

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

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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](#).

⁶ See 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](#).

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