



SENATE AGRICULTURE, NUTRITION, AND FORESTRY COMMITTEE

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

December 1, 2022 – 10:00 AM

OVERVIEW

On Thursday, December 1, the Senate Agriculture, Nutrition, and Forestry Committee held a hearing titled, “Why Congress Needs to Act: Lessons Learned from the FTX Collapse.” During the hearing, Senators and witnesses discussed: LedgerX; FTX; the Digital Commodities Consumer Protection Act (DCCPA); digital asset regulation; illicit finance; and financial stability.

OPENING STATEMENTS

- [Chairwoman Debbie Stabenow \(D-MI\)](#)
- [Ranking Member John Boozman \(R-AR\)](#)

WITNESS PANEL

- [The Honorable Rostin Behnam](#), Chairman, Commodity Futures Trading Commission

QUESTION AND ANSWER SUMMARY

LedgerX

Chairwoman Debbie Stabenow (D-MI) noted LedgerX, an affiliate of FTX, is registered with the Commodity Futures Trading Commission (CFTC). She then asked Chair Behnam why FTX collapsed, and if the CFTC has additional insight into the failure through its supervision of LedgerX. Chair Behnam stated because LedgerX is registered with the CFTC it is “healthy” and “solvent.” Additionally, he stated for the same reason the CFTC did not have insight into FTX through LedgerX, other FTX affiliates were “not able to pierce through LedgerX and take customer money.” He explained the FTX collapse appears to be attributable to a “classic liquidity crunch that forced a run on the institution.” He explained as concerns were raised about the financial health of FTX, customers and investors withdrew their funds, which FTX did not have enough liquidity to pay the withdrawals because it misappropriated customer funds.

Senator John Thune (R-SD) asked how LedgerX remained solvent after FTX’s collapse. Chair Behnam responded the CFTC’s regulatory regime shielded LedgerX from FTX’s failures. He noted LedgerX had a “forceful, strong, and transparent regime they had to comply with.”

Senator Dick Durbin (D-IL) asked Chair Behnam if LedgerX is the only digital commodity platform it regulates. Chair Behnam answered LedgerX is the only entity the CFTC has direct oversight of.

Senator John Hoeven (R-ND) asked Chair Behnam if the CFTC has authority to ensure LedgerX remains solvent and operational. Chair Behnam stated absent fraud, the CFTC can ensure LedgerX’s solvency. He noted 130 entities are experiencing bankruptcy due to their ties to FTX, but due to CFTC’s oversight, LedgerX is not experiencing bankruptcy.

FTX

Chairwoman Stabenow asked about the CFTC's interactions with FTX and former CEO, Sam Bankman-Fried, regarding its clearing house license request. Chair Behnam responded FTX was "dogged in its pursuit in getting an approval for the clearing house" license. He stated his team and him met with Bankman-Fried 10 times over the past 14 months at the CFTC office at the request of FTX. He claimed these meetings were all in relation to FTX's clearing house application. He asserted due to the importance and "strong feelings on both sides," he made the decision to be "as transparent as possible" with FTX's application process. He claimed the approval of the application had the potential to impact market structures, including the derivatives markets. He concluded FTX's application was submitted in December 2021 and withdrawn on November 11, 2022, adding the CFTC never made a determination on an approval or rejection.

Ranking Member John Boozman (R-AR) asked Chair Benham if FTX was a registered U.S. exchange, would CFTC regulations have prevented its collapse. Chair Benham responded "with our current authority, no." He continued if the CFTC had "more authority and FTX was registered, given what we know about the collapse, we would have been able to prohibit it." He asserted if the CFTC had a "daily lens into the location of customer money and property ... we could have prohibited the actions we are hearing about." Ranking Member Boozman asked if the FTX collapse exposed the need to "bring entities into the U.S. to enable regulatory oversight and create a framework regulating custodian exchanges and scrutinizing conflicts of interest related to common ownership." Chair Behnam answered in the affirmative. He explained one core aspect of CFTC's market oversight is ensuring an individual entity cannot offer different services to the same customer, in addition to prohibiting the comingling of house and customer money.

Senator Amy Klobuchar (D-MN) asked how centralization and vertical integration allowed FTX to "conceal operational fraud." Chair Behnam highlighted the importance of mitigating vertical integration, noting the Financial Stability Oversight Council (FSOC) has previously identified vertical integration as a potential risk. He explained vertical integration is a result of consolidating multiple parts of a trade execution which introduces "a lot of potential risk."

Senator Tommy Tuberville (R-AL) stated FTX was given "high marks for corporate governance" by an environmental, social, and governance (ESG) rating firm. He then asked how federal regulators can audit ESG ratings to ensure ratings are accurate. Chair Behnam responded if a security is receiving an ESG rating, it would be under the Securities and Exchange Commission's (SEC) jurisdiction. He agreed it is important to ensure rating agencies are issuing "truly objective ratings to give consumers and investors the information they need." Senator Tuberville asked if ensuring ESG rating accuracy should be included in cryptocurrency ("crypto") legislation. Chair Behnam responded to the extent crypto firms are receiving ESG ratings, "we should discuss further" because "this goes to the heart of disclosures and customer information."

Senator Chuck Grassley (R-IA) asked if FTX shared any "financial information" or organizational charts with the CFTC. Chair Behnam responded the CFTC "did not have legal authority to police, examine, or ask questions about an unregulated entity," such as FTX. He noted the "only circumstance" the CFTC could legally require information sharing is if a whistleblower provided the CFTC with a tip that allowed the agency to obtain a subpoena to investigate or examine a non-registered entity.

Digital Commodities Consumer Protection Act (DCCPA)

Chairwoman Stabenow asked if the Digital Commodities Consumer Protection Act (CCPA) would have prevented the FTX failure. Chair Behnam stated "a lot of issues" have arisen from the FTX failure, including "significant" conflicts of interest; allegations of comingling customer and house money; and lack of record keeping, corporate governance, and risk controls. He asserted "core elements" of the DCCPA "does address these issues and would have prohibited those actions from occurring at FTX."

Senator Grassley asked if there are aspects of the DCCPA that should be re-written due to lessons learned from the FTX collapse. Chair Behnam agreed lawmakers should "pause and look at the bill to ensure there are no gaps or holes." He stated the CFTC will share lessons learned from the FTX collapse and provide recommendations on where the bill may be strengthened. He highlighted the need to tighten and strengthen conflicts of interest prohibitions, in addition to ensuring adequate disclosures of financial information.

Senator Kirsten Gillibrand (D-NY) asked how the CFTC can address conflicts of interest within digital asset firms. Chair Behnam responded the DCCPA would be “effective in addressing these issues,” but reiterated support for “tightening” conflicts of interest provisions included in the legislation. He stated when the CFTC is “able to impose [conflict of interest] requirements on a regulated entity, it is workable and effective.”

Senator Deb Fischer (R-NE) asked if the DCCPA provides the CFTC or SEC regulatory authority over digital tokens, such as FTX’s FTT token. Chair Behnam responded FTT characteristics would most likely qualify it as a security and not a commodity. Senator Fischer asked if the CFTC would have spot market oversight under the DCCPA. Chair Behnam responded the DCCPA would give the CFTC authority to register spot exchanges. He explained the CFTC and SEC would have to “figure out which tokens are commodities and which are securities,” noting “there will likely be dual registration.” He concluded this lack of authority to register tokens creates a regulatory gap that “presents customer protection risk.”

Senator Fischer noted the DCCPA directs the CFTC to write rulemakings and guidelines to implement digital commodity regulations. She then asked Chair Behnam how quickly the CFTC could issue rulemakings if the DCCPA became law. Chair Behnam noted after the 2008 financial crisis, the CFTC implemented over 60 rules in the swaps market in three years. He stated the DCCPA would require single-digit rulemakings, which he asserted the CFTC “would do everything to get the rules done as soon as possible within a 12- to 18-month” timeline. Senator Fischer asked if the CFTC would benefit from additional guidance from Congress in the DCCPA. Chair Behnam responded it is important to balance “providing statutory authority and direction” without being “too prescriptive” and prohibiting the agency from evolving its rules as the marketplace changes. He concluded, as drafted, the DCCPA adeptly “balances direction with flexibility to evolve with changing technology.”

Senator Cory Booker (D-NJ) asked about FTX’s involvement in shaping the DCCPA. Chair Behnam responded the CFTC provided technical assistance and legal analysis to the Senate Agriculture Committee when lawmakers were crafting the DCCPA. He added the Committee was “inclusive in their exercise of taking folks in.” Senator Booker asked about the expansion of authority and resources included in the DCCPA to give the CFTC the ability to prevent another collapse like FTX. Chair Behnam explained the DCCPA would give the CFTC authority to register exchanges, surveil market activity, and prohibit misuse of customer funds.

Digital Asset Regulation

Senator Klobuchar asked Chair Behnam if the CFTC and SEC both have oversight jurisdiction of digital assets. Chair Behnam responded the CFTC’s and SEC’s digital asset oversight would be delineated by which digital asset tokens are securities or commodities. He concluded “nothing has to change for what we do now with what we should do for digital asset markets.” Senator Klobuchar then asked what regulations should apply to digital commodity brokers. Chair Behnam responded Regulation Best Interest (Reg BI) and “similar rules are needed to ensure investors understand the risk of the [digital] asset.” He highlighted the importance of high-quality investor disclosure before investors choose to invest in a digital asset or commodity.

Senator Klobuchar noted digital asset firms have utilized social media platforms and celebrities to promote their digital tokens or trading platforms. She then asked how the CFTC could combat the nexus of digital commodity fraud and social media. Chair Behnam noted this advertising strategy is “not new or different” from how the CFTC historically has regulated the swaps and futures markets.

Senator Roger Marshall (R-KS) asked if there “should be a pause” on buying or trading digital assets until the technology is better understood and regulated. Chair Behnam stated the CFTC does not have the “luxury to sit back.” He asserted digital asset markets are “going to exist” and garner participation from institutional and retail investors. Senator Marshall asked if current legislative proposals would adequately regulate digital assets. Chair Behnam answered in the negative, but asserted current proposals would be “a significant step.” He reiterated support for the DCCPA, stating any digital asset regulation should be modeled off traditional financial regulations.

Senator Tina Smith (D-MN) asked if crypto exchanges are required to separate company money from customer money. Chair Behnam answered in the negative. Senator Smith asked if crypto firms have Reg BI requirements. Chair Behnam

answered in the negative. Senator Smith asked if crypto issuers have Know Your Customer (KYC) requirements. Chair Behnam responded KYC requirements may be implicated in state money transmitter licenses, but this is not as comprehensive as a federal KYC regulatory regime.

Senator Tuberville asked if regulators should encourage digital asset firms to register with either the CFTC or SEC. Chair Behnam explained the CFTC currently does not have regulatory authority to register cash market exchanges or any intermediary broker dealers. He noted this lack of regulatory authority was identified as a risk by FSOC. He argued if “we do not do something, customers will continue to lose money and we will be right back here in a couple months.”

Senator Sherrod Brown (D-OH) asked about regulatory safeguards to prevent conflicts of interest in digital asset firms. Chair Behnam responded “the idea an exchange can act as a dealer, lender, and custodian just does not work or exist in our traditional financial system.” Senator Brown asked if there are other conflicts of interest that should be addressed or prevented in the digital asset space. Chair Behnam stated “there may be other things worth looking into,” specifically conflicts of interest that “could never be allowed in traditional financial services.”

Senator Gillibrand asked if the CFTC could employ current enforcement authority to overseas exchanges with “significant business” in the U.S. Chair Behnam noted institutions do have offshore entities that “could bring risk back to the U.S.” He stated some domestic retail investors use VPNs to access offshore investing. He agreed protecting and prohibiting “U.S. customer from getting around” prohibitions is important.

Senator Ben Ray Lujan (D-NM) asked about necessary regulations for digital commodity platforms. Chair Behnam reiterated support for applying “core fundamentals of market structures” to digital assets. However, he noted there are “distinguishing factors” between traditional assets and digital tokens, including differences in custody and cybersecurity. He explained custody and cybersecurity considerations are “areas that would come from the rulemaking process” through the DCCPA. He again welcomed a “rethink of current DCCPA” provisions to strengthen cybersecurity and the “minimum requirements a custodian of digital assets should have to protect those assets.”

Senator Thune asked if the CFTC is considering changing its approach to oversight enforcement activity for other digital commodity platforms in the wake of the FTX collapse and absent a legislative framework. Chair Behnam noted CFTC’s limited authority to oversee unregistered digital commodity platforms. He explained the CFTC has a “limited lens into the cash market,” which is a “gap we are not able to fill right now.” He also highlighted a number of incumbent exchanges that list Bitcoin and Ether tokens.

Senator Thune asked if there are any international digital asset regulatory structures that could serve as a model for U.S. regulation. Chair Behnam claimed his top priority for digital asset regulation is customer protections and risk management. He acknowledged the argument that regulating digital assets gives validity to them, but “as a market regulator, we cannot regulate this out of existence or regulate outside the borders of the country.” He asserted he will “remain agnostic on the success or failure of the technology,” noting his “job is to protect customers ... and tell this Committee what is important to do so your constituents do not lose money” fraudulently.

Senator Hoeven asked how U.S. regulators define digital assets and delineate oversight authority among themselves. Chair Behnam explained differentiating between a digital security or commodity “goes to the heart of today’s traditional legal analysis of what is a security or commodity.” He stated the CFTC and SEC must work to collaborate and further define what characteristics are incumbent for defining a digital commodity versus security. He asserted the CFTC and SEC “will figure out a path forward to have reasonable, productive, and effective means to figure out what a security versus a commodity token is.”

Senator Hoeven asked how the CFTC and SEC would “sort out jurisdiction” of digital tokens. Chair Behnam noted the CFTC and SEC have historically agreed on differing jurisdictions with the futures and swap markets. He claimed if the DCCPA, or a similar bill, is passed, his “first step would be a meeting with Chair Gensler to flesh out a framework for characteristics of securities and commodities tokens.” He stated the agencies would “have to go through each token to determine what it is” to set the precedent for future regulatory jurisdiction.

Senator Michael Bennet (D-CO) asked about having two regulatory agencies overseeing digital tokens versus consolidating jurisdiction into one regulator. Chair Behnam explained the SEC is a capital formation and investor disclosure agency, while the CFTC is a risk management and price discovery agency. He noted the “debate about two market regulators is not new.” However, he expressed confidence the CFTC and SEC can comprehensively fill in regulatory gaps, just like the agencies have successfully done in the security futures and commodity futures markets. Senator Bennet asked Chair Behnam to define the gaps in digital asset regulation. Chair Behnam explained the CFTC has authority to regulate financial products where the price is based on an underlying commodity, so the “gap that exists is cash commodity digital tokens.”

Illicit Finance

Senator Marshall asked how digital currencies are used to facilitate ransomware payments and other illicit financing. Chair Behnam noted Treasury “does a fantastic job doing what it can with what it has” to stop digital asset illicit finance. He stated more regulatory oversight of digital asset markets “would be a huge step, but we will never be able to comprehensively cover every element of fraud.” Senator Marshall asked if crypto poses a threat to national security. Chair Behnam agreed there is a potential national security threat. He stated U.S. regulators cannot “put a pause on digital assets” because they will exist offshore even if they are not in the U.S. He highlighted two percent of customers in the U.S. had exposure to FTX.

Senator Brown asked about the importance of combatting the use of crypto in illicit financing. Chair Behnam agreed “this is an enormously important issue,” as “there is so much opacity” and potential use of crypto for illicit activities. He stated to the extent the CFTC has enforcement authority under the Bank Secrecy Act (BSA), the agency will “work to curb these illicit activities.” However, he reiterated comprehensive regulation “is going to be an important and critical tool to take a step in the right direction” to curb crypto in illicit financing.

Financial Stability

Senator Smith asked about crypto’s impact on financial stability. Chair Behnam responded crypto’s potential impact on financial stability “has not been a huge concern thus far.” He noted the traditional banking and market systems have been siloed from the crypto ecosystem, highlighting Terra and FTX collapses did not impact traditional financial institutions. He asserted the crypto industry’s \$1 trillion market cap does not pose a direct impact to financial stability. However, he cautioned against assuming “things will remain the same,” and advocated for closing regulatory gaps to prevent “future crises.”

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Please click [here](#) for the archived hearing.