

## Public Statements & Remarks

### Concurring Statement of Commissioner Dawn D. Stump Regarding Enforcement Action Against Coinbase, Inc.

March 19, 2021

I concur in the Commission's findings that Coinbase, Inc., the owner and operator of an online digital asset exchange,<sup>[1]</sup> violated anti-manipulation provisions of the Commodity Exchange Act ("CEA") and the CFTC's rules based on: 1) reporting false, misleading, or inaccurate transaction information; and 2) secondary, principal-agent liability for wash sales by a former "Employee A." I write separately, though, to ensure the public is not misled to believe that the CFTC regulates exchanges such as Coinbase. It does not. This fact leads me to express my serious concerns about the Commission's dedication of resources to this matter involving an exchange for cash transactions in digital assets (e.g., Bitcoin, Litecoin), given that—

- Coinbase has not offered any futures contract, option, or swap (collectively, "derivatives products") regulated by the CFTC;
- As a result, Coinbase is not required to register with, and is not regulated by, the CFTC;
- Coinbase's activities concerning the digital assets at issue did not affect the trading of any listed derivatives product regulated by the CFTC because there were no listed derivatives products on digital assets traded at that time; and
- The settled charges are based largely on conduct that is several years old, has not been repeated, and in the case of the charge of secondary liability, is based on conduct by an employee who left Coinbase years ago and who is not being charged.

In short, the CFTC must: 1) maintain its focus on its primary area of responsibility - the derivatives markets; and 2) be clear with the public that the CFTC does not regulate cash digital asset exchanges like Coinbase. I fear that today's settlement falls short on both objectives.

#### The CFTC Does Not Regulate Cash Digital Asset Exchanges Like Coinbase

The CFTC does not regulate Coinbase (or any other exchange for cash digital asset transactions). That important point bears repeating, because it is not made anywhere in the Commission's settlement Order: The CFTC does not regulate Coinbase.

The CFTC's regulatory authority derives from the CEA, which provides it with exclusive jurisdiction to regulate certain derivatives products: futures contracts, certain types of options, and swaps.<sup>[2]</sup> The CEA does not provide the CFTC with jurisdiction to regulate exchanges or other markets involving cash commodity transactions – be they for corn, oil, or digital assets. Coinbase is a cash market that has never offered any derivatives products, and thus falls outside the scope of the CFTC's regulatory authority under the CEA.

If Coinbase offered derivatives products, the CEA would require Coinbase to register with the CFTC.<sup>[3]</sup> In order to register, it would have to demonstrate to the CFTC that it is in compliance with a host of core principles set out in the CEA, as well as the CFTC's implementing regulations. And in order to maintain its registration, it would have to demonstrate to the CFTC its ongoing compliance with those core principles and regulations.<sup>[4]</sup>

As a trading platform for cash transactions in digital assets, however, Coinbase is not subject to any of the regulatory requirements of the CEA or the CFTC's rules. As a result, the trading public that participates on Coinbase's trading platform cannot rely upon the protections afforded by those regulatory requirements.

The Commission should be very clear about that whenever it acts in the digital asset space so as not to confuse the trading public regarding the CFTC's role as a regulator of futures, options, and swaps and the exchanges on which they trade – and the lack of corresponding regulatory protections under the CEA for those who trade on cash digital asset exchanges like Coinbase. It is unfortunate that today's settlement Order fails to do so.

### **The CFTC Cannot be a Full-Time “Cop on the Beat” for Cash Digital Asset Exchanges**

The CEA has always provided the CFTC with certain limited enforcement authorities with respect to cash commodity markets,<sup>[5]</sup> and those authorities were expanded to some degree by the Dodd-Frank Act.<sup>[6]</sup> The public should be aware that where cash commodity markets are concerned, this limited authority (anti-fraud/manipulation/false reporting, as opposed to day-to-day regulatory oversight) is bestowed upon the CFTC as a tool to assist in its primary function of regulating derivatives products, such as futures. Futures contracts serve a price discovery function. Well-functioning futures (and other derivatives products) rely upon a sound underlying cash market and may reference cash market indexes in their pricing. Therefore, cash market transactions can potentially be part of a scheme to manipulate prices of derivatives products that are regulated by the CFTC. Congress has recognized these relationships between prices of cash transactions and derivatives products, and thus the CEA provides the CFTC with limited enforcement authorities with respect to cash transactions. This is the hook that today's settlement Order uses with respect to Coinbase.

Let me be very clear: I do not condone the conduct that the Commission finds Coinbase and its former Employee A to have engaged in. My point in writing is not to defend Coinbase. Rather, it is to voice my concern about the implications of today's action for the trading public, the American taxpayer, and the Commission's priorities.

#### Public Perceptions

Although data is difficult to come by, a conservative estimate is that there are, at a minimum, dozens of cash digital asset exchanges in operation today. I am concerned that today's exercise of the CFTC's cash market enforcement authority against Coinbase misleadingly suggests that the CFTC is a full-time “cop on the beat” for all manipulation, false reporting, and fraud involving this multitude of exchanges. It is easy to see how the public might get such an impression, especially in light of separate statements on the CFTC's website that “the CFTC maintains general anti-fraud and manipulation enforcement authority over virtual currency cash markets as a commodity in interstate commerce.”<sup>[7]</sup> While such statements may be intended to be educational in nature, when read in conjunction with today's enforcement action against Coinbase, they are likely to create unrealistic public expectations for an agency primarily tasked with regulating derivatives markets, not cash markets.

#### Allocation of Resources

Further, the allocation of the Commission's resources is inherently zero-sum in nature. Every tax dollar and every staff hour spent investigating or prosecuting conduct involving a cash digital asset exchange is a tax dollar or staff hour that is not spent investigating or prosecuting conduct in the derivatives markets that American taxpayers have every reason to expect will be at the center of the CFTC's attention under the CEA. Further, these resources are diverted away from such activities as examining the derivatives exchanges and clearinghouses that do fall within the CFTC's direct oversight. Expending resources on the universe of cash digital asset exchanges outside the CFTC's regulatory oversight risks leaving unaddressed misconduct and compliance deficiencies in the derivatives markets and exchanges that are the CFTC's primary responsibility – or, if addressed, not addressed as promptly.<sup>[8]</sup>

#### Setting Priorities

Let me again be very clear: I fully endorse a robust enforcement program at the CFTC. Holding wrongdoers to account and deterring future misconduct is an essential part of the CFTC's mission, and the Commission and its Division of Enforcement do it well.

For the reasons discussed above, however, it is incumbent upon us to carefully consider where cash digital asset exchanges fit when setting our enforcement priorities. And although I expect the CFTC press release announcing today's settlement will contain the customary patting-ourselves-on-the-back for the \$6.5 million civil monetary penalty imposed on Coinbase, nevertheless, I believe that this case reflects poorly on the Commission's enforcement priorities.

Most importantly, at the time of the conduct at issue, there were no futures contracts, option contracts, or swaps on Bitcoin or other digital assets traded on a DCM or SEF regulated by the CFTC. The false reporting by Coinbase stopped by July 2017, yet the first listed Bitcoin derivatives products did not trade until a few months later.

Throughout its history, the Commission has rightly been judicious, and cautious, about exercising the CEA's enforcement authority in cash markets for commodities for which there is no listed derivatives product traded subject to the CFTC's regulatory authority under the CEA. I see no reason why the Commission should alter that approach for cases involving cash digital asset transactions, simply because they are the latest high-profile headline. The Commission should reserve its enforcement efforts with respect to cash digital asset exchanges like Coinbase for situations in which there is a listed derivatives product traded subject to the regulation of the CFTC with respect to the digital asset in question.

Beyond that, the charges against Coinbase being brought and settled by the Commission are based largely on conduct that is several years old. Indeed, were it not for tolling agreements between Coinbase and the Division of Enforcement, most of the falsely reported transactions would fall outside the applicable statute of limitations. The remaining false reporting by Coinbase came to an end in mid-2017, independent of any action by the Commission, and has not been repeated since then. <sup>[9]</sup>

Once again, this is not to minimize the misconduct of Coinbase (or its Employee A) in any way. If Coinbase were a DCM or SEF required to register with the CFTC and the conduct involved derivatives products regulated by the CFTC, enforcement would unquestionably be appropriate. But that is not the case. And in light of the circumstances described above, in my view, prioritizing this case reflects a misallocation of the Commission's resources.

## Conclusion

The phenomenal growth of digital assets and the proliferation of exchanges for cash digital asset transactions, like many other past market innovations, present unique challenges for various regulators around the globe. It is, therefore, incumbent upon the entire community of regulators, including the CFTC, to clearly convey the scope – and the limitations – of our role in ensuring such new innovations can be brought to the public with integrity.

It is thus the responsibility of the Commission to:

- Clearly and frequently communicate to the trading public that the CFTC does not regulate cash digital asset exchanges such as Coinbase;
- Clearly and frequently communicate to the trading public that the CFTC cannot be the “cop on the beat” with respect to all misconduct that may transpire involving cash digital asset exchanges;
- Focus the expenditure of its limited human and financial resources on the derivatives markets, which is the CFTC's primary responsibility under the CEA; and
- Carefully consider the priority it attaches to unregulated cash digital asset exchanges in its enforcement efforts, especially when there is no listed derivatives product traded subject to CFTC regulation based on the relevant digital asset.

While I concur in the findings and terms of the settlement Order before us today, I question whether the Commission has fulfilled the foregoing responsibilities in this case.

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[1] For convenience, Coinbase, Inc. and the online digital asset exchange that it owned and operated will be collectively referred to herein as “Coinbase.”

[2] CEA Section 2(a)(1)(A), 7 U.S.C. § 2(a)(1)(A).

[3] Depending on the types of derivatives products offered, the CEA requires that a trading platform become a designated contract market (“DCM”) or a registered swap execution facility (“SEF”). DCMs and SEFs are defined as “registered entities” in the CEA. CEA Section 1a(40), 7 U.S.C. § 1a(40). Accordingly, for convenience, both DCMs and SEFs will be referred to herein as being “registered” with the CFTC.

[4] One regulation of particular relevance here is CFTC Rule 38.152, which specifically requires that DCMs prohibit wash trading. 17 C.F.R. 38.152.

[5] See, e.g., CEA Section 9(a)(2), 7 U.S.C. § 13(a)(2).

[6] See CEA Section 6(c)(1), 7 U.S.C. § 9(1), enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010) (“Dodd-Frank”).

[7] See CFTC Release Number 7697-18, CFTC Issues First Pump-and-Dump Virtual Currency Customer Protection Advisory (February 15, 2018), available at <https://www.cftc.gov/PressRoom/PressReleases/pr7697-18> (last visited March 19, 2021).

[8] I am aware of the CFTC’s touting of a “record-breaking enforcement year” in fiscal year 2020, having filed more enforcement actions than any year in the agency’s history. See CFTC Release Number 8274-20, CFTC Posts Record-Breaking Enforcement Year (October 6, 2020), available at <https://www.cftc.gov/PressRoom/PressReleases/8274-20>. Yet such numbers are not necessarily a useful measurement given that, for example: 1) 24 of the cases were significantly smaller (albeit important) actions filed as part of two “sweeps” for firms falsely claiming CFTC registration or membership in the National Futures Association (“NFA”), or failing to maintain NFA membership, see FY 2020 Division of Enforcement Annual Report at 4 n.6-7 (December 1, 2020), available at <https://www.cftc.gov/PressRoom/PressReleases/8323-20>; and 2) some matters were brought against the same respondent at the same time, yet were structured as multiple cases, see CFTC Release Number 8220-20, CFTC Orders the Bank of Nova Scotia to Pay \$127.4 Million for Spoofing, False Statements, Compliance and Supervision Violations (August 19, 2020) (3 separate orders), available at <https://www.cftc.gov/PressRoom/PressReleases/8220-20>. Regardless, while these numbers provide an interesting metric, they do not permit an assessment of the cost to the CFTC’s overall enforcement of the CEA and the CFTC’s rules governing derivatives products as a result of the Commission directing resources to enforcement involving unregulated cash digital asset exchanges instead.

[9] With respect to the conduct of Employee A, I recognize that a company's principal-agent liability for the acts of its employees is strict liability under the CEA. Nevertheless, it is hard to understand prioritizing this secondary liability charge where Coinbase self-reported the misconduct, which occurred during a six-week period nearly five years ago, and the employee in question left Coinbase a year later and is not being charged.

**-CFTC-**