

WRITTEN STATEMENT OF

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INCLUSION

“The Future of Digital Assets: Identifying the Regulatory Gaps in the Digital Asset Market
Structure”

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Thank you, Committee Chairman McHenry and Ranking Member Waters, Subcommittee Chairman Hill and Ranking Member Lynch, and members of the Subcommittee for the opportunity to testify before you today. I am the founder and CEO of Gattaca Horizons LLC, an advisory firm, an adjunct professor at the Georgetown University Law Center, and a co-founder of the non-profit Digital Dollar Project, which is focused on exploring a U.S. central bank digital currency (CBDC). I am also the former chief innovation officer and director of LabCFTC at the U.S. Commodity Futures Trading Commission (CFTC). The testimony presented here today reflects solely my own personal views, and not the views of any client or organization with which I am affiliated.¹

The topic of today’s discussion is “The Future of Digital Assets: Identifying the Regulatory Gaps in the Digital Asset Market Structure.” This is an important topic and one that has featured prominently since my time in government more than four years ago. Despite significant policymaker, regulatory, and market participant interest, the fundamental regulatory landscape for digital assets in the United States, especially at the federal level, has not changed significantly since the inception of Bitcoin in 2009.

As I will discuss, the current landscape remains one where spot or cash digital asset trading activity, which means the buying and selling of an asset for immediate delivery, is largely regulated at the state level under money transmission frameworks (or those tailored to cryptocurrencies, as in New York), while federal regulators apply various rulesets depending on the specific digital asset and activity involved. Notably, under the status quo, digital asset exchanges that mirror the activities of traditional exchanges and facilitate the matching of trades for digital assets that are commodities are not subject to comprehensive federal market oversight and supervision.

Understanding Digital Assets & Underlying Infrastructure

Before delving deeper into the current regulatory landscape for digital assets, it is important to underscore some important points regarding the involved assets, technology and nature of innovation. As a threshold matter, digital assets can be distinguished from the underlying infrastructure used to transfer such assets from one computer to another without the need for a trusted, central party traditionally needed to verify that each party to a transaction has – and does – what it promises.² Differentiating digital assets from the underlying infrastructure or rails transacted upon is conceptually helpful for two reasons.

First, the nature and characteristics of the digital asset itself, along with the particular activity, frequently determine which set of financial rules or regulations are applicable. For example, regardless of the underlying transaction rails, if the digital asset is a security, then we would apply

¹ My professional associations are set out in my biography attached as Appendix A.

² See Written Testimony of Daniel S. Gorfine before the House Committee on Agriculture, *Cryptocurrencies - Oversight of New Assets in the Digital Age* (July 18, 2018), available at https://agriculture.house.gov/uploadedfiles/07.18.18_gorfine_testimony.pdf.

the securities law to transactions involving that asset. And if the digital asset is a commodity, then we apply the commodities laws.

In my view, some of the problems we have observed in the crypto space over the past year are a result of too much focus on novel digital assets rather than real-world applications that yield productive gains and improve lives. If there is a silver-lining in the significant market correction we have witnessed over the past months, including a number of tokens that have gone to zero, it is that for any token to survive in the long run, it will need to have a clear value proposition and differentiating characteristics. This could be, for example, that it is true competition to other forms of payment, is an effective hedge against fiat currencies (like gold), preserves privacy, and/or includes unique and desired programmability and coding features. My expectation is that in the medium-to-long-term, we will see a significant reduction in the number of outstanding tokens.³

A second reason to differentiate the asset from the underlying infrastructure is that it can help us better understand the benefits of that underlying infrastructure—which can also be thought of as new, automated transaction rails. While a native cryptocurrency like Bitcoin cleverly provides an incentive for validators to participate in the network, the fundamental innovation in this space is the ability to transact a digitally scarce asset on the Internet from one computer to another with relatively few intermediaries, at relatively low cost, and with near-instant settlement. Such systems may also bring compelling privacy and decentralization benefits as compared to a traditional accounts-based system.

Before Bitcoin, the only way to transfer certain assets or tokens (commonly referred to as “bearer instruments”) directly from one person to another without relying on an intermediary was in the physical world. Now, with digital tokens and automated transaction rails, we can do so in cyberspace. This computing advance is notable in that it allows individuals halfway around the world to use computers to send unique items of value directly from one to another similar to the way the Internet has enabled the sending of information through email with relatively few intermediaries, at low cost, and with great speed. In the context of economic activity, this digital advance in infrastructure holds promise in unlocking decentralized computing, increasing access and efficiency, driving competition and lower costs, and allowing for increasingly programmable and automated economic activity.

³ It has been reported that there are [nearly 23,000 cryptocurrency tokens](#) and the website CoinMarketCap [lists pricing for more than 9,000 tokens](#)—most of which are not available on the largest U.S. exchanges. *See also* Daniel Gorfine, *Valuing Cryptocurrencies As . . . Currencies?*, Medium (Mar. 26, 2019) (discussing the economics and market realities of tokens), available at https://medium.com/@CFTC_/valuing-cryptocurrencies-as-currencies-c37fa965923e.

The Existing Regulatory Landscape

As noted above, the overall regulatory landscape for digital assets has not changed significantly since Bitcoin first traded in 2009—which means that there is no comprehensive market oversight framework. FinCEN was the first financial regulator to specifically address the regulatory status of cryptocurrency (referred to then as “virtual currency”) by determining in 2013 that exchanges and certain other cryptocurrency intermediaries meet the 2011 definition of money transmitter and are money service businesses (MSBs) under the BSA regulations.⁴ Such MSB’s are required to register with FinCEN and report suspicious activity potentially indicative of crime.

Following FinCEN’s analysis, many states have required exchanges and related intermediaries to secure a money transmission license (MTL) pursuant to each state’s respective law; some states have gone further and created tailored and even more robust regulatory frameworks for cryptocurrency businesses, built on the foundation of MTL regulation (e.g. the NY BitLicense).⁵

The state MTL framework and related state-based oversight do impose meaningful requirements on payments companies and money transmitters, frequently including implementation of AML and financial crime compliance programs, permissible investments standards, and minimum net worth and related security requirements. These frameworks do not, however, uniformly impose the same types of markets and trading oversight as is common with federal market regulators, such as the CFTC and the SEC. For example, state money transmitter regulation would typically not impose market surveillance requirements and supervision intended to detect fraudulent or manipulative trading activity, including practices such as wash trading (where a market participant executes counteracting buy and sell orders in order to manipulate trade data) and spoofing (where a market participant places an order but then rapidly cancels it, never intending to execute the trade in the first place). They would also not include certain trading conflict of interest and self-dealing prohibitions as would typically be found in capital markets regulation.

Beyond FinCEN and state licensure requirements, various federal regulators apply their respective rules to digital assets depending on the categorization of the asset and the involved activity. As noted above, the CFTC has certain statutory and regulatory authorities to the extent an asset is a commodity, the SEC applies the securities laws to the extent an asset is a security, and the federal

⁴ Financial Crimes Enforcement Network (FinCEN), *New FinCEN Guidance Affirms Its Longstanding Regulatory Framework for Virtual Currencies and a New FinCEN Advisory Warns of Threats Posed by Virtual Currency Misuse* (May 9, 2019), available at <https://www.fincen.gov/news/news-releases/new-fincen-guidance-affirms-its-longstanding-regulatory-framework-virtual>.

⁵ See Peter Van Valkenburgh & Jerry Brito, *State Digital Currency Principles and Framework* (March 2017), available at <https://www.coincenter.org/app/uploads/2020/05/statevirtualcurrencyprinciplesandframeworkv2.0.pdf>; Peter Van Valkenburgh, *The Bank Secrecy Act, Cryptocurrencies, and New Tokens: What is Known and What Remains Ambiguous* (May 2017), available at <https://www.coincenter.org/aml-kyc-tokens/>; Written Statement of NYDFS Superintendent Adrienne Harris before the House Financial Services Subcommittee (Apr. 19, 2023), available at <https://docs.house.gov/meetings/BA/BA21/20230419/115753/HHRG-118-BA21-Wstate-HarrisA-20230419.pdf>.

banking regulators will apply banking regulations to the extent that a bank seeks to engage in certain digital asset activities, including custody or providing banking services to digital asset firms.

The CFTC’s jurisdiction related to digital assets was established in 2015 when the Commission determined that certain “virtual currencies,” such as Bitcoin, met the definition of “commodity” under the Commodity Exchange Act (CEA).⁶ The definition of commodity under the CEA is very broad and the CFTC has indicated that other cryptocurrencies beyond Bitcoin, including Ether and Litecoin, are commodities.⁷ The CFTC’s determination that certain digital assets fall under the CEA’s commodity jurisdiction have subsequently been upheld by a number of federal courts.⁸

Under the CEA, however, the CFTC’s jurisdiction over activity involving spot or cash trading in a commodity is relatively limited. More specifically, the CFTC *does* have limited enforcement authority provided under Dodd Frank to police for fraud and manipulation in underlying spot digital commodity markets, but this authority is backward-looking and invoked only when wrongdoing is suspected. The CFTC has used its enforcement authority to help police digital commodity markets since 2014, having brought more than 50 cases since that time.⁹ The CFTC’s authority over cash or spot markets, however, is not oversight or supervisory authority, which entails rulemaking and the registration and regular examination of involved intermediaries, including exchanges.

It is important to underscore this last point: the CFTC does *not* currently have market oversight authority over spot or cash trading in digital commodities (nor, for that matter, in any other commodity, including precious metals or agricultural commodities).¹⁰ This point is commonly confused because the CFTC *does* have oversight authority over futures and derivatives products that may be predicated on an underlying commodity—for example, oil, gold, or even bitcoin futures contracts—and the exchanges and intermediaries that facilitate trade in such contracts. Exchanges and related intermediaries that facilitate trading in regulated derivatives products are subject to robust CFTC requirements, including with respect to registration, trade surveillance and monitoring, transaction reporting, compliance with personnel conduct standards, customer education, conflicts of interest, custody, capital adequacy, platform and trading system safeguards,

⁶ U.S. CFTC LabCFTC, *A CFTC Primer on Virtual Currencies* (Oct. 17, 2017), available at https://www.cftc.gov/sites/default/files/idc/groups/public/documents/file/labefc_primercurrencies100417.pdf.

⁷ See *Commodity Futures Trading Commission (CFTC) v. Changpeng Zhao, Binance Holdings Limited, Binance Holdings (IE) Limited, Binance (Services) Holdings Limited, and Samuel Lim*, 1:23-cv-01887 (N.D. Ill. 2023), available at <https://www.cftc.gov/PressRoom/PressReleases/8680-23>.

⁸ See e.g., *Commodity Futures Trading Commission v. My Big Coin Pay, Inc.*, 334 F. Supp. 3d 492 (D. Mass. 2018); *Commodity Futures Trading Commission v. McDonnell*, 287 F. Supp. 3d 213 (E.D.N.Y. 2018).

⁹ Testimony of Chairman Rostin Behnam Regarding before the U.S. Senate Agriculture Committee, *Examining Digital Assets: Risks, Regulation, and Innovation* (Feb. 9, 2022) (hereinafter “Behnam Testimony”), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam20>.

¹⁰ The CFTC does also have oversight authority over certain leveraged or financed retail commodity transactions where actual delivery of the commodity does not occur within 28 days.

and cyber security examinations.¹¹ Similarly, the market participants (e.g. dealers, pool operators, and trading advisors) that engage in these activities are subject to oversight by the CFTC, the exchanges where they transact, and, in some instances, by the National Futures Association (NFA), a delegated self-regulatory organization (SRO).

With respect to the SEC, its jurisdiction is implicated when an asset is deemed to be a security; in this case, both the offering and the involved intermediaries, including exchanges, are required to comply with the securities laws and may be subject to registration with the SEC and/or FINRA. To date, the SEC has broadly asserted its enforcement authority and suggested that many cryptocurrencies are securities.¹² As discussed below, however, a lack of clarity in determining when an asset is a security remains a key challenge in this space—this ambiguity has profound implications since market participants and regulators alike may struggle in determining which rulesets apply to a particular asset and the involved intermediaries.

Finally, to round out the financial regulatory landscape related to cryptocurrencies, it is important to note the role of state and federal banking regulators. Banking entities involved in digital asset activities, including with respect to custody or providing banking services to digital asset firms and exchanges, must satisfy requirements imposed by their respective regulator. Since the end of last year, the federal banking regulators have been increasingly active in publishing guidance concerning how banks should approach and mitigate risks related to digital asset activities.¹³

Looking Ahead & Addressing Gaps

As discussed above, while some states have developed mature and robust regulatory frameworks for supervising digital asset activities, there is no current federal market regulator overseeing spot digital commodity markets. Financial market regulators are empowered by Congress to develop and apply rules that promote market integrity, transparency, and investor protection, as well as “prevent fraud and manipulation, provide adequate disclosure and reporting, ensure proper handling of investor assets, prevent conflicts of interest, and ensure operational resiliency.”¹⁴

¹¹ See *Behnam Testimony*; Testimony of Chairman J. Christopher Giancarlo before the U.S. Senate Agriculture Committee (Feb. 15, 2018) (hereinafter “Giancarlo Testimony”), available at https://www.agriculture.senate.gov/imo/media/doc/Testimony_Giancarlo_02.15.18.pdf.

¹² Baker Hostetler, *SEC Chair Stands Firm: ‘Vast Majority’ of Cryptocurrency Tokens Are Securities* (Sept. 9, 2022), available at <https://www.bakerlaw.com/alerts/sec-chair-stands-firm-vast-majority-cryptocurrency-tokens-securities>.

¹³ See, e.g., The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, *Joint Statement on Crypto-Asset Risks to Banking Organizations* (Jan. 5, 2023), available at <https://www.fdic.gov/news/financial-institution-letters/2023/fi123001.html>.

¹⁴ Timothy G. Massad & Howell E. Jackson, *How to Improve Regulation of Crypto Today—Without Congressional Action—and Make the Industry Pay For It*, Brookings (Oct. 2022), available at <https://www.brookings.edu/wp-content/uploads/2022/10/WP79-Massad-Jackson-updated-2.pdf>.

For this reason, as CFTC Chairman Behnam testified last year, “[the] CFTC is well situated to play an increasingly central role in overseeing the cash digital asset commodity market.” By statute, the CFTC is a principles-based regulator established by Congress “to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to [its jurisdiction] and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation and fair competition among boards of trade, other markets and market participants.” Absent congressional authorization, however, the CFTC does not have the current authority to directly oversee and supervise spot digital commodity markets.

The CFTC, however, is familiar with supervising large and complex markets traditionally focused on facilitating risk transfer between parties. Indeed, U.S. derivatives markets are the envy of the world and include financial instruments with notional values totaling in the trillions of dollars. The Agency also maintains a robust enforcement division focused on policing its markets, protecting investors, and ensuring market integrity. In 2022 alone, the CFTC brought 82 enforcement actions—with 18 related to digital assets—and “obtained orders imposing over \$2.5 billion in restitution, disgorgement and civil monetary penalties either through settlement or litigation.”¹⁵

The CFTC has historically leveraged its framework and congressional mandate to adapt to constantly changing markets and to gain a deep understanding of the commodities that commonly underpin regulated derivatives products. Whether the asset be a precious metal, natural resource, agricultural product, or a digital commodity, the CFTC studies underlying markets to help inform its enforcement authority over potential fraud and manipulation and its oversight of derivatives products and intermediaries. To this end, I was proud to have had the opportunity during my time at the CFTC to lead LabCFTC and support the Commission’s mission of promoting market integrity, customer education, and innovation.¹⁶ We spent considerable time studying digital asset markets, identifying risks, and advancing sound policy – efforts that continued upon my departure and continue to this day through the recently renamed Office of Technology Innovation.¹⁷

Since 2018, and specific to digital assets, the CFTC has overseen well-regulated, robust, and transparent bitcoin futures markets facilitated by CFTC regulated exchanges and intermediaries. The initial self-certification of these products were subject to the CFTC’s tailored “heightened review” framework in order to address unique characteristics related to digital commodities, including their high degree of retail participation, unique custody considerations, and the nature of

¹⁵ U.S. Commodity Futures Trading Commission, *CFTC Releases Annual Enforcement Results* (Oct. 20, 2022), available at <https://www.cftc.gov/PressRoom/PressReleases/8613-22>.

¹⁶ See e.g., U.S. Commodity Futures Trading Commission, *Customer Advisory: Use Caution When Buying Digital Coins or Tokens* (2018), available at https://www.cftc.gov/sites/default/files/2018-07/customeradvisory_tokens0718.pdf.

¹⁷ U.S. Commodity Futures Trading Commission, *Chairman Behnam Announces Technology and Customer Outreach Reorganization* (July 26, 2022), available at <https://www.cftc.gov/PressRoom/PressReleases/8563-22>.

their underlying spot markets.¹⁸ To this end, the CFTC differentiated between digital commodities and traditional commodities and established the basis for their differential treatment.

Since that time, these well-regulated markets have continued to grow and are subject to important reporting, market surveillance, investor protection, and customer education requirements.¹⁹ NFA, the CFTC's delegated SRO, which plays a similar role to that of FINRA with the SEC, has also implemented certain disclosure requirements on intermediaries involved in spot markets and proposed new standards of conduct. And, the CFTC's enforcement division has remained vigilant, working to actively police CFTC markets and pursue bad actors. It is worth noting that under Chairman Gary Gensler, the SEC has approved a number of exchange traded products predicated on CFTC regulated bitcoin futures contracts given the robust CFTC supervisory framework in place around those contracts.

A takeaway from this discussion is that digital asset futures and derivatives markets are well-regulated and are working as expected. It should further be noted that the existence of these markets provides policymakers with transparency and insights into digital asset instruments, and provides Americans with well-regulated opportunities to participate in futures and options markets. This outcome is far preferable to seeing investors lured to offshore, unregistered, and illegal derivatives markets prone to fraud and financial crime violations, as we have seen.

Similar to the CFTC, the SEC has rules and requirements for intermediaries involved in facilitating trading in securities. As we have also seen over the years, especially during the prior ICO mania, many crypto tokens were developed and sold to retail investors in order to raise capital for the development of an enterprise or simply to defraud investors. In either case, the SEC appropriately has applied the securities laws and its enforcement authority to pursue such unregistered offerings.

It is important to note, however, that outside of clear-cut and established examples of when a token may be a security, there are ongoing marginal and ambiguous cases. This lack of definitional clarity is highly problematic since jurisdictional determinations are based on whether an asset is or is not a security. This is an area where more work needs to be done, whether by the courts, regulators, or Congress.

To this end, it is worth noting that part of the reason we regulate commodities differently from securities is that they are not subject to the same information asymmetry inherent in security investments, whereby a specific management team holds critical information about the enterprise

¹⁸ See *Giancarlo Testimony*.

¹⁹ One of the largest bitcoin and ether futures and options exchanges, CME, publishes robust market data. CME reported that a record number of bitcoin options traded on a recent day in March of this year and that open interest hit a record at the end of the month. Over 2.8 million ether futures contracts have traded since the product's launch in February 2021. See CME Group, *Cryptocurrency futures and options* (last visited Apr. 25, 2023), available at <https://www.cmegroup.com/markets/cryptocurrencies.html>.

that the public must be aware of to inform and facilitate price discovery. In this way, owning shares in McDonald's is quite distinct from owning a gold bar—and the nature of information regarding each asset and how one might access that information is similarly distinct. With at least some digital assets, we seem to have agreement that they are more akin to the gold bar, but we lack broader and generalized consensus with respect to many others.

For this reason, it is worth exploring ways to address this ambiguity. A potentially viable path would be invoking the spirit of the original JOBS Act legislation that created tailored frameworks for certain capital-raising efforts subject to SEC oversight and disclosures and that are intended to leverage the democratizing impact of the Internet. One could imagine a scenario where digital ecosystem developers avail themselves of a similar, but properly tailored, framework to facilitate initial sales of a token subject to SEC regulation and then revisit registration if an ecosystem has developed to the point it looks more like Bitcoin than a share of McDonald's stock—meaning sufficiently decentralized to the point that no set of managers hold key valuation information about the token or whose ongoing efforts are essential to the value of such token. This is but one solution worth considering, but by no means the complete universe. The key takeaway, however, is that developing appropriate regulatory frameworks for digital assets will remain incomplete if it remains unclear when such frameworks apply.

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Thank you for your time and inviting me to speak with you today. As detailed above, aside from the development of particular, tailored regimes in select states, the regulatory landscape in the U.S. has remained fairly constant since the first Bitcoin was mined in 2009. A particular gap in this landscape remains the lack of a coherent and comprehensive market regulatory framework aimed at ensuring trade surveillance, market integrity, and certain baseline investor protections common in trading environments. The CFTC and SEC have experience establishing such requirements in their respective markets and more can be learned from states, like New York, with experience regulating digital assets. Ultimately, I have confidence in the professional staff and capabilities of our market regulators. Today's panel—as well as others before us—have identified existing gaps and opportunities to create a more efficient, uniform and comprehensive national regulatory framework. Against this backdrop, I think there is a great opportunity for policymakers to work collaboratively to craft that framework in order to ensure the responsible development of digital assets and markets in the United States.

Thank you. I am happy to answer any questions that you have.

Appendix A
Daniel Gorfine Biography

My name is Daniel Gorfine, and I am the founder and CEO of Gattaca Horizons LLC, a boutique advisory firm. I am also a co-founder and director of the non-profit Digital Dollar Project, which focuses on exploration of a U.S. central bank digital currency (CBDC), and I am an adjunct professor at the Georgetown University Law Center. I am honored to have previously served as chief innovation officer at the U.S. Commodity Futures Trading Commission (CFTC) and Director of LabCFTC.

In my advisory capacity, I work with a range of clients, including financial firms, technology companies, fintech and digital asset-related firms, and startups. My work with the non-profit Digital Dollar Project includes publishing white papers and opinion pieces on the potential designs and merits of a digital dollar. And as an adjunct professor at Georgetown, I teach a course titled “Fintech law and policy.”

I am a graduate of Brown University (A.B.), hold a J.D. from the George Washington University Law School and an M.A. from the Paul H. Nitze School for Advanced International Studies (SAIS) at Johns Hopkins University.