

Commodity Futures Trading Commission Chair Rostin Behnam makes the case for a proactive federal regulatory approach in the digital asset commodity market

In a hearing before the U.S. Senate Committee on Agriculture, Nutrition and Forestry (the Committee) on February 9, 2022, U.S. Commodity Futures Trading Commission (CFTC) Chair Rostin Behnam recommended a proactive federal regulatory approach to digital assets, requesting that Congress legislate to (1) address the regulatory patchwork currently impeding the development of the digital asset commodity market and (2) provide the CFTC with additional authority and resources to oversee this market.

The Committee also invited a panel of experts and industry professionals to share their know-how on the digital asset market and their views on the current state of the applicable regulation, comprising: Perianne Boring (Founder and Chief Executive Officer, Chamber of Digital Commerce), Samuel Bankman-Fried (Founder and Chief Executive Officer, FTX), Sandra Ro (Chief Executive Officer, Global Blockchain Business Council) and Kevin Werbach (Professor, the Wharton School, University of Pennsylvania). The experts broadly echoed Chairman Behnam's analysis of the current regulatory environment as fragmented¹ and some advocated for an expanded role for the CFTC as the digital asset supervisor.²

Digital assets at a glance

At a high level, a digital asset is something of value that is intrinsically in digital form,³ often on a digital record or ledger known as a blockchain. Some digital assets are cryptocurrencies that can be deployed in a way that is similar to fiat, or traditional, cash or currency. More generally, however, as in the case of traditional financial instruments, digital assets can have a number of other applications, such as being: (1) traded by investors; (2) leveraged as collateral; or (3) used for other purposes in decentralized finance.⁴

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¹ See [here](#): Prepared Remarks of Perianne Boring, Founder and Chief Executive Officer, Chamber of Digital Commerce, Before the U.S. Senate Committee on Agriculture, Nutrition and Forestry: Examining Digital Assets: Risks, Regulation, and Innovation (February 9, 2022), ("**P. Boring Prepared Remarks**") at 11.

² See [here](#): Prepared Remarks of Samuel Bankman-Fried, Founder and Chief Executive Officer of FTX, Before the U.S. Senate Committee on Agriculture, Nutrition and Forestry: "Examining Digital Assets: Risks, Regulation, and Innovation" (February 9, 2022), ("**Bankman-Fried Prepared Remarks**") at 9.

³ Tokens, which are other kinds of assets represented by some form of electronic record (including on a distributed ledger), including tokenized securities or central bank money or liabilities, would be treated for regulatory purposes as appropriate to the underlying asset (with perhaps some account of any operational risk associated with the form).

⁴ See [here](#): Prepared Remarks of Kevin Werbach, Professor, the Wharton School, University of Pennsylvania, Before the U.S. Senate Committee on Agriculture, Nutrition and Forestry: "Examining Digital Assets: Risks, Regulation, and Innovation" (February 9, 2022), at 3.

The current regulatory environment

The Committee recognized that there are hundreds of thousands of unique digital assets currently in circulation with an estimated combined market capitalization of over USD2 trillion. While acknowledging the many benefits such digital assets may bring to market participants, Committee Chairwoman Debbie Stabenow, Ranking Member John Boozman and Members of the Committee noted the potential risks of the digital asset market and its undeveloped regulatory system—such as volatility, fraud, national security concerns and climate implications.

Chairman Behnam described the current regulatory environment as a patchwork, with digital assets being most directly supervised through state money transmitter licenses at present.⁵ The CFTC is responsible for regulating the U.S. derivatives market and does not have direct statutory authority to regulate cash markets. This means that the CFTC is able to regulate and oversee derivative

products that reference digital assets, though not the digital asset markets themselves. The CFTC does have fraud and manipulation enforcement authority in respect of underlying reference cash markets (including digital asset markets). Chairman Behnam noted that this enforcement authority gives the CFTC only a narrow lens with which to police the underlying digital asset market.⁶ To illustrate this point, Chairman Behnam noted that of the approximately 50 enforcement actions brought by the CFTC in the digital asset space since 2014, nearly all relied on tips from retail investors and whistleblowers as opposed to resulting from regular CFTC oversight or surveillance programs.⁷ According to Chairman Behnam, no one regulator has sufficient visibility into digital asset commodity trading activity to fully police conflicts of interest and deceptive trading practices impacting retail customers.⁸

Risk factors in the digital asset market

Chairman Behnam outlined a number of risks factors in the digital asset market that, in his view, strengthened the case for CFTC oversight:

A high number of retail investors:⁹ Chairman Behnam differentiated the digital asset market with the majority of other cash commodity markets. While most cash commodity markets are dominated by institutional and other sophisticated investors facilitating the transfer of commodities for commercial use, the digital asset market is characterized by a high number of retail investors engaged in price speculation.

Speculative fervor:¹⁰ Many digital asset investors regularly take on high levels of leverage when trading, resulting in heightened price volatility.

Digital asset platforms:¹¹ Most digital asset investors entrust their digital assets to the platforms upon which they trade. Chairman Behnam asserted that this presents a failure to differentiate this type of custody arrangement from that offered by the traditional regulated banking industry.¹² The technical challenges posed by securing digital assets have resulted in some platforms losing funds due to hacks and cybersecurity failures.

Climate implications: Chairman Behnam echoed the concerns of many Committee members in describing the reports of energy usage resulting from some digital asset mining as staggering.¹³ He noted that any regulatory response to digital assets must include measures to bring additional transparency to this area.

National security and trade:¹⁴ A number of Committee Members and Chairman Behnam emphasized the potential use of digital assets by foreign adversaries in actions that may detrimentally impact the United States. Chairman Behnam stressed that the need to uphold American leadership and stewardship of this technology is critical to prevent and deter fraud, manipulation and abusive practices from both state and non-state actors.

⁵ See [here](#): Prepared Remarks of Rostin Behnam, CFTC Chair, Before the U.S. Senate Committee on Agriculture, Nutrition and Forestry: “Examining Digital Assets: Risks, Regulation, and Innovation” (February 9, 2022), (“**Behnam Prepared Remarks**”) at 2.

⁶ See [here](#): Remarks of Rostin Behnam, CFTC Chair, Before the U.S. Senate Committee on Agriculture, Nutrition and Forestry: “Examining Digital Assets: Risks, Regulation, and Innovation” (February 9, 2022), (“**Behnam Testimony**”).

⁷ *Id.*

⁸ See Behnam Prepared Remarks at 2.

^{9, 10, 11, 12} *Id.*

¹³ *Id.* at 3.

¹⁴ *Id.*



CFTC recommendations

To address the risks arising from the growth of the digital asset market, Chairman Behnam emphasized that Congressional action is needed to develop a federal regulatory framework that governs the digital asset market on a consistent and comprehensive basis. Chairman Behnam outlined the key pillars of the proposed regulatory regime to ensure a well-functioning, transparent market for digital assets:¹⁵

- Embedding pre-trade and post-trade transparency measures;
- Ensuring a centralized order book to see bids and offers in one place;
- Developing clear rules for execution; custody; clearing and settlement; and
- Incorporating disclosure mechanisms to inform market participants of any climate implications.

While acknowledging that the digital asset market presents novel issues for the CFTC (in particular, the new challenges that custody and settlement of digital assets present), Chairman Behnam observed that a number of the CFTC proposals mirror the regulatory structure already in place for derivative products.¹⁶ Chairman Behnam asserted that

these recommendations are designed to (1) foster an open, transparent and competitive market; (2) prevent and deter misconduct and disruptions to market integrity; and (3) protect market participants from abusive practices, each in turn bolstering consumer confidence to participate in these markets.¹⁷

Chairman Behnam informed the Committee that the CFTC would require additional resources if Congress were to approve the CFTC's proposal for expanded authority, estimating in the region of USD100 million in additional funds.¹⁸

Additionally, Chairman Behnam and a number of the industry participants¹⁹ flagged to the Committee the challenge caused by the lack of clarity as to whether a digital asset is a "commodity" or "security" under the Commodity Exchange Act (CEA) as it applies to some digital assets for market participants in determining which regulatory regimes apply to certain assets. In particular, Bankman-Fried recommended a number of reforms to more clearly establish the CFTC's jurisdiction over non-security digital asset commodity markets.²⁰ These reforms would go beyond the CFTC proposals put forward by Chairman Behnam to the Committee.

The CFTC as the appropriate federal agency to oversee the digital asset market

While acknowledging there must necessarily be a degree of interagency cooperation in regulating digital assets, Chairman Behnam set out the reasons why, in his view, the CFTC would be best placed to oversee the digital assets commodity market:

- **Experience:** As a market regulator of derivative assets, the CFTC has been uniquely exposed to the digital asset market since 2014, in large part due to the emergence of regulated futures products that reference digital assets over which the CFTC has jurisdiction;²¹
- **Expertise:** The exposure to digital asset markets has enabled the CFTC to develop surveillance and enforcement methods and strategies for digital assets.²² Chairman Behnam pointed to the creation of LabCFTC, a dedicated CFTC function to engage with new financial technologies,²³ and

- **Market trends:** As noted by Committee Member Marshall, incumbent digital asset companies and exchanges have already started to purchase traditional CFTC-licensed entities.²⁴

In their testimonies to the Committee, a number of experts and industry professionals also promoted the CFTC as the appropriate agency to supervise the digital asset market, due to its considerable experience and expertise in the sector.²⁵

¹⁵ See Behnam Testimony.

^{16, 17, 18} *Id.*

¹⁹ See Bankman-Fried Prepared Remarks at 8.

²⁰ *Id.* at 10 to 11 (inclusive).

²¹ See Behnam Testimony.

²² *Id.*

²³ See CFTC website, [LabCFTC](#).

²⁴ See Behnam Testimony.

²⁵ See P. Boring Prepared Remarks; and Bankman-Fried Prepared Remarks.

Certain Committee Members raised the prospect of state regulation as an appropriate means by which to oversee the digital asset market. Chairman Behnam emphasized that while state regulators have a role to play in consumer education, consumer protection and enforcement, federal regulatory oversight is necessary given the international scope of the digital asset market to ensure a level playing field for market participants.²⁶

In response to queries from several Committee Members, Chairman Behnam noted that he expected that the CFTC and the Securities Exchange Commission (SEC) would be able to share jurisdiction over the digital asset market in a broadly similar manner to the way the agencies have overseen the swaps market since the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).²⁷ Dodd-Frank broadly gave (1) the CFTC primary regulatory authority over swaps and (2) the SEC the authority to

regulate “security-based swaps”: swaps based on (a) a single security; (b) a loan; (c) a narrow-based group or index of securities; or (d) events relating to a single issuer or issuers of securities in a narrow-based security index. Applying this structure to digital assets, Chairman Behnam proposed that the CFTC may have primary jurisdiction over the digital asset spot market and the SEC may have jurisdiction over any “security-based” digital asset. Chairman Behnam emphasized that a noticeable gap would remain if the regulatory structure for swaps was simply replicated for the digital asset market.²⁸ As such, as noted above, Chairman Behnam and certain industry professionals flagged that a key component of any new regulatory regime would be reforms aimed at clearly delineating between (1) digital assets that are “securities” and (2) digital assets that are “commodities” under the CEA.

Coming developments

Chairman Behnam notified the Committee that he had tasked the CFTC’s Climate Risk Unit and LabCFTC with examining the climate implications of digital assets and noted he expects the CFTC to produce policy directives following the conclusion of this analysis in the near future.²⁹

Chairman Behnam also confirmed that the CFTC, along with a number of other federal agencies, have been cooperating with the White House in the development of an Executive Order regarding digital assets.³⁰ Chairman Behnam was unable to provide a timeframe on the issuance of such order.

Conclusion

Chairman Behnam’s testimony represents an important step by the U.S. federal regulators in making clear their position that digital asset commodity markets should be subject to comprehensive federal regulation. Committee members appeared receptive to the testimony of Chairman Behnam as well as the industry experts and professionals. However, Congressional action on digital asset regulation appears to remain a distant prospect. It also remains to be seen if and how the Executive Order in development by the White House will impact these efforts.

²⁶ See Behnam Testimony.

^{27, 28, 29, 30} *Id.*

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