U.S. COMMODITY FUTURES TRADING COMMISSION
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February 8, 2022

The Honorable Debbie Stabenow
Chair
U.S. Senate Committee on Agriculture,
Nutrition, and Forestry
328 Russell Senate Office Building
Washington, D.C. 20510

The Honorable John Boozman
Ranking Member
U.S Senate Committee on Agriculture,
Nutrition, and Forestry
328 Russell Senate Office Building
Washington, D.C. 20510

The Honorable David Scott
Chairman
House Committee on Agriculture
1300 Longworth House Office Building
Washington, D.C. 20515

The Honorable Glenn Thompson
Ranking Member
House Committee on Agriculture
1300 Longworth House Office Building
Washington, D.C. 20515

Dear Chairwoman Stabenow, Ranking Member Boozman, Chairman Scott, and Ranking Member Thompson:

Thank you for your letter, dated January 12, 2022, which posed a number of questions regarding the scope and size of digital asset markets, the risks and potential benefits of these emerging technologies, and the potential role of the Commodity Futures Trading Commission (CFTC).[1] I appreciate the opportunity to share my observations, and look forward to working with each of you in the future.

1. **What is the current estimated size of the digital asset marketplace? How does this marketplace compare in size and participation to those markets directly regulated by the Commission?**

As an initial matter, it should be noted that the markets for digital assets largely developed outside of traditional market structures, acting as both use-case and catalyst for the burgeoning decentralized, distributed, and digital infrastructure. The range includes a wide variety of assets transacted in and across many different types of platforms from peer-to-peer to traditional boards of trade. Accordingly, while we can compare cash markets in one asset class to derivatives in

[1] Absent fraud or manipulation, the CFTC's regulatory regime does not directly apply to spot markets for commodities, including digital assets. Accordingly, the CFTC does not typically have direct access to nonpublic information regarding trade data or other relevant information for such markets. Similarly, while some futures and other derivatives contracts based on digital assets trade on CFTC-regulated exchanges, a large volume do not. As a result, I cannot verify the accuracy or sourcing methods of the data providers cited in this response.

another asset class, doing so may also highlight their differences. It is nevertheless a meaningful way to explore the differences and determine whether the preference for one over another is in response solely to market forces or rather a function of one being subject to extensive regulatory oversight.

Based on the best available information, the current total market capitalization of all digital assets categorized as "cryptocurrencies" in circulation is approximately $2 trillion.[2] At the center of this industry are trading platforms where participants directly exchange digital assets in what we generally refer to as "cash" or "spot" transactions. There are also trading platforms more akin to traditional boards of trade for derivative contracts referencing the underlying digital asset cash markets. The CFTC directly regulates certain registered platforms offering exchange-traded futures, options, and swaps to U.S. persons.

Among CFTC registrants, there are several exchanges that offer trading to U.S. market participants in futures contracts tied to the two largest digital assets by market capitalization, Bitcoin and Ether. In January 2022, the average daily open interest for these futures contracts was approximately $3 billion in notional value with an average daily trading volume of approximately $2.7 billion in notional value. As of February 4, 2022, there was also over $1 billion in over-the-counter derivatives referencing Bitcoin and Ether.

Among exchanges not registered with the CFTC, there is also a fairly sizeable global market for trading digital asset-based derivative contracts on exchanges purportedly operating outside of the CFTC's jurisdiction. According to industry estimates, in January 2022, the average daily open interest in Bitcoin and Ether-based derivatives on these exchanges was $22 billion in notional value, with average daily trading volume of $74 billion in notional value.[3]

The chart below reflects a comparison of the size of these markets to the daily open interest in CFTC-regulated markets for certain well-established futures contracts.

Underlying Commodity	**Open Interest (daily average – 2022 YTD)**	**Trading Volume (daily average – 2022 YTD)**
BTC and ETH CFTC registered exchanges	$3 billion	$2.7 billion
BTC and ETH Unregistered exchanges	$22 billion	$74 billion
Corn	$86 billion	$10.5 billion
Crude Oil	$507 billion	$90 billion
Gold	$220 billion	$50 billion
S&P 500	$2 trillion	$500 billion

Underlying the market for digital asset derivatives is a large spot or cash market for directly buying and selling thousands of different digital assets beyond just Bitcoin and Ether. According

[2] *See* CoinGecko, https://www.coingecko.com/ (accessed on Feb. 7, 2022).

[3] Calculations using data from The Block, https://www.theblockcrypto.com/data (accessed on Feb. 7, 2022).

to public data, in January 2022, the average daily trading volume in the global digital asset spot market was approximately $26.9 billion.[4]

2. **What proportion of the digital asset market do you estimate is currently traded by U.S. persons?**

   Please see response to question 3 below.

3. **Within the United States, what is the estimated scope of retail participation in digital asset markets? How does this compare to the level of retail participation in derivatives markets for other commodities?**

Due to limited visibility into the digital asset market, it is difficult to provide an accurate estimate of participation by U.S. persons in this market and what proportion may be categorized as retail. However, recent surveys identified that approximately 13% to 14% of Americans invested in digital assets as of 2021.[5] To provide some perspective, a separate analysis suggests that less than 1% of the global population has invested in digital assets.[6]

Several metrics demonstrate that retail investors are a significant portion of participants in the digital asset market. A recent study finds that a notable number of retail investors are diverting funds from stocks to digital assets,[7] and the largest digital asset exchange in the U.S. reported an increase from 2.1 million to 7.4 million monthly users in the year prior to Q3 2021.[8] Public data reflects that mobile applications providing retail access to digital asset trading platforms are some of the most downloaded applications,[9] and some of these same platforms are paying significant sums to advertise to retail participants.[10]

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[4] *Id.*

[5] *See* Laycock and Choi, "A rising number of Americans own crypto." Finder, https://www.finder.com/how-many-people-own-cryptocurrency (June 14, 2021); Iacurci, "13% of Americans traded crypto in the past year, survey finds." CNBC, https://www.cnbc.com/2021/07/23/13percent-of-americans-traded-crypto-in-the-past-year-survey-finds.html (July 23, 2021).

[6] *See* Hon, et al., "Crypto Market Sizing: Global Crypto Owners Reaching 300M." Crypto.com report (Jan. 2022) (estimating global digital asset owners at 295 million as of December 2021).

[7] *See* Reinicke, "Some investors are putting more money into cryptocurrencies than stocks." CNBC, https://www.cnbc.com/2021/10/20/some-investors-putting-more-money-into-cryptocurrencies-than-stocks.html (Oct. 20, 2021).

[8] *See* Coinbase, Q3 2021 Shareholder Letter, https://investor.coinbase.com/financials/quarterly-results/default.aspx (Nov. 9, 2021).

[9] *See* Zhou, "Cryptocurrency Accelerates on Mobile with PayPal Leading Download Rankings Across Global Regions." App Annie, https://www.appannie.com/en/insights/mobile-minute/cryptocurrency-accelerates-on-mobile-globally/ (Nov. 2, 2021).

[10] *See* Vigna and Vranica, "Bengals, Rams, and Bitcoin: Crypto Ads Invade the Super Bowl." The Wall Street Journal, https://www.wsj.com/articles/bengals-rams-and-bitcoin-crypto-ads-invade-the-super-bowl-11644159817 (Feb. 6, 2022).

By comparison, within the futures markets on CFTC-registered exchanges, trading activity by market participants above a certain threshold is reported to the CFTC. For analytical purposes, the CFTC categorizes reportable trading above that threshold "institutional trading," while non-reportable trading is generally indicative of retail participation. Recent CFTC studies find that non-reportable trading makes up approximately 25% of long open interest in the Bitcoin futures market, which is significantly higher than is generally observed in other futures markets, such as corn, soybean, wheat, WTI crude, gold, and S&P E-mini futures, where non-reportable long open interest ranges from 5% to 11%.[11] These studies suggest the amount of retail participation in the digital asset futures market is more than double that in other futures markets.

4. **In what ways are digital asset markets and intermediaries different than the existing markets and intermediaries under the CFTC's jurisdiction? In what ways are they similar? Are there principles for market regulation that can be applied to both?**

The most notable difference between the digital asset market and other commodity markets is the level of retail participation. Most commodity derivative markets, such as the agriculture and energy markets, are dominated by wholesalers, end-users and institutional investors engaging in hedging and other risk management transactions. However, the digital asset market is characterized by a high level of retail participants engaged in price speculation, often with high levels of leverage.

At first glance, participants in the digital asset market may seem to be interacting with exchanges and intermediaries structured like those seen in other financial markets. However, the lack of a comprehensive regulatory regime applicable to businesses operating in the digital asset market has led to inconsistent practices around issues such as trade settlement, conflicts of interest, data reporting, and cyber security.

Another distinguishing factor of the digital asset space is the direct impact that international markets, particularly those outside CFTC jurisdiction, have on the digital asset markets being accessed by U.S. participants, which promotes risk.

There are unique elements of the digital asset market that require special consideration, but as with any trading market, the digital asset market would benefit from uniform imposition of requirements focused on ensuring certain core principles, including market integrity, customer protection, and market stability. At the CFTC, we have seen that a regulatory regime focused on core principles can be successful in overseeing a wide variety of markets, and have no reason to think those same principles cannot be applied to digital asset markets.

[11] *See* Ferko, et al., "Who Trades Bitcoin Futures and Why?" CFTC, https://www.cftc.gov/sites/default/files/2021-11/WhoTradesBTC_V2_ada.pdf (Nov. 4, 2021); CFTC Commitments of Traders, *available at* https://www.cftc.gov/MarketReports/CommitmentsofTraders/index.htm.

5. **Discuss the types of misconduct the CFTC has observed in the digital asset marketplace and how, if at all, this differs from misconduct found in traditional financial markets.**

The CFTC has filed 49 enforcement actions involving digital assets since 2015. Those 49 actions include 23 matters filed in fiscal year 2021, and include defendant entities located in the United States and abroad. Notably, while the specific assets and methods at issue may differ, the types of misconduct closely resemble misconduct found in traditional financial markets. For example, the CFTC has investigated and filed actions involving: (i) fraudulent schemes, such as Ponzi and pump-and-dump price manipulations; (ii) wash and prearranged trading; and (iii) the offering of illegal off-exchange transactions to name a few.

The CFTC has enforcement authority over fraud and manipulation involving commodities in interstate commerce as well as derivatives. Using this authority, in the past four years, the CFTC has brought 23 cases involving some sort of fraud connected with digital assets. The majority of those actions involve fraudulent activity in the spot markets. Entities and individuals who solicit retail customers to trade digital assets may use online chat, gaming, and dating applications to connect with potential customers. Frequently, they also use websites to market and "offer" trading, often employing names that closely resemble CFTC registrants or other legitimate entities to cloak themselves in the indicia of reliability. Separately, digital assets, including bitcoin and other cryptocurrencies, are often used as a form of payment to fund fraudulent enterprises, including those involving more traditional financial products such as binary options, forex, and other commodities.

As alluded to above, a significant number of derivatives transactions involving digital assets occur on exchanges that are, or at least purport to be, located outside of the United States and are not directly supervised by the CFTC. Unlike CFTC-registered derivatives exchanges, these exchanges may be subject to limited regulation and do not have uniform compliance approaches. They often lack robust know-your-customer and anti-money laundering procedures as well as other necessary consumer protections, and they offer highly leveraged transactions. The CFTC has brought enforcement actions against such exchanges operating in the U.S., and/or engaging in transactions with U.S. customers, without being registered with the CFTC or following applicable regulations as required.

While the types of misconduct are similar, the fact that the CFTC does not have the authority to directly supervise and regulate the digital asset cash markets may be a contributing factor in the increasing frequency of fraud and similar misconduct in the digital asset market. Fraudsters tend to move toward areas where there is little regulation and limited transparency.

6. **How has LabCFTC been working with stakeholders in the digital asset and DeFi space to support innovation and development, while also ensuring customer protection and financial market integrity?**

Since its inception in 2017, LabCFTC has played an important role as a bridge between financial technology innovators and the CFTC. LabCFTC has served as the front door for innovators to come meet with staff to facilitate a dialogue in an effort to ensure innovators are focusing on important issues such as customer protection and market integrity. LabCFTC has also worked to accelerate the CFTC's research and consideration of novel approaches to accomplishing those same goal. However, the growth of the digital asset market has moved beyond the ability to address these issues in one-on-one conversations, and the technology has moved past the sandbox phase such that the CFTC is continuing to evolve to address these issues through new approaches.

7. **Discuss how the CFTC has collaborated with other federal financial regulators regarding digital assets.**

The CFTC works closely with several financial regulators regarding digital assets. Most notably, CFTC staff is in regular communication with staff of the Securities and Exchange Commission (SEC). The CFTC also participates in broader interagency initiatives, such as the President's Working Group on Financial Markets, which issued a report related to stablecoins in November 2021, as well as recent efforts led by the Biden administration in this area.

At an international level, the CFTC participates in multiple international bodies that address digital asset-related issues, such as the International Organization of Securities Commissions and the Financial Stability Board. Through LabCFTC, the CFTC has entered FinTech Cooperation Agreements with the UK's Financial Conduct Authority, the Monetary Authority of Singapore, the Australian Securities and Investments Commission, and the South African Reserve Bank.[12]

8. **Do you foresee any shortfalls in the Commission's authorities to protect customers and ensure market integrity as the digital asset marketplace grows in volume and scope?**

The cash market for trading digital assets is currently subject to an insufficient patchwork of regulations imposed mostly at the state level. Yet the market is global in reach with many well-capitalized international companies operating the largest trading platforms and attracting an increasingly large user base of retail customers.

In my opinion, there are important principles missing from the current regulatory framework applicable to digital asset markets that we see in other federally regulated markets, particularly ones that primarily cater to retail investors. A federal regulatory regime may ensure that certain safeguards are in place to address the risks to individual investors, market integrity, and systemic stability. Those safeguards could include pre-trade and post-trade transparency and uniform standards around settlement, data reporting, cyber security, and leverage.

Despite historically focusing on the derivatives market, the CFTC is prepared and well-suited to play an increasingly central role in overseeing the cash markets for digital assets. At its core, the CFTC is a markets-focused regulator that works to ensure market integrity and vibrancy through oversight of exchanges and clearinghouses that are required to comply with well-established core principles, as well as through oversight of market participants. This flexible approach has allowed the CFTC, with authority from Congress, to evolve from initially being

[12] CFTC, FinTech Cooperation Agreements, https://www.cftc.gov/LabCFTC/FinTechCoopArrangements/index.htm.

tasked with 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 with the digital asset market.

Again, thank you for your letter. Please do not hesitate to contact me or have a member of your staff contact Ann Wright, Acting Director of the Office of Legislative and Intergovernmental Affairs at (202) 441-0453 or awright@cftc.gov if we can be of further assistance.

Sincerely,

R. Behnam