

SPEECHES & TESTIMONY

Remarks of Commissioner Brian Quintenz before the Eurofi High Level Seminar 2018

April 26, 2018

Introduction

Good morning. This is the first Eurofi Seminar that I have had the privilege to attend and I am delighted to be able to participate in this remarkable conference. Before I begin, let me quickly say that the views I express are my own and do not represent the views of the Commission.

In addition to being my first Eurofi conference, this is also my first trip to Sofia. I have been struck by the city's beauty and its embodiment of living history. Sofia has been inhabited for over 8,500 years, but perhaps its closest modern day precursor was the Thracian settlement Serdica built by the Roman Emperor Trajan in the second century BC. Reminders of antiquity are scattered amongst modernity in this bustling city. Indeed, I have only to look out the window of my hotel to see St. George's Church – built in the 4th century AD – safely ensconced in the courtyard. I discovered that the very parking lot of my hotel was once rumored to sit on top of Constantine the Great's palace.[1] However, recent excavations of St. Nedelya square unearthed not a palace, but the ruins of an enormous building containing various artefacts, including a ceramic vessel containing 3,000 silver Roman coins inside, with the owner's name, Selvius Calistus, scratched on the outside.[2]

Sofia is a city where the ancient past and present converge. In many ways, we are living through that same convergence now with respect to technology and innovation. Once novel inventions – like the home phone, film cameras, VHS tapes – have become obsolete. And yet, the underlying functions and needs they addressed remain with us, persisting into the future to be solved by new, once unthinkable, but quickly taken for granted, innovations. Although our world would certainly be unrecognizable to Selvius Calistus if he were here with us – we do know there would be some shared understanding – the need for money as a medium of exchange, the desire for shared society and recreation. The question emerges, how do we harness creativity and technological innovation so that they work to better meet the needs and desires of all of us today, so that they have a lasting positive impact in our daily lives, on our cultures, and, in light of the focus of this conference, on our financial markets.

Supporting Responsible Financial Innovation

In the midst of the technological renaissance we are living through, what then is the proper role of the regulator? I believe it starts with leadership, clarity, cooperation, and open-mindedness. I think it is incumbent upon regulators to create a workable and appropriate regulatory framework that facilitates market-enhancing innovation. This means adopting regulation that is fair, technology-neutral, and does not stifle positive innovations. It means actively engaging with the financial technology (FinTech) community and other regulators to provide the regulatory certainty necessary to support innovation that promotes competition, vibrancy, and growth in our financial markets. It also means developing thoughtful, balanced regulation that allows nascent markets to develop while also protecting investors and preserving market integrity.

In order to further these objectives, the CFTC is engaging with industry to learn more about FinTech, through the LabCFTC initiative and the Technology Advisory Committee (TAC). Chairman Giancarlo and the agency launched LabCFTC in the spring of 2017. Through early engagement during the development process, LabCFTC hopes to offer clarity and guidance about the CFTC's regulatory framework. Since its launch less than a year ago, LabCFTC has met with over 150 market participants.

LabCFTC also assists staff in identifying where potential changes to the existing regulatory framework may be beneficial. For example, if an innovation achieves the desired outcome of a regulation, but does not fit within the letter of the rule, LabCFTC advises on whether regulatory relief should be provided or if it may be appropriate to consider rule revisions. LabCFTC's knowledge and expertise also promote technology-neutral regulations—ones which mandate a particular result but not the means by which the result is achieved.

LabCFTC also coordinates with other U.S. and international regulatory authorities. Through formal and informal relationships, LabCFTC seeks to collaborate with, and learn from, the experience of fellow regulators to develop best practices and recognize emerging trends. Most recently, the CFTC entered into an arrangement to collaborate on financial innovation with the United Kingdom's Financial Conduct Authority (FCA). LabCFTC and Project Innovate, the FCA's FinTech initiative, will share information regarding market trends and developments, as well as insights derived from innovation competitions, sandboxes, or other similar endeavors.

In addition to LabCFTC, the agency also has five advisory committees which solicit the input of outside experts on different topics to advise on developments, risks, and regulatory issues. I have the privilege of sponsoring the TAC, which explores the potential application of new technologies to the derivatives markets. For example, at our inaugural meeting this past February, the TAC discussed several areas where rapid technological innovation was creating both challenges and opportunities in our markets, including blockchain and distributed ledger technology, cryptocurrencies, machine learning and artificial intelligence, automated trading technologies, and cybersecurity best practices. Over the course of the next year, the TAC will explore each of these issues in greater detail, with the ultimate goal of providing the CFTC with actionable, practicable advice.

Cryptocurrencies

One area of technological innovation that has captured the world's attention is the cryptocurrency space. Since Satoshi Nakamoto first published his groundbreaking paper on a cryptocurrency called Bitcoin almost a decade ago, we have witnessed the proliferation of many new cryptocurrency concepts and tokenized products.[3]

In fact, I believe it is important to separate the idea of cryptocurrencies, whose main purpose is only to serve as a medium of exchange or a store of value, from the proliferation of "tokens" generally. As I postulated two days ago at the City Week conference in London, I see three main motivations for the broader tokenization revolution. One motivation for a company or entity to tokenize a product is purely as a marketing ploy – to take advantage of the popular and speculative mania surrounding all things "token." However, just because a product is tokenized does not change its underlying qualities. For example, if Disney World were to tokenize the admissions to its theme parks, those tokens would still be tickets. Tokenizing the tickets does not make them currencies and it does not make them securities. It makes them tickets. Similarly, tokenizing a security does not change the fact that it is a security.

A second motivation to create a token is to enable and realize the efficiency of the blockchain construct in assigning and tracking ownership. This is having, and will continue to have, an impact on title transfer and settlement processes. Think of this as the back office tokenization revolution.

Lastly, a third motivation is to utilize the transferability of tokens to create a secondary market for any and all non-tangible things – the eBay of Intangibles so to speak – for rights, services, permissions, etc., that the seller allows to be transferred between parties. Empowering a secondary market's price discovery and valuation functions for products that were previously untransferable – such as extra storage space on a home computer – is a fascinating development.

Certainly, not all tokens are cryptocurrencies – in fact, very few are. And even those best representing a currency-focused concept have yet to truly attain that functionality. Yet it would be a mistake, in my view, to dismiss those products because of that fact. Sure, some of these cryptocurrencies have not yet, and may never, achieve the acceptance and stability of a true reserve currency, like the dollar or the euro. But, there may also be instances where an established cryptocurrency's volatility and transferability could compare favorably against a sovereign currency.

In fact, it is quite possible, that just as the cryptocurrency trading market evolved from the bottom-up, starting at the retail level and slowly reaching the institutional level, so may the global driver of cryptocurrency acceptance come not from places like Washington, London, Frankfurt, or Tokyo, but rather through a bottom-up process as well. That may ultimately prove wrong, but it is worth pondering.

Indeed, the intense, ongoing debate about cryptocurrency's intrinsic value has caused regulators around the globe to grapple with how best to respond. Some nations have banned cryptocurrency mining and trading.[4] Others permit cryptocurrency trading, but restrict anonymous trading or require spot platforms to register with regulators.[5] Many others are vigilantly monitoring developments to determine if additional regulatory oversight is necessary and, if so, what form it should take.[6] Most recently the G20 called for the Financial Stability Board, in consultation with other standard-setting bodies, including the Committee on Payments and Market Infrastructure (CPMI) and International Organization of Securities Commissions (IOSCO), to report in July 2018 on their work to develop global standards for what they label as crypto-assets.[7]

Given that there are many participants on those boards and groups who are here today, I would like to take a few minutes now to discuss the regulatory framework for cryptocurrencies in the United States as it stands today.

Regulatory Framework in the United States

At the outset, I would note that the regulatory landscape for cryptocurrencies, including so-called tokens, within the United States is an evolving one. Regulators in the United States, including the CFTC, are monitoring cryptocurrencies and working collaboratively to develop effective regulatory approaches for this new asset class. The Treasury Department has established a crypto-asset working group which includes the CFTC, Securities and Exchange Commission, and banking regulators. Ongoing communication among regulators is critical because oversight jurisdiction over cryptocurrencies is shared across multiple agencies in the United States.

For example, state regulators and the Treasury Department's Financial Crimes Enforcement Network (FinCEN) regulate cryptocurrency platforms as money services businesses, thereby subjecting those "exchanges" to anti-money laundering and know-your-customer requirements. The Internal Revenue Service views cryptocurrencies as property and subjects sales to capital gains tax without a de minimis threshold.[9]

The CFTC and SEC also have jurisdiction over cryptocurrencies depending on their status as a commodity or as a security. From our own perspective, the CFTC has both oversight and enforcement authority over derivatives on commodity cryptocurrencies, but only enforcement authority over the spot transactions of commodity cryptocurrencies. This means that the CFTC's role is broad and far reaching with respect to derivatives trading on cryptocurrencies – such as futures contracts on Bitcoin – including setting requirements for registration of trading platforms or firms, trade execution, orderly trading, data reporting, and recordkeeping. However, in the spot markets, or the platforms where cryptocurrencies themselves are actually bought and sold, the CFTC has *only* enforcement authority - the CFTC can only police fraud and manipulation in the actual trading of cryptocurrencies, but has no ability to make platforms register with the Commission or set any customer protection policies.

On the other hand, if the cryptocurrency or digital asset is a security, it must be traded on a platform that is registered with the

SEC or is specifically exempt from registration.[10] In addition, the SEC has stated that many initial coin offerings (ICOs) used to raise capital for business projects may be securities, thereby triggering the fully panoply of registration and investment protection requirements under American securities laws.[11]

From my perspective as a CFTC Commissioner, I think the area with the greatest need for enhanced regulatory certainty and oversight is the spot market. In that regard, the CFTC has undertaken an educational campaign to provide customers with information about cryptocurrencies and to warn about potential fraud in these markets. The CFTC's Division of Enforcement has aggressively targeted deception and manipulation to ensure that innocent customers are not exploited by fraudsters. And with respect to jurisdictional considerations, the CFTC has been, and continues to be, in close communication with the SEC.

In light of the patchwork of state and federal regulation that currently exists in the United States, and until such time as Congress might choose to add spot commodity markets to a regulator's jurisdiction, I have also encouraged cryptocurrency spot platforms to come together and form an SRO-like entity that could develop and enforce customer protection rules to strengthen the integrity of these growing markets. I think an independent, self-regulating body for spot platforms in the United States could significantly contribute to ongoing efforts to rationalize and formalize cryptocurrency regulation. I am not now suggesting, nor have I ever suggested, that this potential body should be a substitute for federal oversight in this area; rather, I believe this potential organization's efforts can fill a current void and could eventually complement federal oversight efforts.

I think it is the role of the CFTC, along with other regulators, to support the integrity of these developing markets so that individuals have the information and transparency they need to make informed choices. Indeed, when Congress amended the CFTC's governing statute to give exchanges the ability to list new contracts through a self-certification process, as opposed to requesting the CFTC's approval, I believe Congress did so intentionally to limit the CFTC's power to make value judgements on new contracts. I also think that is appropriate – the markets, investors, and consumers need to decide for themselves which new products and innovations are worthwhile and which are not, and what value truly is.

Conclusion

I am optimistic about the future of financial technology and its potential to improve all of our lives. Gatherings like this help us to build the partnerships and trust, and attain the expertise and wisdom, to recognize and support those innovations that are genuinely innovative, that have the power to enhance our societies. I look forward to working with all of you to develop thoughtful regulatory frameworks that allow our markets to flourish and our innovators to innovate. Thank you.

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