

Testimony of Rostin Behnam
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“Examining Digital Assets: Risks, Regulation, and Innovation”
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Good morning Chairwoman Stabenow, Ranking Member Boozman, and members of the Committee. I am honored to appear before you today for the first time as Chairman of the Commodity Futures Trading Commission (CFTC). I appreciate the opportunity to share my views on digital assets, and look forward to working with this Committee as we collectively address the many issues related to this emerging technology.

The CFTC’s Role as a Market Regulator

The CFTC is the primary regulator of the U.S. derivatives markets in which commodity futures, swaps and options are traded. For over a century, the derivatives markets have played an integral role in the U.S. economy, facilitating risk management and price discovery, and contributing to financial stability and predictability of prices that impact the daily lives of all Americans. Through the Commodity Exchange Act, Congress both mandates and empowers the CFTC to implement rules and regulations aimed at fostering open, transparent, competitive, and financially sound markets; to prevent and deter misconduct and disruptions to market integrity; and to protect all market participants from fraud, manipulation, and abusive practices.

Part of our role in ensuring the integrity of derivatives markets demands that the agency understand a great deal about underlying reference cash markets – where producers, including farmers and ranchers, manufacturers, and institutional investors directly exchange agriculture commodities, energy products, precious metals, and even digital assets. As history demonstrates, the potential for fraud or manipulation in these underlying markets often poses the most immediate threat to the integrity of derivatives markets.

While the CFTC does not have direct statutory authority to regulate cash markets, it does have fraud and manipulation enforcement authority. Accordingly, when the CFTC becomes aware of potential fraud or manipulation in an underlying market, either through regular oversight and surveillance programs, or through other means such as a whistleblower tip or referral, we address the misconduct through our enforcement authority.

The Commission’s exercise of its enforcement authority as applied to both the derivatives and underlying reference cash markets and resulting judicial interpretation has provided an effective means of protecting customers and market integrity for decades. It is a feature of the system created in our statute, providing legal certainty within jurisdictional markets that are constantly evolving against a regulatory system that may not always keep pace. And while the crystallization of our enforcement authority through judicial interpretation has proven an effective means of

uncovering and addressing some of the regulatory gaps presented by innovation and evolution in the financial markets with respect to digital and related assets, it cannot be viewed as a viable substitute for a functional regulatory oversight regime for the cash digital asset market.

This is not to diminish the fact that many cash commodity markets benefit from federal oversight. However, the digital asset market, which at present is most directly supervised through state money transmitter licenses, is unique and presents many novel issues for the CFTC, given our limited authority to police these volatile markets. In fact, there is no one regulator, either state or federal, with sufficient visibility into digital asset commodity trading activity to fully police conflicts of interest and deceptive trading practices impacting retail customers.

The Digital Asset Market

There are now hundreds of thousands of unique digital assets in circulation with a combined market capitalization of approximately \$2 trillion. At the center of this burgeoning industry are the trading platforms where most investors access this market. Several of these platforms operate on a global scale and host marketplaces for trading both in the underlying digital assets, as well as derivative contracts referencing those assets. According to public data, every month in 2021 except one saw over \$1 trillion in monthly trading volume in the digital asset cash market, with a high of \$2.23 trillion in trading volume in May 2021.¹ And the derivatives market is even larger, with notional exchange volumes in just bitcoin futures surpassing those numbers.²

Although the CFTC's core responsibility is regulating the commodity derivatives market, there are several unique elements of the digital asset commodity cash market that distinguish it from other cash commodity markets, suggesting it would benefit greatly from CFTC oversight. For example:

- Unlike most cash commodity markets, which are dominated by wholesalers and large financial institutions facilitating the transfer of commodities for commercial use and consumption, the cash market for digital assets is currently characterized by a high number of retail investors mostly engaged in price speculation.
- The speculative fervor around digital assets, frequently feeling like a modern gold rush, has led many investors to regularly take on high levels of leverage when trading, leading to heightened price volatility, often exacerbated by cascading liquidations during price downturns.
- Most investors in the cash market entrust their digital assets to the platforms upon which they trade, failing to differentiate this type of custody arrangement from that offered by the traditional regulated banking industry. The technical complexities around securing and

¹ Cryptocurrency Exchange Volume, The Block (<https://www.theblockcrypto.com/data/crypto-markets/spot/cryptocurrency-exchange-volume-monthly>).

² Volume of Bitcoin Futures, The Block (<https://www.theblockcrypto.com/data/crypto-markets/futures/volume-of-bitcoin-futures-monthly>)

transacting in digital assets, particularly issues around custody, have resulted in numerous platforms losing funds to hacks, exploits, and poor cyber security.

I believe these unique characteristics, combined with the growing size and customer, operational, and potential future financial stability risks associated with the cash market necessitate a proactive federal regulatory approach to ensure that the standards that American investors have come to expect from our financial markets are equally present in digital markets.

I also believe that in order to reach the lofty goals that many of the technology's most ardent proponents advocate, it is important that we find ways to sensibly bring this emerging market within the regulatory fold. If in fact the future global economy holds a place for digital assets, tokenization, blockchain technology, decentralized finance, and other elements of the FinTech driven ecosystem, then the need to uphold American leadership and stewardship of this technology is clear. Critical issues, such as national security, trade, and effectively addressing climate change risks, to name a few, will also be at stake.

The CFTC's role in the Digital Asset Commodity Market

The digital asset industry in the U.S. does not fall under a single comprehensive regulatory regime. Instead, the CFTC and other federal agencies and state regulators have all been responsible for collectively establishing the existing, and very incomplete, regulatory environment. And while our oversight capabilities are generally complimentary, market regulation and financial supervision often rely on the development of cooperative arrangements. This is made more difficult by the rapid emergence and development of the digital asset market which, by design, has largely taken place on the outskirts of the traditional financial market structures. While it cannot be said that the industry is completely unregulated, there are important principles missing from this framework that we see in other federally regulated markets, particularly ones that primarily cater to retail investors.

Since 2014, the CFTC has been aggressive in using its limited fraud and manipulation authority in the digital asset space. The CFTC has brought nearly 50 enforcement actions, overseen an increasing number of registrants offering digital asset based derivative products, and established dedicated internal functions to stay abreast of the technical innovations fueling this market.

However, many challenges remain, and the digital sector now demands more and more of the CFTC's attention and time, which I believe necessitates additional resources to adequately address these issues. We are past the stage where digital assets and decentralized financial technologies are a research project, sandboxing what may come in the future. The issues are at the front and center of our thinking at the Commission in addition to our traditional regulatory, oversight, and enforcement responsibilities.

The CFTC is well situated to play an increasingly central role in overseeing the cash digital asset commodity market. Fundamentally, the CFTC is a market regulator that ensures market integrity

and vibrancy aimed at supporting financial stability, while ensuring individual customer protections through principles-based oversight of exchanges, clearinghouses, data repositories, and market participants. This flexible approach has allowed the CFTC, with authority from Congress, to evolve along with the derivatives markets from their historical roots in overseeing agricultural markets to now overseeing markets in everything from energy and precious metals to financial indices and swaps. And we now stand ready to do the same within the digital asset commodity market.

The Road to Come

As Chairman, I will ensure that the CFTC continues to use our existing enforcement authority to its fullest extent in the digital asset commodity space to protect customers from fraud and manipulation. However, it is important to recognize that the challenges in this space going forward are likely to extend beyond the confines of the Commodity Exchange Act.

The nature of this innovation results in impacts to more than just financial markets. We are seeing several government agencies consider how this technology impacts federal policy related to payments, custody, illicit activity, national security and a host of other issues. Additionally, reports regarding energy usage resulting from mining are staggering, often times being compared to that of entire countries. On this note, I believe any regulatory response to digital assets must include measures to bring additional transparency to the conduct that makes this innovation possible. Internally, I have directed the CFTC's Climate Risk Unit and LabCFTC to examine the climate implications of digital assets. Staff have also begun initial communications with other federal agencies to ensure the knowledge and expertise of the whole federal complex is brought to bear on this challenge.

I wrote in 2019 that “where the technology could become a common and social good rather than a significant threat to financial stability, the regulatory patchwork is our greatest hurdle to mainstreaming integration and adoption.”³ As a result, I expect there will be an increasing need to ensure a coordinated federal approach in this area, and I plan to have the CFTC be a proactive participant in this process, whether building on the strong relationship the CFTC shares with the Securities and Exchange Commission, or contributing to broader efforts like the recent President's Working Group report on stablecoins.

I believe many of the CFTC's regulatory principles that have made the U.S. derivatives markets the strongest in the world can also serve to aggressively address many of the risks of digital assets. Since its inception, the CFTC and its markets have been at the forefront of innovation and technological development. We have also been a forceful and disciplined cop on the beat. The

³ Push Us Past Inertia—How the White House Can Help Mainstream FinTech (<https://news.bloomberglaw.com/us-law-week/insight-push-us-past-inertia-how-the-white-house-can-help-mainstream-fintech>).

continued emergence of digital asset technology presents risks and opportunities, and the CFTC stands ready to leverage its expertise and experience to confront both.

Thank you for your time and I look forward to answering your questions.