Alameda for its proprietary trading. But the customer property at LedgerX – the CFTC regulated entity – has remained exactly where it should be, segregated and secure. This is regulation working.

CFTC regulations further require that LedgerX be completely walled off from the other unregulated FTX entities in order to properly protect customer property. To that end, as part of the ongoing bankruptcy, FTX has reported that LedgerX holds more cash than all the other FTX debtor entities combined. Whereas this separation has seemingly been extremely important to protecting the customers of the CFTC-registered entity, it is critically important to emphasize that it also means that the CFTC lacked any legal authority to examine any entity other than the registered entity, and had no insight to the operations and treatment of customer property in the unregulated FTX entities.

We are continuing to closely monitor LedgerX, but the initial evidence suggests that in the collapse of the broader FTX universe, CFTC regulations are working to ensure that those registered with the CFTC are in a position to protect customers and continue market operations. The lesson here is clear: thoughtful, comprehensive regulation works to protect customers and prevent the type of events that have befallen the other FTX entities.

Invariably, the questions we are all obligated to answer as regulators are: “How did you let this happen?” and “How will you prevent this from happening again?” In the pivotal moment we find ourselves in, the answer to both questions is comprehensive, market regulation. At the CFTC, we lacked the authority to comprehensively regulate the digital commodity market, and to prevent this from happening again, we must be provided appropriate authority by Congress. Without new authority for the CFTC, there will remain gaps in a federal regulatory framework, even if other regulators act within their existing authority. In fact, the recent Financial Stability Oversight Council Report concludes that, “[A] regulatory gap exists in spot markets for crypto-assets that are commodities and not securities.”⁹

⁸ See Press Release Number 8230-20, CFTC, CFTC Approves LedgerX, LLC to Clear Fully-Collateralized Futures and Options on Futures (Sept. 2, 2020), [CFTC Approves LedgerX, LLC to Clear Fully-Collateralized Futures and Options on Futures | CFTC](#).

⁹ Financial Stability Oversight Council, Report on Digital Asset Financial Stability Risks and Regulation at 88 (Oct. 2022), [Report on Digital Asset Financial Stability Risks and Regulation 2022 \(treasury.gov\)](#).

There are certainly issues for debate, but from my perspective the path forward is grounded in the regulations that have served to make the U.S. financial markets the safest and most trusted. Foremost, trading platforms targeting retail market participants must be registered with a federal market regulator. Those platforms must be subject to strong regulatory requirements designed to protect retail customers, such as mandated segregation and protection of customer funds, maintenance of sufficient capital to operate efficiently, implementation of internal controls and governance processes, and accurate and honest public disclosures backed by independent, certified accounting. Those platforms must be restrained by conflicts of interest rules and mandatory separation. They cannot be allowed to take on conflicting roles such as operating an exchange while also trading against customers on that exchange. The CFTC and SEC must have direct insight into these platforms with the authority to surveil ongoing trading activity, conduct examinations, and approve material changes to the platform's business. And for those who do not choose to follow those rules, they must know that they will be subject to an aggressive enforcement response, in the civil and criminal context. These are many of the principles built into existing legislative proposals.

The CFTC will remain vigilant with respect to our registered entities, use our existing fraud and manipulation authority to the fullest extent of the law, and engage with this Committee to ensure you have as much information as needed. I look forward to answering any of your questions.

**DOCUMENTS SUBMITTED FOR THE
RECORD**

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November 30, 2022

The Honorable Debbie Stabenow
Chairwoman
U.S. Senate Committee on Agriculture,
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328A Russell Senate Office Building
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The Honorable John Boozman
Ranking Member
U.S. Senate Committee on Agriculture,
Nutrition, and Forestry
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The Honorable Sherrod Brown
Chairman
U.S. Senate Committee on Banking,
Housing, and Urban Affairs
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The Honorable Patrick J. Toomey
Ranking Member
U.S. Senate Committee on Banking,
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Re: NASAA Calls on Congress to Learn the Right Lessons from the FTX Bankruptcy

Dear Chairwoman Stabenow, Chairman Brown, and Ranking Members Boozman and Toomey:

On behalf of the North American Securities Administrators Association (“NASAA”),¹ I write in support of efforts underway to uncover the facts that led to the bankruptcy of FTX Trading Ltd. and its affiliates (“FTX”).² Your oversight and investigatory efforts will help inform the ongoing regulatory policy discussions related to digital assets occurring at the state and federal levels of government.³ In addition, I write to urge you and your colleagues to help us learn the right lessons from the FTX bankruptcy. As explained below, high on the list of reforms should be the need to (1) maintain strong state regulatory authority, (2) strengthen the disclosures and corporate governance of large private companies, and (3) strengthen coordination among regulators.

I. Congress Should Preserve the Authority of State Securities Regulators

For over a century, state securities regulators have been on the frontlines of innovations that have made our capital markets safer, more efficient, and more inclusive. Today, we continue

¹ Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grassroots investor protection and responsible capital formation.

² See, e.g., [Letter from Chairman Raja Krishnamoorthi](#) (D-IL), U.S. House Committee on Oversight and Reform, Subcommittee on Economic and Consumer Policy, to Mr. Bankman-Fried and Mr. Ray (Nov. 18, 2022).

³ See [Jeremy Hill, Enron’s Liquidator to Oversee FTX’s Massive Crypto Bankruptcy](#), BLOOMBERG (Nov. 11, 2022).

President:	Andrew Hartnett (Iowa)	Secretary:	Diane Young-Spitzer (Massachusetts)	Directors:	Marni Rock Gibson (Kentucky)
President-Elect:	Claire McHenry (Nebraska)	Treasurer:	Tom Cotter (Alberta)		Eric Pistilli (Pennsylvania)
Past-President:	Melanie Senter Lubin (Maryland)				Andrea Seidt (Ohio)
Executive Director:	Joseph Brady				Leslie Van Buskirk (Wisconsin)

to work hard to ensure that the latest innovations occur within the well-established regulatory framework for supporting investor protection and responsible capital formation. Among other activities, we license firms and their agents, investigate violations of the law, file enforcement actions when appropriate, and educate the public about investment fraud.

State securities regulators have a strong record of protecting and educating investors in matters involving digital assets. About a decade ago, NASAA began warning investors about scams tied to digital assets.⁴ The first state enforcement actions against a fraudulent digital asset scheme occurred soon thereafter when state regulators issued orders to stop an initial coin offering (“ICO”) by BitConnect. This work evolved into Operation Cryptosweep, which was a task force comprised of U.S. and Canadian NASAA members who produced significant enforcement results related to ICOs and other cryptocurrency-related investment products.⁵ Most recently, state regulators have been at the forefront of cases involving the unregistered offerings of securities in the form of interests in so-called crypto-lending programs like those offered by BlockFi, Celsius, and Voyager.⁶

The FTX collapse is yet another reminder of how important it is to preserve the existing authority of state securities regulators. As highlighted above, long before the FTX collapse made news around the world, state securities regulators were hard at work investigating alleged violations of the law in the digital assets space and moving quickly to protect Main Street investors. We can assure you that the extent of the harm in the digital assets space right now would be worse if only the federal government had authority to act.⁷

⁴ See NASAA, [Informed Investor Advisory: Virtual Currency](#) (Apr. 2014). For additional NASAA advisories, see, e.g., [Informed Investor Advisory: Decentralized Finance \(DeFi\) Defined](#) (Dec. 6, 2021); [Informed Investor Advisory: Protecting Your Online Accounts](#) (Sept. 16, 2021); [Informed Investor Advisory: Social Media, Online Trading and Investing](#) (Apr. 1, 2021); [Informed Investor Advisory: Initial Coin Offerings](#) (Apr. 16, 2018); [Informed Investor Advisory: Cryptocurrencies](#) (Apr. 13, 2018); [Informed Investor Advisory: The Next Big Thing](#) (Nov. 9, 2015).

⁵ See, e.g., NASAA, [Operation Cryptosweep Results as of 2018](#). Upon the indictment of the founder of BitConnect in 2022, the U.S. Department of Justice (“DOJ”) described the ICO as a “massive cryptocurrency scheme” that defrauded investors of more than \$2 billion. See DOJ, [Founder of Fraudulent Cryptocurrency Charged in \\$2 Billion BitConnect Ponzi Scheme](#) (Feb. 25, 2022).

⁶ See, e.g., [NASAA Letter to the Senate and House Agriculture Committees Regarding the DCCPA](#) (Sept. 9, 2022); [Written Testimony of NASAA President and Maryland Securities Commissioner Melanie Senter Lubin delivered to the U.S. Senate Committee on Banking, Housing, and Urban Affairs](#) (July 28, 2022); NASAA, [NASAA and SEC Announce \\$100 Million Settlement with BlockFi Lending, LLC](#) (Feb. 14, 2022).

⁷ See, e.g., Alex Nguyen, [Cryptocurrency Firm FTX, Billionaire CEO Focus of Texas Securities Investigation](#), THE TEXAS TRIBUNE (Oct. 17, 2022); Francis Yue, [‘I Just Wake Up and Cry’: Voyager and Celsius Bankruptcies Have Destroyed Some Crypto Investors’ Confidence in Centralized Platforms](#), MARKETWATCH (July 15, 2022); Maria Ponnezhath and Tom Wilson, [Major Crypto Lender Celsius Files for Bankruptcy](#), REUTERS (July 14, 2022); Cheyenne Ligon, [Texas, Other States Open Investigation Into Celsius Network Following Account Freeze](#) (June 16, 2022); [Five States File Enforcement Actions to Stop Russian Scammers Perpetrating Metaverse Investment Fraud](#) (May 11, 2022); [Sand Vegas Casino Club Located in the Metaverse Is Soliciting Investors to Invest Real Money in Un-Registered Investments](#) (Apr. 13, 2022); [New Jersey Bureau of Securities Orders Cryptocurrency Firm Celsius to Halt the Offer and Sale of Unregistered Interest-Bearing Investments](#) (Sept. 17, 2021). See also [NASAA Reveals Top Investor Threats for 2022](#) (Jan. 10, 2022); [NASAA Announces Top Investor Threats for 2021](#) (Mar. 3, 2021); [NASAA Announces Top Investor Threats for 2020](#) (Dec. 23, 2019).

II. Congress Should Restore Additional Oversight and Transparency to the Private Securities Markets

As state securities regulators, we regularly advocate for Congress to join us in our longstanding efforts to restore oversight and transparency to the private securities markets. Among other such efforts, NASAA recently endorsed S. 4857, the Private Markets Transparency and Accountability Act. This legislation would extend reporting and disclosure requirements of the U.S. Securities and Exchange Commission (“SEC”) to companies that have (i) a valuation of \$700 million (excluding shares held by insiders) or (ii) 5,000 employees and \$5 billion in revenues.

In a nutshell, we believe the FTX collapse should remind all of us of the importance of ensuring that no private company can hide fraud or other misconduct from legislators, regulators, or investors. As background, the law governing private securities offering disclosure is weak. Generally, private companies do not have to make their offering disclosures accessible to the SEC. Instead, they can submit an 8-page form notice (“Form D notice”) to the SEC and the applicable states where securities have been sold without registration under the Securities Act of 1933 in an offering based on a claim of a qualifying exemption. The notice is published in a public database called EDGAR and includes basic information regarding the securities issuer, the offering, the investors, and related fees. It also includes a disclaimer that the notice may contain inaccurate or incomplete information. As further background, the law governing periodic reporting by large private companies is also weak. Presently, Section 12(g) of the Securities Exchange Act of 1934 (“Exchange Act”) requires a company to report publicly after reaching 2,000 “holders of record.” This trigger is easily avoidable because a single broker or investment fund is counted as one recordholder, while holding securities on behalf of thousands of underlying investors.⁸

In the case of FTX, there is no doubt that stronger disclosure and corporate governance requirements in the private securities markets would have made it easier for all of us to spot or prevent the alleged fraud and other misconduct earlier. By way of illustration, under existing law, FTX Trading Ltd. submitted Form D notices to the SEC after raising over \$1.4 billion in capital from dozens of investors. Moreover, in these notices, the corporation only had to disclose basic information regarding it, the offering, the investors, and related fees.⁹ Had the law required more timely and fulsome disclosure, regulators and other market watchers may have identified the gaps and weaknesses in FTX’s corporate governance earlier.¹⁰ Another way the SEC and

⁸ See former SEC Commissioner Allison Herren Lee, [Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy](#) (Oct. 12, 2021).

⁹ On August 5, 2021, Samuel Bankman-Fried submitted a Form D to the SEC on behalf of FTX Trading Limited. The notice disclosed that the company had relied on a securities offering exemption in order to offer \$1 billion of equity in his company without first registering the securities with the SEC. The notice disclosed that seventy-seven (77) investors had already invested in the offering. [View the Form D filing on EDGAR](#). On November 2, 2021, Mr. Bankman-Fried submitted another Form D to the SEC. In this one, he notified the SEC that FTX Trading Limited had relied on a securities offering exemption in order to offer \$415,341,812 of equity in his company without first registering the securities with the SEC. The notice disclosed that eighty-five (85) investors had already invested in the offering. [View the Form D filing on EDGAR](#).

¹⁰ See generally David Yaffe-Bellany, [New Chief Calls FTX’s Corporate Control a ‘Complete Failure’](#), N.Y. TIMES (Nov. 17, 2022).

others may have detected the alleged misconduct earlier is through Exchange Act reporting. Under existing law, FTX apparently did not have to submit Exchange Act reports, such as a Form 10-K, to the SEC. If the law had required large private companies such as FTX to submit Exchange Act reports, the government and other market watchers would have had access to the corporation's financial statements and, depending on the size of the corporation, those statements would have been audited. Such reporting also would have necessitated the identification of a senior executive at FTX to serve as the primary or chief financial officer.¹¹

III. Policymakers Should Foster Better Coordination Among Regulators

We, as state securities regulators, work with the SEC and the U.S. Commodity Futures Trading Commission ("CFTC"), as well as other federal agencies and offices, on many issues and matters. Among other ways of coordinating and collaborating, we serve alongside our federal regulators on various regulatory working groups. For example, since 2010, a state securities regulator has served as a non-voting member of the Financial Stability Oversight Council ("FSOC"). To FSOC, we bring the insights of a 'first responder' who can see trends developing at the state level that may affect the larger financial system.¹²

Despite existing regulatory coordination, we believe the FTX collapse should teach us all to find new and better ways to work together to prevent investor harm before it occurs. As background, limited processes presently exist for regulators to exchange information that has been provided to them by market participants regarding the same or similar matter. Often, the other regulator learns of the development by searching the other regulator's website or reading about it in the press. Moreover, market participants generally are aware of these regulatory communication challenges. While many do not, some participants take advantage of the challenges to secure outcomes that are more favorable to them or their clients.

In addition to other solutions, Congress could improve communication among regulators by passing legislation that requires the federal government to invite state securities regulators to participate in any federal advisory council, committee, task force, or similar working group convened to examine some aspect of the U.S. securities regulatory framework. At present, state securities regulators must review all federal legislation and seek textual changes where lawmakers inadvertently excluded state regulators from a working group. For example, NASAA has asked the staff of Rep. Patrick McHenry (R-NC) to make clear that the CFTC and SEC must invite state securities regulators to participate in the digital assets working group that would be established by H.R. 1602, the Eliminate Barriers to Innovation Act of 2021.¹³

In closing, I want to commend you and your colleagues for the bipartisan steps taken in 2022 to advance policy discussions related to digital assets. Ultimately, investors and taxpayers

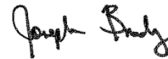
¹¹ See SEC, [Exchange Act Reporting and Registration](#) (last updated Apr. 28, 2022).

¹² See NASAA, [State Regulators Announce Representatives for the Financial Stability Oversight Council](#) (Sept. 23, 2010); NASAA, [Maryland Securities Commissioner Lubin To Represent NASAA on Financial Stability Oversight Council](#) (Oct. 12, 2015).

¹³ See [H.R. 1602](#), the Eliminate Barriers to Innovation Act of 2021. To date, no change has been made to the legislative text. However, NASAA has no reason to believe that the present leadership of the CFTC and SEC would exclude state securities regulators from the digital assets working group contemplated by this legislation.

benefit when we all work together in a positive and effective manner. If NASAA can be of assistance at any point in these discussions, please do not hesitate to contact me or Kristen Hutchens, NASAA's Director of Policy and Government Affairs, and Policy Counsel, at khutchens@nasaa.org.

Sincerely,

A handwritten signature in black ink that reads "Joseph Brady". The signature is written in a cursive, slightly slanted style.

Joseph Brady
Executive Director

CC: Members of the U.S. Senate Committee on Banking, Housing, and Urban Affairs
Members of the U.S. Senate Committee on Agriculture, Nutrition, and Forestry
Members of the U.S. House Committee on Financial Services
Members of the U.S. House Committee on Agriculture

QUESTIONS AND ANSWERS

DECEMBER 1, 2022

U.S. Senate Committee on Agriculture, Nutrition, and Forestry
Why Congress Needs to Act: Lessons Learned from the FTX Collapse
December 1, 2022
Questions for the Record
The Honorable Rostin Behnam

Ranking Member John Boozman

- 1. I believe we can improve the DCCPA and provide clarity by mandating concrete rulemaking deadlines and reasonable implementation timelines. Do you support Congress legislating 12–18-month implementation periods in order to ensure U.S.-based businesses are able to transition to a new regulatory construct? If not, explain your reasoning.**

If the DCCPA is enacted, the CFTC would make every effort to implement the statutory framework as quickly as possible. The agency has significant experience in implementing complex financial laws, including work on swaps following the adoption of Dodd-Frank. We are therefore confident we can meet the complex and novel issues raised by digital asset markets in an expedited and orderly manner. But, because of this complexity and novelty, we believe that the timetable for rulemaking should have some flexibility.

- 2. It would be irresponsible to try and capture every transaction across the world simply because someone in the U.S. may have something to do with it. There is a long history with respect to cross-border jurisdiction over the swaps markets, and I don't think anyone wants to re-litigate this in the digital asset context. Do you support Congress, through legislation, granting the CFTC authority to regulate digital commodities abroad when such activities have a "direct and significant connection with activities in, or effect on, commerce of the United States?" If not, and understanding the history of this policy issue, what do you believe are the dangers of Congress granting the CFTC a different standard to regulate digital assets across borders than the standard for regulating swaps abroad?**

The digital asset market is inherently global. Assets can be transferred in a peer-to-peer manner between any two people with an internet connection. As seen in certain CFTC enforcement actions, actors outside the U.S. are able to access the U.S. customers in a unique manner in this market. I strongly encourage Congress to consider the unique nature of this technology and this market when crafting legislation specific to the digital asset market to ensure that goals of market regulation through an agency like the CFTC can be successfully implemented.

- 3. Our bill is carefully written to prevent any application of a user fee onto traditional derivative market activity absent clear congressional authority. Should the bill become law, do you believe the CFTC will need funds appropriated upfront before the agency can begin collecting user fees? If so, will you provide the Committee a detailed calculation of the necessary funding, and specific steps the agency will take to ensure that all appropriated money for the purposes of implementing the DCCPA will only be used for that purpose?**

If the DCCPA becomes law, the CFTC would need to start implementation work immediately. We will only receive user fees after rules are proposed and finalized and platforms are registered. As a result, we will incur significant costs before implementation of a user fee structure is enacted. We would therefore need to request additional appropriations from Congress to meet these costs and would be happy to work with the Committee and our appropriators to develop detailed funding plans.

- 4. There have been a lot of questions surrounding what's a security and what's a commodity, and about BTC and ETH specifically being included in the DCCPA. We assume the position of the CFTC is that both are commodities given the technical assistance you provided on the bill. Do you believe ETH is a commodity? If not, why? Also, can you detail how you are thinking about additional assets as commodities?**

As multiple courts have recognized, fungible digital assets like BTC and ETH are commodities under the CEA. Many other digital assets available on the market have similar characteristics, such as being able to function as a medium of exchange or unit of account, and the CFTC has alleged in enforcement actions that several other digital assets meet the definition of a commodity.

However, whether a digital asset is a commodity does not determine whether the asset separately meets the definition of a security under securities laws. Indeed, the CEA provides that many securities also fall within the definition of a commodity. Thus, any given digital asset may or may not be subject to the securities laws, but that does not depend on whether the asset is a commodity. It depends instead on whether the asset is a security under the securities laws.

- 5. FTX's founder testified before Congress explaining their model was superior to traditionally regulatory approved models. They attempted to define a regulatory regime that only fit their purpose. Now, in the aftermath and a pending bankruptcy process, it seems their proposal was not able to stop fraud or poor decision-making. Given the traditional clearing model has a number of checks and balances in place for CCPs, how can we make certain these types of bad actors are held to the same standards, so their systemically risky behavior is discovered before the markets are truly harmed?**

The CFTC has brought nearly 70 actions against bad actors in the digital asset markets and continues to be very active in policing markets against fraud. But, as I have indicated in the past, there are gaps in the U.S. supervisory regime for digital asset markets. If legislation, such as the DCCPA, is adopted to fill those gaps, then we and other regulators will adopt rules that will enable us to detect bad actors and discourage fraud before it occurs. Any rules that we adopt would apply the same general principles as those we currently use to police financial markets.

6. We have seen the fallout from FTX affect Genesis and other centralized intermediaries in digital commodity markets. However, we have seen bluechip decentralized finance (DeFi) services perform exceptionally well during recent events. Why do you believe that is the case? Is the CFTC seeing any contagion affect DeFi?

Many crypto platforms that have been at the center of attention in the past year operate in a manner akin to traditionally regulated financial institutions and present familiar risks that are not specific to digital assets. In contrast, discussions about DeFi platforms gets right to the heart of the underlying technology in the digital asset market and the unique potential benefits and risks that the technology presents to markets. I will note that DeFi platforms have also proven to have significant risks, including most notably, the loss of billions of dollars in funds through hacks and exploits of the novel technology infrastructure. These risks demand the attention of policymakers and regulators just as much as those presented by some of the platforms that have failed in the past year.

7. It's reported that \$10 Billion in Customer Funds were transferred by FTX to its trading affiliate Alameda. FTX engaged in thousands of Off Chain Transactions a day – that is digital asset transactions not recorded on the blockchain - for Customers. Did the Off-Chain Transactions make it easier for FTX to the transfer Customer Funds to Alameda because the transfer was not recorded on the Blockchain?

I cannot discuss details that may be at issue in ongoing enforcement actions.

8. What can policymakers do to better ensure consumer funds are safeguarded and, in the event of bankruptcy, protected?

The most important step that policymakers can do to protect customer funds in the digital asset market is to pass legislation to impose a market regulatory regime over those assets that do not constitute securities. Bringing exchanges and other intermediaries within the regulatory boundary will allow regulators like the CFTC to impose rules designed to comprehensively protect customer funds and supervise those entities for compliance with those rules. Of particular note, in regulated markets like the derivatives market overseen by the CFTC, customer funds receive statutory priority in the event of a bankruptcy. My call for legislation to fill the regulatory gap over digital asset markets is to ensure those types of rules are in place as they have proven to best way to protect customer funds in similar markets.

9. What was the state of funds held by FTX US, and were these funds properly segregated as required by regulation? If so, why has FTX US been included in the bankruptcy filing?

I cannot discuss details that may be at issue in ongoing enforcement actions. However, I note that LedgerX, which is a US subsidiary of FTX that is regulated by the CFTC, did not go into bankruptcy and continues to operate, as discussed further below.

10. What specific steps did the CFTC take to effectively monitor LedgerX and how did those measures protect customer dollars? Can the supervision model for LedgerX (e.g. liquidity buffers, account segregation, exams) be one for future regulation of the industry more broadly?

LedgerX has been subject to the same regulations and CFTC oversight as all similarly registered entities. As a result, LedgerX has been required to segregate customer funds, maintain adequate financial resources, submit regular reports to the CFTC, and comply with the wide variety of other regulations imposed by the CFTC and designed in part to protect customers in the derivatives market. As I testified, in the wake of FTX's bankruptcy, CFTC staff were in daily contact with LedgerX as well as its custodians to confirm customer funds were safe. This model of comprehensive regulation combined with proactive supervision by the CFTC would be an incredibly helpful model for the regulation of the digital asset spot market.

11. Do you believe that trading activity, like that facilitated by cryptocurrency exchanges, should be separated from other activities, such as digital asset custody? If so, should Congress and the CFTC explicitly bar exchanges by law and through regulation from performing activities beyond trading?

As I have testified, and as FTX has shown, there are significant conflicts of interest when a trading platform also acts as a custodian. We believe these conflicts of interest should be subject to controls and restrictions but we do not have specific recommendations at this time as to the best form and structure for these rules. We would be happy to provide technical assistance on Congressional proposals on this issue.

12. Should exchanges be barred from issuing their own proprietary tokens or, if not barred, subject to additional regulatory requirements before such listings would be permitted?

By imposing a statutory framework for CFTC oversight of digital commodity platforms, as contemplated by the DCCPA, the CFTC would be in a position to write rules governing the conduct of exchanges on such issues as conflicts of interest, financial resources, and product listing. In that event, the CFTC would be able to review the practice of issuing and listing proprietary tokens and determine whether such conduct would comport with the core principles in the statute. It is fair to say that based on existing regulations for similarly situated entities in

the derivatives market, there may well need to be restrictions on issuing and listing proprietary tokens.

13. In your estimation, what role did a lack of regulatory clarity in the U.S. play in driving companies off-shore and out of the reach of U.S. regulators? How would U.S. regulation and oversight have helped prevent or mitigate the harm FTX inflicted on Americans and other consumers?

I can't comment on the motivation of digital asset companies in choosing where to locate. We have been clear about our rules, which require registration of derivatives trading platforms and prohibit fraud and manipulation in commodities markets. As I have testified, I believe that appropriate regulation of spot markets would have mitigated the harms caused by recent crypto failures by imposing rules on segregation of customer funds, conflicts of interest, minimum financial resources, and other areas. I note that LedgerX, which is a CFTC-regulated entity in the FTX family, did not go into bankruptcy and continues to meet its obligations to customers.

14. Was the CFTC at any point aware that U.S. users were skirting domain restrictions to access derivative products and services on FTX Global?

I cannot discuss details that may be at issue in ongoing enforcement actions.

15. There are risks to national security that come with offshoring financial infrastructure, including sanctions evasion or poor money AML/CFT controls. What additional areas should U.S. regulators be concerned about and how does offshoring impact America's national security?

The CFTC is vigilant in enforcing its requirements on offshore firms with US clients. US activities of offshore firms within our jurisdiction are subject to the CFTC's customer protections, registration requirements and the other regulations applicable to domestic firms. We have brought multiple enforcement actions against non-US firms that fail to comply. Such enforcement helps protect the US against national security risks from offshore firms.

16. Do you believe Congress should impose restrictions and limitations on CFTC registered digital assets trading platforms engaging in transactions with affiliates similar to the restrictions and limitations on banks transactions with their corporate affiliates under the Bank Holding Company Act?

As I suggested in my testimony, I think any legislation that gives the CFTC authority to regulate digital commodity platforms should also contemplate the need for authority to review the impact affiliate relationships may have. Prudential regulation of bank holding companies is different in form and purpose than market regulation implemented by the CFTC, so I cannot say whether something akin to that model is necessary, but I look forward to continuing to provide technical assistance as Congress shapes these provisions.

17. Why shouldn't digital asset trading platforms, which permit retail investors to trade spot digital asset commodities be required to register with the CFTC as designated contract markets (DCMs)? In the US futures market today retail investors are only permitted to trade futures and options on CFTC registered DCMs like CME and ICE?

The CFTC does not currently have authority to require registration of spot trading platforms, even if the platforms permit retail investors to trade. FSOC has identified this as a gap in the US regulatory regime and recommends closing the gap, and I have endorsed this recommendation in my testimony.

18. Under Sec. 2(c)(1) of the CEA (the Treasury Amendment) fiat currencies such as the US Dollar are specifically identified and the CFTC's authority over them is described. The CFTC has clear statutory authority over futures, options and swaps involving fiat currencies. Further, the CFTC settled in 2021 an enforcement case against Tether for \$40 Million related to false and misleading statements regarding the collateralization of USD Tether tokens which the CFTC were "commodities" under the CEA. Is it your view that all fiat based stablecoins similar to USD Tether are "commodities" under the CEA?

I cannot speak to all fiat backed stablecoins in circulation but, as discussed above, many fungible digital assets, including stablecoins, will meet the existing definition of a commodity under the CEA regardless of whether they may also fit within other definitions of regulated financial products.

19. Regarding Digital Asset Classification, Sen. Hoeven suggested it would be appropriate to provide more statutory guidance and legal certainty with respect to the classification of various digital assets. Legislation has been introduced – HR 4741, the Digital Market Structure Improvement and Investor Protection Act - which would mandate a joint SEC-CFTC public rulemaking on the top 25 digital assets by market cap and average daily trading volume which would identify the legal classification of each digital asset involved. Do you have objections to Congress adding this provision to the DCCPA? If so, specifically explain those objections.

The critical issue for classification is whether or not digital assets are securities, as described in our response to Question 4, above. We do not have any specific recommendations on how this determination should be made. However, we look forward to providing technical assistance on proposals made by Congress and implementing any provisions Congress chooses, including one such as a joint agency public rulemaking.

Senator Ben Ray Lujan

1. We must act swiftly to fix an industry that has gone too long without consumer safeguards and guardrails. Without quick and decisive action, we will find consumers once again taking the fall for systematic failures like the FTX collapse.

a. What would your first actions be with the authorities granted in the Digital Commodities Consumer Protection Act?

Our first actions would be to develop agency rules to establish consumer safeguards and guardrails, and other protections for investors and financial markets. The CFTC has taken similar decisive action in the recent past for swap markets, following the adoption of Dodd-Frank in 2010. I am confident that we could do so again.

2. **Recent surveys suggest that Hispanics and other communities of color are using digital assets at a higher rate than the general population. However, communities of color seem to have little input on these assets' creation and management. For example, according to a New York Times report in 2020, only 3% of Coinbase's 600-strong workforce at the time was Black, and yet these few workers were pushed out by a hostile and discriminatory work environment. As a result, digital asset platforms may not be prioritizing the needs of all communities.**

a. What should the digital asset industry do to increase diversity and inclusion amongst its employees and upper management? Is there a role for a regulator like the CFTC to play here?

As Chairman, in January of 2022, I appointed the CFTC's first ever Chief Diversity Officer (CDO) who is now leading the agency's Office of Minority, Women and Inclusion (OMWI). The CDO's role is to provide leadership to the Commission's efforts to integrate diversity into every aspect of our talent and business operations.

I am eager to see the CFTC's OMWI office statutorily authorized, similar to other financial regulators. Language providing statutory authority to CFTC's OMWI office has been included in recent larger reauthorization bills that received bipartisan support but have not been passed by Congress. With that authority, we would be able to further engage with registered entities on practices that would encourage and promote the fair inclusion and utilization of minorities, women, and minority-owned and women-owned businesses in all business and activity.

Senator Reverend Raphael Warnock

1. **Some digital assets industry stakeholders have suggested that the digital asset industry has the potential to support the financial inclusion of historically excluded or underserved populations. If the CFTC were to gain oversight over a portion of the digital asset market, what would you do to ensure that these historically excluded or underserved populations have safe and responsible access to this market?**

The DCCPA requires us to conduct a study on digital assets and historically under-served populations. We would use our experience and the conclusions of that study to develop tools for safe, inclusive access to digital markets.

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It is a priority of the agency to see the CFTC's OMWI office statutorily authorized, similar to other financial regulators. Language providing statutory authority to CFTC's OMWI office has been included in recent larger reauthorization bills that received bipartisan support but have not been passed by Congress. With that authority, we would be able to further engage with registered entities on practices that would encourage and promote the fair inclusion and utilization of minorities, women, and minority-owned and women-owned businesses in all business and activity.

2. **If the CFTC would gain greater authority over digital assets, how would you work to educate the general population about the increased oversight, and how would the CFTC make clear the separation between the portion of the digital asset industry that the CFTC has oversight over versus the portion that it does not? Would the CFTC commit to conducting regular studies of the investor population to ensure that these differences are transparent and well understood and would the CFTC commit to making these studies available to Congress?**

The CFTC's Office of Consumer Education and Outreach is statutorily authorized to educate and inform customers in our markets about risks related to fraud and manipulation. OCEO has issued numerous customer advisories and related materials specifically about the digital asset market (see <https://www.cftc.gov/digitalassets/index.htm>).

If given greater authority, I commit to ensuring that OCEO, in conjunction with the CFTC's operating divisions, closely reviews the digital commodity market and the relevant investor population, and proactively engages with customers to assess investor risks in those markets, provide information about the CFTC's customer protection regime and continues to publish customer advisories regarding market risks. I will report back to Congress on all activity as appropriate.

Senator Roger Marshall, M.D.

- 1. Under the current provisions of the Commodity Exchange Act and CFTC regulations, any bank or trust company in the U.S. is a good location for customer money, securities and property. S. 4760 restricts it to insured depository institutions, insured credit unions, and any digital commodity platform. Would you support the expansion of good locations to include any bank or trust company? If not, why not?**

As FTX has shown us, customer property rules are critical to protect the interests of customers of digital asset platforms. I believe that these rules should limit the types of eligible custodians so as to shield customer property from the possible insolvency of a trading platform. However, we do not have a recommendation as to which specific entities should be eligible to act as custodians. We would be happy to provide technical advice on Congressional proposals.

- 2. S. 4760 introduces the concept of a digital commodity custodian that has to be registered with the CFTC. What experience does the CFTC have in effectively supervising custodians?**

The CFTC currently regulates entities, such as futures commission merchants and derivatives clearing organizations, which act as intermediaries and clearing houses in the derivative markets. Under this robust regulatory regime, these CFTC regulated entities protect and hold customer funds used to support performance obligations in the derivative markets.

- 3. There have been a lot of questions about what is a security and what is a commodity, and about BTC and ETH specifically being included in the DCCPA. Assuming the position of the CFTC is that both are commodities, given the technical assistance you provided on the bill. Can you help us understand how you are thinking about additional assets as commodities?**

The CFTC has taken the view that many traded digital assets are commodities and will determine the status of other digital assets as commodities based on the statutory definition, court decisions and the specific characteristics of the assets. However, the critical issue for digital asset classification is whether a digital asset is a security or not. A digital asset could be both a security and a commodity. If so, the SEC would have primary regulatory jurisdiction. The CFTC has not taken a position on how to determine whether digital assets are securities.

- 4. Why exactly does the CFTC want to have jurisdiction over crypto?**

As Chairman of the CFTC, I believe it is my duty and responsibility to protect US investors from harm that may result from the trading of any commodity financial instrument. Watching this market develop over the past nearly fifteen years, I believe the CFTC cannot stand idle as this speculative, retail-oriented commodity market continues to present risks to American investors. I believe it is important to constantly monitor the landscape of market developments for potential

risks to the U.S. financial system, including new commodity assets that are widely adopted by both retail and institutional investors for speculative purposes. As recognized in last year's FSOC report, all the federal financial agencies agree that the gap in regulation over certain digital commodity markets presents significant risks and that the market should be brought within a federal regulatory regime. I think the CFTC is well positioned to fill that gap to protect customers and prevent the types of failures from the past year, which cannot be predictably contained within any boundaries across the domestic and global financial markets.

5. Because you handled the petition by FTX do you think people should have confidence in your ability to have jurisdiction over crypto?

Yes. I believe the American public should have confidence in the CFTC's ability to regulate digital commodity markets. Not only did the CFTC handle the FTX petition consistent with the CEA and relevant regulations, but such adherence to the law and transparency demonstrate precisely why our regulatory framework is the global standard.

The petition by FTX was a request by LedgerX to the CFTC to amend the CFTC order registering LedgerX as a DCO. Regulation 17 CFR 39.3(d)(3) states that the CFTC "shall issue" an amended order upon a determination that the DCO would maintain compliance with the CEA and regulations upon amendment of the order. Paragraph (4) says the CFTC "may decline to issue" an amended order upon a determination that the DCO would not maintain compliance. The regulations do not provide the CFTC with the discretion to ignore the LedgerX request. We conducted ourselves pursuant to the law.

In considering the LedgerX proposal, the CFTC sought public comment on LedgerX's request, including both on specific questions and policy issues raised by the use of a non-intermediated model to clear margined products for retail participants. CFTC staff also held a public roundtable on May 25, 2022, to discuss issues related to intermediation in derivatives trading and clearing, as the LedgerX proposal was not the first application for a non-intermediated model.

At the time of the FTX bankruptcy, CFTC staff had been in the process of reviewing the LedgerX proposal in light of applicable regulatory requirements. Among other things, staff had particular concerns regarding price distortive effects (relevant to Core Principle 4's requirement that the DCM shall have the capacity and responsibility to prevent manipulation and price distortion).

On November 11, 2022, LedgerX submitted to the CFTC's Division of Clearing and Risk a formal withdrawal of the LedgerX proposal. At the time of the withdrawal, the proposal had not been approved by the CFTC.

Senator Deb Fischer

1. You stated that under the Digital Commodities Consumer Protection Act, digital spot exchanges would be required to register with the CFTC, which would have to “go through a process to figure out which tokens are commodities, and which are securities.” Can you provide further information about the following?
 - a. If a digital spot exchange such as FTX, which prior to its demise had listed hundreds of different tokens, were to register with the CFTC, how quickly do you anticipate the process would take to complete determinations about whether those listed tokens are commodities or securities?

If the DCCPA were enacted, the CFTC would need to establish a process to determine whether a particular digital asset could be listed on a digital commodity platform. One of the criteria for a listing would be that the digital asset is a digital commodity and not a security. We do not have specific recommendations at this time for structuring the process. As a result, we do not know how long the process would take. We recognize that the classification of a digital asset as a security will be a critical issue for potential registrants under the DCCPA.

- b. **Would the results of this determination process become public? Would this be done through formal rulemaking, guidance, or other means?**

The digital commodities that are listed would be publicly identified. As stated above, we do not have recommendations on the specifics of the process.

- c. **Would determinations made with respect to tokens listed on a registered digital spot exchange and determined by the CFTC as commodities become binding on other spot exchanges?**

The DCCPA does not require other exchanges to recognize the classification of a digital asset as a digital commodity.