May 9, 2022

Mr. Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street NW
Washington, DC 20581

Re: Comments Responding to Commission Publication of FTX's Request for Amended DCO Registration Order; Filing Number 22-001

Ladies and Gentlemen:

Galaxy Digital ("Galaxy") is writing with respect to FTX US Derivatives' ("FTX") recent proposal requesting that the Commodities Futures Trading Commission ("CFTC" or "Commission") amend its Amended Order of Registration as a derivatives clearing organization ("DCO"), which would allow FTX to offer margin directly to customers. In sum, Galaxy believes that FTX's proposal should be viewed in a positive light and bears serious consideration for its innovative approach to managing settlement risks.

Galaxy Digital (TSX: GLXY) is a technology-driven financial services and investment management firm that provides institutions and direct clients with a full suite of financial solutions spanning the digital assets ecosystem. Galaxy operates in the following businesses: Trading, Asset Management, Investment Banking, Mining, and Principal Investments. Galaxy's CEO and Founder is Mike Novogratz. The Company is headquartered in New York City, with offices in Chicago, London, Amsterdam, Tokyo, Hong Kong, the Cayman Islands (registered office), and New Jersey. Additional information about the Company's businesses and products is available on www.galaxydigital.io.

We believe that it is essential for any clearing and settlement system to withstand catastrophic liquidity events. The current mutualized model has evolved over time into a system that has met that objective. The reason it works is that it spreads out risk among many parties based on a simple premise—the more credible counterparties that have agreed to share the risk, the lower the chance the system will fail. In addition, it is typical that such systems include a guaranty fund as a further backstop. Over a considerable time, this model has worked well.

Furthermore, intermediaries currently play a very important role in managing systemic risks. In fact, FCMs, and not DCOs, service the individual customers and is one reason that the regulations on Futures Commission Merchants ("FCMs") differ from DCO regulations. While DCOs seek to novate and net exposures to FCMs, FCMs are required to segregate accounts and funds of individual customers and ensure and guarantee that the margin requirements of those accounts are met. FCMs also have added responsibilities far beyond DCOs, such as being the first line of protection from the fraudulent or manipulative activity of their customers. In this way, risk is further shared and mutualized. Without FCMs, it would presumably fall to the DCO to be responsible for functions that are not typically provided by DCOs, necessitating additional resources and further build out of operations.

FTX posits that its innovations address certain weaknesses of the current model. It proposes a de-mutualized model that relies on FTX's systems and risk models to ensure market settlement and mitigation of risk and which seeks to reduce the time to settlement risks of the mutualized model through near-continuous pay-collects. Properly deployed with appropriate resilience, this is an innovation with the potential to drastically reduce systemic risks.

Like many others, we are concerned that cracks are appearing in the foundation of the risk clearing model. The increasing decline in the number of registered clearing firms signals that there are issues with the profitability of the business model and perhaps suggests growing concentration of risk.[1] Not only that, but just a few of the largest clearing firms account for over half of all funds in the clearing system. A recent Working Paper from the Federal Reserve Bank of Chicago makes this relevant statement:

> For the past few years, the clearing of derivatives has been chiefly handled by a small number of clearing members at major CCPs across the world. In U.S. derivatives markets, for instance, the largest five clearing members (as measured by customer funds) account for over half of all client margin … according to data from the U.S. Commodity Futures Trading Commission (CFTC) … various national authorities, international standard setters, and market participants have argued that, unchecked, the consolidation within the clearing industry, coupled with the concentration of derivatives contracts among a few large CCP clearing members, could be a source of systemic risk.[2]

One of the chief drivers reducing the number of clearing firms is the diminishing profitability of the business. The impact on profitability has several causes—chief among them have been the persistent low interest rates and the heightened capital reserve requirements. Additionally, while the market unrest beginning with the 2008 financial crisis necessitated action, the *Dodd-Frank Act* has increased regulation and the cost of doing business—adding further costs to an already unprofitable business model.

We also believe, as FTX correctly articulates, that the current model and market plumbing has inefficiencies that make it more difficult for clearing firms and clearinghouses to quickly address margin shortfalls caused by sudden and severe market moves, which increases system risk. Re-thinking the current mutualized model is warranted and could perhaps benefit from consideration of new methodologies.

As set forth in their public filings, FTX proposes certain improvements to the clearing model, including real-time mark-to-market of all positions, near real-time pay/collects, monitoring of concentration and liquidity, stress testing, liquidation of under-margined customer positions in the CLOB, and a risk waterfall that includes well-capitalized default liquidity providers and the provision of $250MM for a further safety net. In this way, FTX addresses the time delay risks endemic to current mutualized systems—whose risks grow quickly as market volatility increases. Near real-time settlement is an important innovation and is laudable. Coupling it with the proposed safety net, we submit, seems to adequately address transactional and market risks.

We believe that the FTX proposal should be viewed carefully against the current system, which has consistently enabled markets to survive (and thrive) during tumultuous events. While the current

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[1] *See* 2021 Financial Stability Oversight Council Annual Report, at 57, noting the decline of FCMs clearing futures fell from over 100 in 2002 to 49 as of September 2021, with 22 of the 49 being bank affiliated. https://home.treasury.gov/system/files/261/FSOC2021AnnualReport.pdf

[2] *The concentration of cleared derivatives: Can access to direct CCP clearing for end-users address the challenge?*, Nahiomy Alvarez and John McPartland, Federal Reserve Bank of Chicago Working Paper 2019-06 (Aug. 20, 2019).

system may be cumbersome in certain respects, spreading risks among multiple parties certainly reduces the single point of failure issue. However, we are confident that the CFTC will evaluate whether the FTX systems are sufficiently resilient to guard against material disruptions. And to the extent there are gaps between the DCO Core Principles and the rules governing FCMs, those gaps can be identified and closed by placing additional appropriate obligations on FTX.

Nevertheless, Galaxy urges the Commission to be open to innovation. FTX's ideas are well considered, and they have thoughtfully set forth a proposal on how they will monitor and manage customer risk in a more stringent fashion than is required under the regulatory regimes for DCOs and FCMs.

In addition, introducing competition and innovation into a system that has become increasingly concentrated, and perhaps a bit antiquated, would, if soundly managed, lead to healthier and more stable markets. Supporting competition and innovative business models that introduces new entrants can improve market functions, help reduce costs, make markets stronger, accessible, and resilient, which in turn can have positive impacts on liquidity and price discovery.

For these reasons, we believe that the CFTC should support that potential and give serious consideration to FTX's thoughtful proposal. In order for FTX to demonstrate its ability to prove the efficacy of their risk management standards and practices, perhaps the CFTC could consider encouraging FTX's initiative through some measured restrictions—such as permitting it only with respect to digital asset-related products or the imposition of a conservative minimum margin requirement. As FTX stated in their February 8, 2022 letter to Division Director Clark Hutchinson, FTX fully expects to be able to monitor and manage customer risk in a more stringent fashion than is required by either the DCO or FCM regimes. Further, FTX set forth several metrics by which they will hold themselves to a heightened standard. We believe that the CFTC should use these, and perhaps other, metrics and craft a framework to demonstrate its capabilities while safeguarding customers and markets. Doing so will test the systems, introduce competition, and allow the CFTC to evaluate the performance—which could be simultaneously evaluated by one or more third-party auditors.

Galaxy Digital appreciates the opportunity to present our views on FTX's proposal and would welcome the opportunity to discuss these important matters with the Commission.

Sincerely,

Andrew Siegel
General Counsel

cc: The Honorable Rostin Behnam, Chairman
The Honorable Kristin N. Johnson, Commissioner
The Honorable Christy Goldsmith Romero, Commissioner
The Honorable Summer K. Mersinger, Commissioner
The Honorable Caroline D. Pham, Commissioner
Clark Hutchison, Director, Division of Clearing & Risk
Robert Schwartz, General Counsel