Regulation of Crypto Exchanges

PIFS-IOSCO
Timothy G. Massad
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How are crypto exchanges different

- How to classify the asset
- Centralized and decentralized exchanges
- Instant settlement
- Operate 24x7x365
  - Implications for roles and procedures
- No physical location
How are crypto exchanges different?

- Multiple roles
  - Because of differences in the asset
  - Because they can (less regulated)
- Clearing and settlement models
Top 10 crypto exchanges by volume

<table>
<thead>
<tr>
<th>Ranking (24h volume)</th>
<th>Exchange</th>
<th>24h Volume (USD equiv, billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Binance</td>
<td>$ 23.08</td>
</tr>
<tr>
<td>2</td>
<td>Mandala Exchange</td>
<td>$ 19.72</td>
</tr>
<tr>
<td>3</td>
<td>OKEx</td>
<td>$ 7.03</td>
</tr>
<tr>
<td>4</td>
<td>HitBTC</td>
<td>$ 5.86</td>
</tr>
<tr>
<td>5</td>
<td>FMFW.io</td>
<td>$ 5.75</td>
</tr>
<tr>
<td>6</td>
<td>Upbit</td>
<td>$ 5.52</td>
</tr>
<tr>
<td>7</td>
<td>Changelly PRO</td>
<td>$ 5.19</td>
</tr>
<tr>
<td>8</td>
<td>Coinbase Exchange</td>
<td>$ 4.02</td>
</tr>
<tr>
<td>9</td>
<td>ZT</td>
<td>$ 3.90</td>
</tr>
<tr>
<td>10</td>
<td>Huobi Global</td>
<td>$ 3.74</td>
</tr>
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Source: coinmarketcap.com, 24-hour volume rankings (markets with fees) as of 11/13/2021
Top 10 crypto exchanges by exchange score

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<tr>
<td>3</td>
<td>FTX</td>
<td>$1.98</td>
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<tr>
<td>4</td>
<td>Kraken</td>
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<td>FTX US</td>
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<td>6</td>
<td>Huobi Global</td>
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<tr>
<td>7</td>
<td>KuCoin</td>
<td>$2.54</td>
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<td>8</td>
<td>Bitfinex</td>
<td>$0.63</td>
</tr>
<tr>
<td>9</td>
<td>Crypto.com Exchange</td>
<td>$0.95</td>
</tr>
<tr>
<td>10</td>
<td>Binance.US</td>
<td>$0.64</td>
</tr>
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Source: coinmarketcap.com, 24-hour volume rankings (markets with fees) as of 11/13/2021
How do we regulate them?

- New asset class—doesn’t fit neatly into existing frameworks
- Gaps and lack of clarity may result in lack of oversight
The U.S. Financial Regulatory Framework

- Securities and Exchange Commission (SEC)
- Commodity Futures Trading Commission (CFTC)
- Financial Crimes Enforcement Network (FINCEN)
- Bank Regulators (OCC, FDIC)
- Federal Reserve Board
- State Regulation
The Limits of SEC Jurisdiction

• Jurisdiction over crypto-assets that are securities: (Howey test; distribution questions)
• But the most widely traded crypto-assets are not securities
What’s a Florida orange grove got to do with it?
The Limits of CFTC Jurisdiction

• Jurisdiction over derivatives using cryptocurrencies.
• But authority over the cash market is very limited
  – Fraud and manipulation claims
  – Retail leveraged transactions
CATTLE FUTURES ≠ COWS
Mind the Gap!

Neither the SEC nor CFTC regulates the distribution of a crypto-asset that is not a security or the trading of such assets in the *cash market* . . .

. . . which is most of the trading today—[ie, Bitcoin, Ether, Litecoin, Tether]
The Gap Between the Promise of Bitcoin and the Reality

- Far from disintermediating the financial system, crypto-assets are creating new financial intermediaries.
- While small, they are less accountable than the big banks that almost brought down the financial system.
Crypto Exchanges

Are there “crypto-specific” regulations on:

– Protection of customer assets/custody/segregation
– Order execution and settlement (timing, price)
– Trade transparency
– Recordkeeping and reporting
– Investor disclosure (fees, recourse, etc.)
Crypto Exchanges

Are there “crypto-specific” rules on:

– Governance standards
– Conflicts of interest
– Prevention of fraud, manipulation and abusive practices
– Risk management
– System safeguards (cybersecurity, business interruption, disaster recovery)
Crypto Exchange Policies?

Crypto exchanges may have policies on all or many of the foregoing subjects.

Quality of standards varies

Puts a premium on investor due diligence

A role for voluntary trade assoc?
Potential Risks to Financial System?

- The broader risks arising from the current market for digital assets include:
  - Risk of use of cryptocurrencies for illicit payments, including ransomware and funding of terrorism or black market goods
  - Risk of cyber attack on intermediaries
  - Systemic risk?
- Failure to properly regulate the crypto intermediaries increases these risks
Contact Information

Timothy Massad
Research Fellow, Harvard Kennedy School
Chairman, Commodity Futures Trading Commission 2014-2017
Assistant Secretary of the Treasury for Financial Stability 2010-2014
timothy_massad@hks.harvard.edu
Timothy Massad: Recent Publications on Crypto-assets


“Coinbase’s Small Fine Is a Big Warning to IPO Investors,” Bloomberg, April 8, 2021, https://www.bloomberg.com/opinion/articles/2021-04-08/coinbase-s-small-fine-is-a-big-warning-to-ipo-investors?sref=hU7uPhn8

“Cryptocurrencies: Speculative Bubble or the Future of Money?” Presentation at Harvard University, April 1, 2021, https://www.youtube.com/watch?v=4cJB11qnVqA

"Libra 2.0: Why you might like it even if we can’t trust Facebook,” The Brookings Institute, June 2020, https://www.brookings.edu/research/facebooks-libra-2-0/