David Anderson 01/15/24

Decentralized Finance offers neither promising opportunities to achieve expanded access to basic financial products and services, nor the promise of a more resilient financial system. The notion that DeFi promotes financial inclusivity is a canard which is often cited by proponents of cryptocurrency. This report is full of shortcomings, the main one being repeated assertions that there is a tangible benefit to using cryptocurrencies instead of traditional financial products.

William Pierre-Louis, Jr. writes in his post at https://ourfinancialsecurity.org/2022/07/blog-why-crypto-is-not-the-solution-to-financial-inclusion/:

"Cryptocurrency...portrays itself as the alternative to the traditional financial system, but in reality, its lack of transparency on how it functions, and its limitations could say otherwise...

Advocates for cryptocurrency would like to operate in a new regulatory setting that they design in partnership with friendly regulators. But this industry, once embryonic, now involving hundreds of billions of dollars' worth of assets, has taken off. And regulators already have considerable powers to police it. They should use them. Once again, we see signs that a financial fad is having disproportionate effects on communities of color. Now is the time for policymakers to do what needs to be done."

This report seems to be another exercise in regulatory capture by private industry, and the TAC should be expanded to include advocates for the interests of protected classes. The CFTC should delay any action based on this report and keep public comments open until the end of Q1 2024. This topic is so important that a second meeting is warranted, and should include a panel of policy experts such as Mr. Pierre-Louis, Jr.

Decentralized finance is nothing new. It is disappointing that the subcommittee does not see the bilateral clearing of credit default swaps that was permitted by the Commodity Futures and Modernization Act of 2000 as an example of the unscrupulous behavior that is encouraged by decentralized finance. The resilience of clearinghouse structures demonstrates why centralized clearing with strong collateral requirements is critical to the integrity of our financial system.

There was a significant presentation on algorithmic trading during the hearing that highlighted how difficult it is to recreate audit trails of trades which are often executed with sub-millisecond latencies. The committee should consider that many CFTC-regulated products use Pro-Rata (or similar) matching algorithms rather than FIFO queueing. I believe that the concept of trading at discrete time intervals of ~1ms should be discussed for all products, and have a paper on the topic that I characterize as 'Financial Epistemology' here:
https://www.academia.edu/39791623/A_Modal_Approach_to_Financial_Epistemology

The decision to cite 'Ron Coase' in footnote 5 is an odd typographical error. Coase's theory of the firm is relevant to cases involving real goods and services, not imaginary stores of value derived from solving math problems. Thomas Hobbes would be a more appropriate thinker for the committee to invoke in a revision of this report that should call for a moratorium on decentralized finance until we achieve better control over traditional finance.