Cryptocurrency Musings
(February 16, 2018 - An Ongoing Series)

Government Suppression and Consensus Money: What the Government *Really* Thinks

The tenacity with which people, even investment professionals, hold onto views based upon articles, interviews and hearsay that are not based upon fact is impressive. The question, or presumption, really, of an existential threat to bitcoin or other consensus money by governmental suppression is a particularly popular theme. However, that mistaken perception will do harm to the person holding it to the degree that they catch on to reality too late. Set forth below are some statements that can only be considered to be a fact-based, far more reliable account of the U.S. government attitude toward bitcoin, consensus money and blockchain than one is otherwise likely to hear, since it is, in fact, a statement from the government.

The following is a highly abridged account of testimony provided to the Senate Banking Committee in early February 2018, by the Chairman of the Commodity Futures Trading Commission about this very topic. While plenty of words were removed from this comprehensive, carefully researched and well-articulated 14-page document, no words were added or rearranged. It is unofficially wagered that most Americans and most professional investors would be quite surprised at the message.

> **Written Testimony of Chairman J. Christopher Giancarlo before the Senate Banking Committee, Washington, D.C.**
>
> **February 6, 2018**
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> There is clearly no shortage of opinions on virtual currencies such as Bitcoin.
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> Perspective is critically important. As of the morning of February 5, the total value of all outstanding Bitcoin was about $130 billion based on a Bitcoin price of $7,700. The Bitcoin “market capitalization” is less than the stock market capitalization of a single “large cap” business, such as McDonalds (around $130 billion). Because virtual currencies like Bitcoin are sometimes considered to be comparable to gold as an investment vehicle, it is important to recognize that the total value of all the gold in the world is estimated by the World Gold Council to be about $8 trillion. Clearly, the column inches of press attention to virtual currency far surpass its size and magnitude in today’s global economy.
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> In 2015, the CFTC determined that virtual currencies, such as Bitcoin, met the definition of “commodity” under the CEA. The CFTC has been straightforward in asserting its area of statutory jurisdiction concerning virtual currencies derivatives. In 2016, the CFTC took action against a Bitcoin futures exchange operating in the U.S. that failed to register with the agency. The agency also issued warnings about valuations and volatility in spot virtual currency markets. The CFTC, working closely with the SEC and other fellow financial enforcement agencies, will aggressively prosecute bad actors that engage in fraud and manipulation regarding virtual currencies.
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> It is important to put the new Bitcoin futures market in perspective. It is quite small with open interest at the CME of 6,695 bitcoin and at Cboe Futures Exchange (Cboe) of 5,569 bitcoin (as of Feb. 2, 2018). At a price of approximately $7,700 per Bitcoin, this represents a notional amount of about $94 million. In comparison, the notional amount of the open

interest in CME's WTI crude oil futures was more than one thousand times greater, about $170 billion as of Feb 2, 2018 and the notional amount represented by the open interest of Comex gold futures was about $74 billion.

Practically, both CME and Cboe had numerous discussions and exchanged numerous draft product terms and conditions with CFTC staff over a course of months prior to their certifying and launching Bitcoin futures in December 2017. Given the emerging nature and heightened attention of these products, staff conducted a "heightened review" of CME's and Cboe's responsibilities under the CEA and Commission regulations to ensure that their Bitcoin futures products and their cash-settlement processes were not readily susceptible to manipulation, and the risk management of the associated Derivatives Clearing Organizations to ensure that the products were sufficiently margined.

The CFTC's response to the self-certification of Bitcoin futures has been a balanced one. It has resulted in the world's first federally regulated Bitcoin futures market. Had it even been possible, blocking self-certification would not have stopped the rise of Bitcoin or other virtual currencies. Instead, it would have ensured that virtual currency spot markets continue to operate without effective and data-enabled federal regulatory surveillance for fraud and manipulation. It would have prevented the development of a regulated derivatives market that allowed participants to take "short" positions that challenged the 2017 rise of Bitcoin prices.

The CFTC believes that the responsible regulatory response to virtual currencies must start with consumer education. Amidst the wild assertions, bold headlines, and shocking hyperbole about virtual currencies, there is a need for much greater understanding and clarity. Over the past six months, the CFTC has produced an unprecedented amount of consumer information concerning virtual currencies These consumer materials include an information "primer" on virtual currencies, consumer and market advisories on investing in Bitcoin and other virtual currencies, a dedicated CFTC "Bitcoin" webpage, several podcasts concerning virtual currencies and underlying technology, weekly publication of Bitcoin futures "Commitment of Traders" data and an analysis of Bitcoin spot market data.

I have spoken publicly about the potential benefits of the technology underlying Bitcoin, namely Blockchain or distributed ledger technology (DLT). Distributed ledgers – in various open system or private network applications – have the potential to enhance economic efficiency, mitigate centralized systemic risk, defend against fraudulent activity and improve data quality and governance.

DLT is likely to have a broad and lasting impact on global financial markets in payments, banking, securities settlement, title recording, cyber security and trade reporting and analysis. When tied to virtual currencies, this technology aims to serve as a new store of value, facilitate secure payments, enable asset transfers, and power new applications.

One study estimates that DLT could eventually allow financial institutions to save as much as $20 billion in infrastructure and operational costs each year. Another reportedly estimates that blockchain could cut trading settlement costs by a third, or $16 billion a year, and cut capital requirements by $120 billion. Moving from systems-of-record at the level of a firm to an authoritative system-of-record at the level of a market is an enormous opportunity to improve existing market infrastructure.

DLT also promises assistance to financial market regulators in meeting their mission to oversee healthy markets and mitigate financial risk. What a difference it would have made on the eve of the financial crisis in 2008 if regulators had access to the real-time trading ledgers of large Wall Street banks, rather than trying to assemble piecemeal data to recreate complex, individual trading portfolios. I have previously speculated that, if regulators in 2008 could have viewed a real-time distributed ledger (or a series of aggregated ledgers across asset classes) and, perhaps, been able to utilize modern cognitive computing capabilities, they may have been able to recognize anomalies in market-wide trading activity and diverging counterparty exposures indicating heightened risk of bank failure. Such transparency may not, by itself, have saved Lehman Brothers from bankruptcy, but it certainly would have allowed for far prompter, better-informed, and more calibrated regulatory intervention instead of the disorganized response that unfortunately ensued.

Two decades ago, as the Internet was entering a phase of rapid growth and expansion, a Republican Congress and the Clinton administration established a set of enlightened foundational principles: the Internet was to progress through human social interaction; voluntary contractual relations and free markets; and governments and regulators were to act in a thoughtful manner not to harm the Internet's continuing evolution.

This simple approach is well-recognized as the enlightened regulatory underpinning of the Internet that brought about such profound changes to human society. During the almost 20 years of "do no harm" regulation, a massive amount of investment was made in the Internet's infrastructure. It yielded a rapid expansion in access that supported swift deployment and mass adoption of Internet-based technologies. Internet-based innovations have revolutionized nearly every aspect of American life, from telecommunications to commerce, transportation and research and development. This robust Internet economy has created jobs, increased productivity and fostered innovation and consumer choice.

"Do no harm" was unquestionably the right approach to development of the Internet. Similarly, I believe that "do no harm" is the right overarching approach for distributed ledger technology.

SEC Chairman Clayton and I recently stated in a joint op-ed, that:

> ***"Our task, as market regulators, is to set and enforce rules that foster innovation while promoting market integrity and confidence…"***

We are entering a new digital era in world financial markets. As we saw with the development of the Internet, we cannot put the technology genie back in the bottle. Virtual currencies mark a paradigm shift in how we think about payments, traditional financial processes, and engaging in economic activity. Ignoring these developments will not make them go away, nor is it a responsible regulatory response. The evolution of these assets, their volatility, and the interest they attract from a rising global millennial population demand serious examination.

With the proper balance of sound policy, regulatory oversight and private sector innovation, new technologies will allow American markets to evolve in responsible ways and continue to grow our economy and increase prosperity. This hearing is an important part of finding that balance.

Thank you for inviting me to participate.

Sources:

Full written testimony:

https://www.banking.senate.gov/public/_cache/files/d6c0f0b6-757d-4916-80fd-a43315228060/A2A6C1D8DDBB7AD33EBE63254D80E9E3.giancarlo-testimony-2-6-18b.pdf

Replay to the live testimony:

https://www.banking.senate.gov/public/index.cfm/2018/2/virtual-currencies-the-oversight-role-of-the-u-s-securities-and-exchange-commission-and-the-u-s-commodity-futures-trading-commission

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