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February 20, 2015

Mr. Christopher Kirkpatrick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, D.C.

Re: Public Comment on Related Applications Submitted by LedgerX LLC for Registration as a Derivatives Clearing Organization and Swap Execution Facility; Industry Filing IF 14-007

Dear Mr. Kirkpatrick:

LedgerX LLC ("LedgerX") appreciates the opportunity to respond to comments submitted regarding LedgerX's applications for registration with the Commodity Futures Trading Commission ("CFTC" or the "Commission") as a derivatives clearing organization ("DCO") and a swap execution facility ("SEF"). Based on the comment letters that have been submitted to the Commission, it appears that there is some confusion regarding LedgerX's operations.<sup>1</sup> Below we provide clarification about LedgerX and its risk controls, participant eligibility criteria, clearing operations and other important aspects of the exchange and clearinghouse, as well as responses to the concerns raised. We also thank those that submitted supportive comments.

## **I. LEDGERX HAS APPLIED FOR REGISTRATION WITH THE CFTC AS A SEF AND FULLY-COLLATERALIZED DCO**

### **A. Description of LedgerX's Clearing Model**

Participants in the bitcoin industry have expressed a desire for physically-delivered bitcoin derivative contracts that may be used to hedge risk.<sup>2</sup> LedgerX's SEF intends to offer

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<sup>1</sup> A SEF or DCO applicant may request confidential treatment for portions of an application pursuant to CFTC Regulation 145.9 ("FOIA rule"), which allows confidential treatment for documents that would "reveal the submitter's trade secrets or confidential commercial or financial information." 17 C.F.R. §145.9(d)(1)(ii). In compliance with the Commission's FOIA rule and procedures for registration as a SEF and a DCO, LedgerX sought confidential treatment for documents containing sensitive proprietary information, trade secrets, confidential commercial information or confidential financial information. A few commenters appeared concerned that the application might be insufficient because the commenter could only see the publicly available documents. However, LedgerX has submitted comprehensive applications containing documents comparable to documents submitted by other SEF and DCO applicants and the CFTC is able to fully review our applications.

<sup>2</sup> For example, BitPay, Inc. chief financial officer Bryan Crohn says that he has "nothing to minimize my downside risk" and can only hold bitcoin, waiting for the price to increase. With regard to a bitcoin derivatives exchange,

physically-settled, fully-collateralized bitcoin options contracts. The options contracts will be physically settled because the underlying (*i.e.*, bitcoin) is delivered to the long call holder or the short put holder in exchange for a cash payment to the short call holder or long put holder, respectively. The options contracts are fully-collateralized, meaning that a LedgerX Participant (“Participant”)<sup>3</sup> must transfer to LedgerX collateral in a form acceptable to LedgerX, which may include and, in some cases, require that bitcoin be transferred to LedgerX in an amount that is sufficient to fully cover the maximum potential loss or delivery obligation of the contract before the Participant may enter an order for a contract or execute a trade on the LedgerX Platform. At the present time, LedgerX intends to offer European-style options contracts. Participants will not be permitted to exercise their options contracts before expiration, and the options contracts will not automatically exercise. LedgerX’s options contracts may only be exercised on the expiration date. When an option is exercised, LedgerX applies a random assignment matching procedure whereby long option holders are assigned to short option holders irrespective of other considerations such as the Participant holding the option contract, the length of time the option contract was held or the size of the positions held.

We note that LedgerX would not be the first exchange to offer derivative contracts on a “digital” asset. For example, emission allowances lack a tangible quality and are held only in online registries, yet derivative contracts on emission allowances have been traded for over a decade, may be physically-settled and are regulated by the Commission.<sup>4</sup> The CFTC has previously analyzed intangible environmental commodities and concluded that contracts for such products can be physically delivered.

LedgerX’s DCO is a fully-collateralized and non-intermediated DCO. Each Participant of the LedgerX SEF must be a self-clearing member of the LedgerX DCO. LedgerX’s fully-collateralized clearing model is based on prior precedent that has been reviewed and authorized by the CFTC.<sup>5</sup> LedgerX’s DCO will clear the swaps offered by the LedgerX SEF and report swap data to a swap data repository.

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Crohn says that it is “something that I am anxious to see out there.” Yuliya Chernova, LedgerX Hopes to Establish First U.S.-Regulated Options Exchange for Bitcoin, WALL ST. J. (Oct. 27, 2014), *available at* <http://blogs.wsj.com/venturecapital/2014/10/27/ledgerx-hopes-to-establish-first-u-s-regulated-futures-exchange-for-bitcoin/>.

<sup>3</sup> As required by CFTC regulations, all Participants of LedgerX SEF will be Eligible Contract Participants (“ECPs”) within the meaning of Section 1a(18) of the Commodity Exchange Act (the “Act”) and CFTC Regulation 1.3(m) and will be required to represent that they are ECPs, demonstrate their operational capabilities and satisfy other eligibility criteria before being granted access to LedgerX.

<sup>4</sup> “Those two features – ownership transfer and consumption – distinguish such environmental commodity transactions from other types of intangible commodity transactions that cannot be delivered, such as temperatures and interest rates. The ownership transfer and consumption features render such environmental commodity transactions similar to tangible commodity transactions that clearly can be delivered, such as wheat and gold. For such transactions, in addition to the factors discussed above, intent to deliver is readily determinable, delivery failures general result from the frustration of the parties’ intentions, and cash settlement is insufficient because delivery of the commodity is necessary for compliance purposes. For the foregoing reasons, environmental commodities can be nonfinancial commodities that can be delivered through electronic settlement or contractual attestation.” *See Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”*; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48,208, 48,234 (Aug. 13, 2012).

<sup>5</sup> For example, Nadex offers a fully-collateralized clearing model for binary option contracts.

To begin trading and to ensure that a Participant has sufficient collateral in its account, the Participant must transfer cash in the form of U.S. dollars to LedgerX's settlement bank account or transfer collateral (in the form of bitcoin, for LedgerX's initial contracts) to a designated account under the control of LedgerX.<sup>6</sup> LedgerX obtains a first priority security interest in bitcoin collateral that a Participant transfers to LedgerX by treating the bitcoin as a financial asset under Article 8 of the Uniform Commercial Code ("UCC"). Pursuant to Article 8 of the UCC, LedgerX and each Participant will agree to establish a securities account to which financial assets are deposited. LedgerX and the Participant will further agree that the financial assets deposited into such securities account will be subject to a first priority security interest in the benefit of the transferee (i.e., LedgerX). Participants that transfer cash to LedgerX's settlement bank account must do so by wire transfer from deposit accounts established in their names at a commercial bank. All collateral that Participants post to LedgerX will be physically separated from LedgerX's proprietary funds. At this time, LedgerX does not accept deposits of U.S. government securities, foreign currency or checks in its settlement bank account, but reserves the right to do so in the future.

Before a Participant may enter an order for a short call, the Participant must transfer to LedgerX as initial margin the commodity underlying the contract (i.e., bitcoin) in the potential fully deliverable amount specified in the contract specifications, sufficient to fully collateralize the contract. Conversely, a Participant who wishes to enter an order for a long call must deposit the premium of the option contract. Before the Participant may exercise the long call, the Participant must transfer funds to LedgerX in the amount of the contract's strike price. If the Participant does not transfer the requisite funds, the Participant cannot exercise the long call.

Before a Participant may enter an order for a short put, the Participant must transfer to LedgerX as initial margin the full strike price (i.e., the amount required to purchase the commodity underlying the contract) in collateral acceptable to LedgerX. To enter an order for a long put, a Participant must deposit the premium of the option contract. Before a Participant may exercise a long put, the Participant must transfer to LedgerX the commodity underlying the contract (i.e., bitcoin) in the amount required for delivery as set forth in the contract specifications. If the Participant does not transfer the commodity underlying the contract in the required amount, the Participant cannot exercise the long put.

## **B. LedgerX Maintains Sufficient Financial Resources**

Core Principle B mandates that a DCO maintain adequate financial resources to discharge each responsibility of the DCO.<sup>7</sup> CFTC Regulation 39.11(b)(1) sets forth the types of a financial resources a DCO *may* use to satisfy the Commission's financial resources requirements. Such financial resources include: "(i) Margin to the extent permitted under parts 1, 22, and 190 of this chapter and under the rules of the derivatives clearing organization; (ii) The derivatives clearing organization's own capital; (iii) Guaranty fund deposits; (iv) Default insurance; (v) Potential

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<sup>6</sup> Using bitcoin as an acceptable form of collateral should not "automatically disqualify" LedgerX from operating an innovative business in the U.S., as one commenter suggested. By suggesting that LedgerX should be disqualified for that reason alone, the commenter implies that all future potential products, including many that surely will be settled electronically as trends would indicate, should be refused approval. This will significantly stifle innovation and prevent the U.S. from taking a leading role in the development of a market that is here to stay.

<sup>7</sup> Section 5b(c)(2)(B) of the Act; 7 U.S.C. § 7a-1(c)(2)(B).

assessments for additional guaranty fund contributions, if permitted by the derivatives clearing organization's rules; and (vi) Any other financial resource deemed acceptable by the Commission.”

As provided in LedgerX's application materials, LedgerX will use its own capital, in accordance with CFTC Regulation 39.11(b)(1)(ii), to satisfy the Commission's financial resources requirements. LedgerX does not use margin toward its financial resources requirements.<sup>8</sup> Instead, Participants deposit with LedgerX collateral in the full amount needed to fulfill the Participant's obligations under a contract, and LedgerX uses such collateral to fulfill these obligations after a contract is exercised. As a result, LedgerX would not fall out of compliance with the Commission's financial resources requirements because of the threat of a loss of margin collateral – which in any event is a remote risk, as described below. LedgerX contends that it is in compliance with Core Principle B and CFTC Regulation 39.11 because LedgerX has demonstrated to the Commission that it: (1) is able to cover its operating costs for a period of one year (calculated on a rolling basis); and (2) can satisfy its financial obligations to its clearing members.<sup>9</sup>

### **C. A Guaranty Fund is Not Required by the Commodity Exchange Act or CFTC Regulations**

Neither the Commodity Exchange Act (the “Act”) nor CFTC regulations require a DCO to maintain a guaranty fund. LedgerX does not have a guaranty fund because it is virtually impossible for a Participant to default on fully-collateralized contracts where the collateral is held by the DCO. Participants are protected from counterparty risk because the contracts are fully collateralized. A guaranty fund would be redundant and would impose an additional cost on Participants without additional benefit. CFTC Regulation 39.11 stipulates the types of financial resources a DCO must maintain to satisfy registration requirements. By its express terms, the rule recognizes that not all DCOs will maintain a guaranty fund. CFTC Regulation 39.11(b)(1) lists the types of financial resources that are available to satisfy the CFTC's financial resources requirements and states that the types of financial resources “may include” guaranty fund deposits.<sup>10</sup>

One commenter suggested that LedgerX partner with another financial institution to establish a guaranty fund similar in size to other DCOs such as CME and ICE. CME and ICE offer traditional clearing models that differ from LedgerX's clearing model. CME and ICE clearing members may collect and post performance bond or margin representing just a small percentage of the customer exposure on a contract. In the event of a customer or clearing member default, CME and ICE would need additional financial resources to cover the defaulting participant's obligations. LedgerX would not need additional financial resources if a Participant becomes insolvent because the Participant cannot enter into trades without posting collateral in the amount of the Participant's full exposure on a contract. The commenter's proposal would

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<sup>8</sup> Commenters who questioned whether LedgerX's financial resources are sufficient appear to have assumed that LedgerX would calculate its requirements using initial margin. As described in the accompanying text, this assumption is faulty.

<sup>9</sup> See, e.g., 17 C.F.R. §§ 39.11(a)(1)-(2).

<sup>10</sup> 17 C.F.R. § 39.11(b)(1).

result in an unnecessary financial burden on Participants who would not gain additional benefit from a guaranty fund.

The commenter also remarked that the failure of a DCO like LedgerX could result in negative consequences, including contagion. LedgerX does not present issues related to contagion because LedgerX is not linked to any other DCO. Also, in the event of a DCO failure, LedgerX would not cause the failure of a systemically important financial institution. In a fully-collateralized model, there is less risk of contagion than in a traditional DCO where there is inherent leverage. There is no leverage in LedgerX's model.

#### **D. LedgerX's Market Surveillance Tools Enable Staff to Detect Manipulation**

One commenter remarked that it would be difficult to implement a market surveillance program that has insight into the bitcoin spot market. LedgerX disagrees. LedgerX has already implemented market surveillance software that will enable LedgerX to effectively detect suspicious activity, market disruption or price manipulation, among other activities that violate the Act and Commission and LedgerX rules. LedgerX's contracts are not based on an index, and Participants determine whether to exercise a contract on the expiration date. Although the price of a contract is not based on an index, LedgerX tracks spot exchanges for suspicious activity in the bitcoin spot market using sophisticated, user-friendly software. LedgerX's market surveillance program provides visibility over trading behavior and real-time monitoring, analytics, and customized alerts and reports. LedgerX also has the ability to view bitcoin spot markets' historical and real-time data. LedgerX's market knowledge is further enhanced by incorporating real-time monitoring of news events and social media. LedgerX's holistic approach will enable it to effectively detect market manipulation and other potentially disruptive activities.

## **II. LEDGERX HAS IMPLEMENTED STATE-OF-THE-ART SECURITY TO SAFEGUARD COLLATERAL**

LedgerX recognizes that bitcoin is a unique financial and technological instrument and is potentially susceptible to security threats. Accordingly, LedgerX has implemented state-of-the-art security safeguards to protect the bitcoin that is held by LedgerX on behalf of Participants from cyber-attacks and fraud. LedgerX's hardware and software adds a layer of security currently not offered in the bitcoin wallet industry. Bitcoin industry participants have referred to LedgerX's security measures as "best-in-class."

#### **A. Cutting-Edge Hardware Introduces Best-in-Class Security to the Bitcoin Industry**

LedgerX has installed innovative hardware as part of its security methods to prevent cyber-attacks. LedgerX chose this cryptographic hardware because it provides an extremely high level of security and is similar to hardware used by the U.S. government for encryption purposes. We are unable to further discuss details of our cyber-security methods publicly in the very interest of security. We note that we have shared and will continue to share details of LedgerX's security methods with the Commission.

## **B. Multi-Signature Wallets Help Prevent Fraud and Bitcoin Loss in the Event of a Cyber Attack**

In addition to significant internal security measures, LedgerX holds bitcoin in a multi-signature wallet (“multi-sig”). A multi-sig wallet requires more than one key to be activated before bitcoin can be transferred from one wallet to another wallet. In the case of Mt. Gox, which used only a single-key wallet, Mt. Gox’s key was stolen and the relevant bitcoin was transferred to other wallets using said key. To prevent this type of scenario from occurring at LedgerX, LedgerX uses multi-sig technology and sophisticated hardware and software.

LedgerX has partnered with a BitGo, Inc., a bitcoin security platform provider and pioneer of the multi-sig technology (“BitGo”). BitGo holds one of the keys to LedgerX’s wallet. When a Participant elects to withdraw bitcoin from its collateral account, transferring the bitcoin from LedgerX’s wallet to the Participant’s wallet requires LedgerX to initiate the transaction and BitGo to then co-sign the transaction after following its state-of-the-art authentication, verification and fraud detection procedures. Using multi-sig technology and procedures prevents the single point of attack, which has been the historical vulnerability at other exchanges. If LedgerX or BitGo becomes the subject of a cyber-attack, the theft of a key will not result in the bitcoin being stolen because a successful cyber-attack would give the hacker information about one key only. In these circumstances, the key that is not subject to a cyber-attack would be promptly disabled.

In addition, LedgerX is in the process of obtaining an insurance policy to protect against the theft of bitcoin collateral.

## **III. LEDGERX’S SEF AND DCO COMPLY WITH THE CFTC’S PARTICIPANT AND ACCESS REQUIREMENTS**

LedgerX complies with the Act and CFTC regulations related to participant qualifications and access. LedgerX has Participant eligibility requirements that applicants must satisfy before LedgerX approves applications for Participant status, and must continue to satisfy on an ongoing basis thereafter.<sup>11</sup> CFTC Regulation 37.202(a)(2) requires a SEF to have “[p]rocedures whereby eligible contract participants provide the [SEF] with written or electronic confirmation of their status as eligible contract participants, as defined by the Act and Commission regulations, prior to obtaining access”.<sup>12</sup>

As mandated by Congress, a SEF can only permit ECPs to trade on the SEF. Anyone who is an ECP may be eligible to trade on LedgerX provided that they satisfy LedgerX’s Participant requirements and LedgerX’s know-your-customer (“KYC”) and anti-money laundering (“AML”) policies.<sup>13</sup> LedgerX does not discriminate against Participants or classes of Participants. Unlike traditional designated contract markets or SEFs, LedgerX Participants will not need to first find a futures commission merchant that is willing to clear for the Participant

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<sup>11</sup> LedgerX Rule 3.2.A.

<sup>12</sup> 17 C.F.R. § 37.202(a)(2). The Commission provides that “a SEF that is determining whether to grant an ECP access to its facilities **may rely on a signed representation** of its ECP status.” Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg. 33,476, 33,508 (Jun. 4, 2013) (emphasis added).

<sup>13</sup> See, e.g., LedgerX Rule 3.2.A.

prior to trading because each Participant is self-clearing. LedgerX provides fair and open access to all qualified Participants in accordance with Congressional and CFTC mandates.

Congress also requires a SEF and a DCO to establish fair access criteria. The Act mandates that a SEF “provide market participants with impartial access to the market”<sup>14</sup> and that a DCO establish participation and membership requirements that are objective, publicly, disclosed and “permit fair and open access”.<sup>15</sup> With regard to the impartial access requirement for SEFs, Commissioner Giancarlo states that “[t]his requirement confirms that the Act **does not demand that all market participants receive access to every market.**”<sup>16</sup> The CFTC’s access regulation applicable to DCOs prohibits a DCO from excluding or limiting clearing membership of certain types of market participants unless the DCO can demonstrate that the restriction is necessary to address credit risk or deficiencies in the participants’ operational capabilities that would prevent them from fulfilling their obligations as clearing members.<sup>17</sup> In the preamble to the adopting release, the Commission states that the open access regulation “provides a DCO with discretion to balance restrictions on participation with legitimate risk management concerns and, in this regard, a DCO is in the best position in the first instance to determine the optimal balance.”<sup>18</sup>

One commenter suggested that the self-clearing requirement and fully-collateralized contracts would impede open access. However, LedgerX’s requirements are risk-preventative measures that are expressly permitted by the Commission. LedgerX, in its reasonable discretion, has determined how best to facilitate open access to the DCO while balancing important risk considerations.

It is unclear where one commenter got the impression that LedgerX discriminates against third-party venues by not permitting the clearing of other SEFs’ or exchanges’ contracts. LedgerX’s SEF would be the first platform to offer the product LedgerX’s DCO will clear – physically-settled bitcoin options contracts. LedgerX has not been approached by another

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<sup>14</sup> Section 5h(f)(2)(B)(i); 7 U.S.C. § 7b-3(f)(2)(B)(i).

<sup>15</sup> Section 5b(c)(2)(C)(iii)(III); 7 U.S.C. § 7a-1(c)(2)(C)(iii)(III).

<sup>16</sup> CFTC Commissioner Christopher Giancarlo, “Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: *Return to Dodd-Frank*” 20, 32 (emphasis added) (Jan. 29, 2015), available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf>.

Commissioner Giancarlo continues: “[T]he Dodd-Frank Act’s “impartial access requirement must not be confused with open access. Impartial access, as the Commission noted in the preamble to the final SEF rules, means ‘fair, unbiased, and unprejudiced’ access. This means that SEFs should apply this standard to their participants; it does not mean that SEFs are forced to serve every type of market participant in an all-to-all futures-style marketplace. Only Congress could have imposed this mandate; it chose not to do so. Even the CFTC acknowledged in the preamble to the final SEF rules that a SEF may operate different markets and may establish different access criteria for each of its markets. This preamble language and the statutory language regarding ‘any limitation on access’ are meaningless if the CFTC staff act under the supposition that SEFs are required to serve all types of market participants.” *Id.* at 32-33.

<sup>17</sup> 17 C.F.R. § 39.12(a)(1)(iii).

<sup>18</sup> Derivatives Clearing Organization General Provisions and Core Principles, 77 Fed. Reg. 39,334, 69,353 (Nov. 8, 2011). The Commission permits a DCO to rely on both *qualitative and quantitative analyses*, and provides a DCO with “latitude to determine how it can facilitate open access while determining the risks to which it will expose itself.” *Id.*

exchange regarding a potential clearing arrangement but certainly would consider clearing another exchange's contracts in the event it asked to do so.

#### **IV. THE CFTC HAS THE AUTHORITY AND SOPHISTICATION TO REGULATE BITCOIN DERIVATIVES**

##### **A. The CFTC Will Possess Adequate Oversight of LedgerX**

LedgerX believes that the CFTC has the ability to regulate bitcoin derivatives and provide appropriate oversight of a derivatives exchange that offers and clears bitcoin derivatives contracts.<sup>19</sup> One commenter cited a concern related to cyber-security and the Commission's ability to monitor cyber-security threats to LedgerX because of CFTC budgetary constraints. However, cyber-security is a concern for all financial institutions, not only those that engage in bitcoin transactions. To the extent that budgetary constraints impact the Commission's ability to perform its oversight responsibilities, then all CFTC-registered exchanges would be impacted, not only LedgerX.

##### **B. The Commission Possesses the Authority to Enforce Price Manipulation of Bitcoin Derivatives Contracts**

One commenter questioned the ability of the Commission to bring enforcement actions against persons who attempt to manipulate the price of bitcoin. Section 6 of the Act prohibits manipulative or deceptive devices or contrivances "in connection with any swap, or a contract of sale *of any commodity* in interstate commerce, or for future delivery on or subject to the rules of any registered entity..."<sup>20</sup> The Act does not distinguish between the type of underlying

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<sup>19</sup> Chairman Timothy Massad has provided that the Commission has jurisdiction over derivative contracts based on bitcoin in Congressional testimony. Chairman Massad stated: "Derivative contracts based on a virtual currency represent one area within [the CFTC's] responsibility. Recently, for example, a SEF registered with us made such a contract available. Innovation is a vital part of our markets, and it is something that our regulatory framework is designed to encourage. At the same time, our regulatory framework is intended to prevent manipulation and fraud, and to make sure our markets operate with transparency and integrity." Chairman Timothy Massad, Testimony Before the U.S. Senate Committee on Agriculture, Nutrition & Forestry (Dec. 10, 2014), *available at* <http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-6>. *See also* Chairman Timothy Massad, Testimony Before the U.S. House Committee on Agriculture (Feb. 12, 2015), *available at* <http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-11>.

Commissioner Mark Wetjen has discussed the CFTC's jurisdiction over bitcoin derivatives on numerous occasions. Commissioner Wetjen has stated: "Only with additional understanding can the CFTC be confident that it can effectively execute on its mission of preserving the proper functioning of a crypto-currency derivative market, which includes enforcing rules intended to prevent manipulation of these markets." CFTC Commissioner Mark Wetjen, "Statement of Commissioner Mark Wetjen before the Global Markets Advisory Committee Open Meeting" (Oct. 9, 2014), *available at* <http://www.cftc.gov/PressRoom/SpeechesTestimony/wetjenstatement100914>. *See, e.g.*, CFTC Commissioner Mark Wetjen, "Bringing Commodities Regulation to Bitcoin," Opinion, WALL ST. J. (Nov. 3, 2014), *available at* <http://www.wsj.com/articles/mark-wetjen-bringing-commodities-regulation-to-bitcoin-1415060058>, and Michael J. Casey, CFTC Commissioner Says Agency Has Authority Over Bitcoin Price Manipulation", WALL ST. J. (Nov. 17, 2014), *available at* <http://www.wsj.com/articles/cftc-commissioner-says-agency-has-authority-over-bitcoin-price-manipulation-1416265016>.

<sup>20</sup> Section 6(c)(1) of the Act; 7 U.S.C. § 9(c)(1) (emphasis added). CFTC Regulation 180.1 codifies this prohibition. 17 C.F.R. §180.1.



commodity; rather, the Act allows the Commission to enforce the Act against any market participant transacting in derivatives contracts who is suspected of violating the anti-manipulation statute and related regulations. Bitcoin derivatives contracts are no different,<sup>21</sup> and the Commission possesses the authority to enforce the law against a market participant in the bitcoin derivatives market.

### **C. LedgerX Is Not Circumventing FinCEN or State Money Transmitter Laws**

Under federal law, persons registered with and regulated and examined by the CFTC are excluded from the definition of “money services businesses” (“MSBs”) and are not subject to the Financial Crimes Enforcement Network’s (“FinCEN’s”) registration, reporting and recordkeeping requirements governing MSBs, even if they otherwise meet the definition of an MSB (*e.g.*, are considered to be a money transmitter).<sup>22</sup> A SEF or DCO registered with the Commission would not fall within the definition of “money services business”. Accordingly, LedgerX is not within the scope of the FinCEN registration, reporting and recordkeeping regime.

That being said, LedgerX has crafted robust AML and KYC policies and procedures, which LedgerX submitted to the Commission as part of its application. LedgerX notes that its AML and KYC policies have been reviewed by its outside auditor, Ernst & Young. LedgerX’s policies require LedgerX to comply with FinCEN regulations where applicable.

### **D. The Bitcoin Market Is Robust and in Need of a Derivatives Exchange**

One commenter suggests that the Commission should wait for the bitcoin market to mature sufficiently and until price manipulation presents a lower risk. LedgerX contends that the bitcoin market is sufficiently robust for a derivatives exchange. Common household name companies like Expedia, Overstock.com and Comcast permit payment in bitcoin. As of February 16, 2015, more than 13.8 million bitcoins have been mined and the daily turnover for bitcoin was over 105,000 transactions.<sup>23</sup>

With respect to the concern of potential price manipulation, the Commission has the authority to enforce anti-manipulation laws over commodities but long-established markets continue to suffer from allegations of price manipulation. For example, the current debate over position limits arises from frequent claims of price manipulation in the oil market, which is a centuries-old, robust and mature market. LedgerX has taken the appropriate precautions and surveillance to protect its own market and is in compliance with the Act and CFTC regulations. During the public comment period, actual bitcoin market and eco-system participants submitted supportive comments for LedgerX, including regarding the LedgerX team, and expressed the need for a regulated bitcoin market. The Commission should not wait to act on LedgerX’s applications.

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<sup>21</sup> The Commission already permits the trading of bitcoin derivatives. TeraExchange has offered a bitcoin derivative contract since October 2014. *See* TeraExchange Submission 2014-25: Listing of USD / Bitcoin Non-Deliverable Forward Transaction by Certification Pursuant to Commission Regulation 40.2(a), *available at* <http://www.cftc.gov/filings/ptc/ptc091114teraexcsef001.pdf>.

<sup>22</sup> 31 C.F.R. § 1010.100(f)(8).

<sup>23</sup> Bitcoin Charts, *available at* <http://bitcoincharts.com/bitcoin/>.

## **E. The Implication That “Regulatory Capture” Will Somehow Cause Current CFTC Commissioners and Staff Members To Be Influenced Is an Unfair Allegation**

One commenter contends that the “only plausible reason” to have Mr. Jim Newsome serve as a director of LedgerX is to curry favor with the CFTC. In fact, LedgerX selected Jim Newsome to be a Public Director on LedgerX’s Board because of his prior experience as NYMEX President and Chief Executive Officer (“CEO”), member of the board of the CME Group, and his deep understanding of the derivatives industry, the Act and CFTC regulations. Mr. Newsome is a seasoned professional with both a business and a regulator’s mindset. His regulatory and business knowledge is an asset to any start-up that operates in a highly-regulated industry.

While President and CEO of NYMEX, Mr. Newsome led NYMEX’s initial public offering. He then oversaw NYMEX’s merger with CME Group, which created the world’s largest futures marketplace. Mr. Newsome’s significant experience in exchange strategy, liquidity events and regulation is extremely beneficial to a start-up like LedgerX. We value Mr. Newsome’s extensive business experience in regulated markets and find that his experience, given his successful leadership at NYMEX, to be a very “plausible” reason to desire his involvement.

We also should note that the Act does not prohibit former CFTC commissioners or staff members from serving on the board of directors of companies in the derivatives industry. Prior CFTC experience is beneficial for understanding and advising companies that are subject to evolving and complex regulatory regimes. Numerous former CFTC Commissioners serve on the boards of regulated companies. We do not believe that CFTC commissioners or staff members will be improperly influenced by a board member who is a former CFTC commissioner. Mr. Newsome left the Commission in 2004, over 10 years ago. CFTC commissioners and staff members are professional and are held to high standards of integrity.

## **V. INTEGRITY CONCERNS**

LedgerX has serious concerns about the integrity of the “Michael Green” comment letter because the letter appears to have been submitted by a person using a false name. By viewing the document’s metadata, one can clearly see the document’s properties, including the name of the author, which is shown to be “Dimitri Nemirovksy”. In addition to the integrity of this comment letter, LedgerX is concerned that its arguments are based on presumptions that are themselves based on incomplete and inaccurate information that demonstrate a lack of understanding of LedgerX’s clearing model and operations. We believe we have provided the necessary clarifications herein.

## **VI. CONCLUSION**

LedgerX is an innovative platform for derivatives contracts. LedgerX intends to offer options contracts on bitcoin as its initial product offering in an effort to satisfy the demand of market participants in the bitcoin industry. Industry member comments support that market demand. Bitcoin is a unique product with unique security concerns. As a result, LedgerX has implemented advanced security procedures and safeguards to mitigate against sophisticated cyber-attacks. In the remote event that LedgerX becomes subject to a cyber-attack, the theft of

bitcoin is still highly unlikely because of the multi-signature wallet and the technology that LedgerX uses to hold bitcoin.

LedgerX appreciates the opportunity to provide more information about our innovative exchange and to respond to commenters' concerns. Should the Commission have any questions about the foregoing, please contact the undersigned at [kari@ledgerx.com](mailto:kari@ledgerx.com) or (917) 677-7598.

Sincerely,



Kari Larsen,  
General Counsel and Chief Regulatory Officer

cc: Chairman Timothy Massad  
Commissioner Mark Wetjen  
Commissioner Sharon Bowen  
Commissioner Christopher Giancarlo  
Phyllis Dietz, Acting Director, Division of Clearing and Risk  
Nancy Markowitz, Deputy Director, Division of Market Oversight