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May 11, 2022

Via On-Line Submission

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

Re: Comments Responding to Commission Publication of FTX's Request for Amended DCO Registration Order

Dear Mr. Kirkpatrick,

R.J. O'Brien & Associates, LLC ("RJO") appreciates the opportunity to comment on the above-referenced proposal ("Proposal") filed by LedgerX LLC, d/b/a FTX US Derivatives ("FTX") on December 26, 2021, and made available by the Commodity Futures Trading Commission ("CFTC") on March 10, 2022.

RJO has consistently supported innovation and technological advancements in the futures industry that provide for a safer and more efficient industry. For example, RJO embraced the evolution of trading when the industry transitioned from open outcry trading on exchange floors to electronic trading. RJO provides direct market access to certain of its customers and supports multiple trading platforms, all while providing our customers real-time views into their accounts. Most recently, RJO expanded its services to include crypto trading on the Bitnomial Exchange. Though not limited to the above, RJO possesses a track record of supporting innovation and efficiency where such developments maintain or enhance customer protections and/or mitigate risk in the marketplace.

The Proposal claims to offer innovation through use of real-time monitoring and implementation of an auto-liquidation feature of under-margined accounts, features which already exist. As such, the focus of the Proposal then becomes the application of these in a disintermediated model and the impact on customer protections and marketplace integrity, including segregation of customer funds, residual interest availability, capital requirements, and margining and liquidation procedures, all of which, we feel, are not adequately addressed in FTX's rule book.

We reviewed the proposal through the lens of the CFTC's Strategic Objectives, "The Commission works vigilantly to protect customer assets and information. We [CFTC] are

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identifying potential rule revisions and orders that promote asset and information protection."[1] We believe the Proposal contradicts this goal, and will, in fact, lead to a degradation of customer protections and increase risk to the overall marketplace. To that end, it must be noted that we appreciate the CFTC's consideration of these concerns and would welcome the opportunity to discuss them further as we strive toward the common goal of maintaining the enhanced customer protections already in place and the integrity of the futures markets. Below, we respectfully state our principal concerns with the Proposal. Please note that this letter is not inclusive of all issues and concerns that RJO has identified. As an active member of the Futures Industry Association ("FIA"), we are also generally supportive of the well-reasoned and thoughtful comments that are being submitted by the FIA.

I. Background

A. R.J. O'Brien & Associates, LLC

Chicago-based RJO, which celebrated its Centennial in 2014, is the nation's oldest and largest independent futures brokerage firm and the last surviving founding member of the Chicago Mercantile Exchange (now CME Group). RJO offers 24-hour execution and clearing on futures exchanges worldwide. RJO, together with its global affiliates, has more than 500 employees, with a presence in Chicago, New York, Denver, Des Moines, Houston, Orlando, Toronto, Montreal, Winnipeg, London, Paris, Dubai, Hong Kong, and Beijing.

Clearing more than 80,000 client accounts, RJO provides a full range of services to the industry's largest global network of introducing brokers (IBs) and to commercial, institutional, international, and individual investors. These include more than 300 IBs and many of the world's largest financial, industrial, and agricultural institutions. RJO does not engage in speculative proprietary trading; all its business focuses on valued clients.

RJO is one of the last 'boutique' futures firms in the industry. It is majority-owned by the O'Brien family of Chicago. The O'Brien family was instrumental in the development of the futures industry and remains committed to the continued growth of the company and RJO's leadership within the industry.

As part of RJO's leadership, Gerald F. Corcoran has served as Chief Executive Officer since 2000 and Chairman of the Board since 2007. Mr. Corcoran joined RJO in 1987 as Chief Financial Officer, and he was named Chief Operating Officer in 1992.

Mr. Corcoran is a leading voice in the futures industry and has been an advocate for fair markets and appropriate customer protections. In 2014, he was elected Chairman of the FIA (formerly Futures Industry Association), serving in that position until 2016. Mr. Corcoran is also a member of the FIA's Executive Committee and several other committees. He has been a member of FIA's Board of Directors since March 2008 and also served as Vice Chairman from 2013 until 2014. Since 2018, Mr. Corcoran has also served on the CFTC's Global Markets Advisory Committee as well as since 2006 serving as a member of the Board of Directors of the National Futures Association ("NFA"), the self-regulatory organization for the futures industry. Following

[1] See CFTC Strategic Plan 2020 – 2024 at Strategic Goal 2.4.

the collapse of MF Global in 2011, Mr. Corcoran testified before the House Committee on Agriculture and advised on ways to strengthen the customer asset protection regime He also served on the NFA's SRO Committee that implemented several changes strengthening customer protection, including electronic verification of segregated fund deposits by FCMs at depositories. Later in 2012, after the downfall of Peregrine Financial Group, the NFA's Board of Directors appointed Mr. Corcoran to a special committee tasked with overseeing the implementation of recommendations designed to improve the operations of NFA audits.

B. The FTX Proposal

FTX proposes to modify its current Derivatives Clearing Organization ("DCO") license to offer at a designated contract market ("DCM") a disintermediated model of derivatives trading directly to individual participants on a margined basis. This differs from current models previously approved by the CFTC that include the customary intermediated model where customers are allowed to trade derivatives on margin through a futures commission merchant ("FCM"), and alternate disintermediated models. The previously approved disintermediated models are limited in their scope, in that they only offer specific products, may only offer trades on a fully collateralized basis, or are limited to specific customers (i.e., not retail).[2]. The Proposal, as written, suggests that FTX would allow its participants, whether retail or institutional, to trade derivatives, on margin, directly with the DCO. The Proposal is not limited to cryptocurrency, digital assets, or any type of customer.

This margined, disintermediated model has never been tested in U.S. markets and, with limited information included in the Proposal, there remain several open questions and concerns. We therefore ask the CFTC to carefully consider the potential effects on the robust customer protections already in place and overall integrity of the marketplace before amending FTX's DCO license, if at all.

II. FTX's Disintermediated Model Will Lead to a Degradation of Customer Protections.

FTX currently operates as a DCO, and FTX is undoubtedly subject to numerous regulatory requirements. However, the CFTC put in place these regulatory requirements with the understanding that FCMs would be responsible for key functions that would allow DCOs and DCMs to operate as intended. An FCM's role is integral to the futures market. Under the proposal, as a DCO, FTX will be interfacing directly with participants (which would be equivalent to customers in an FCM structure) without complying with or adhering to the legal requirements placed on an FCM, many of which were instituted under the watch of Gary Gensler, CFTC's chairman from May 2009 through January 2014 and one of the leading futures industry reformers following the 2008 financial crisis. Under Chairman Gensler's leadership, the CFTC comprehensively reformed the customer protection regimes for the futures and swaps markets. Approving the Proposal as is would undo years of necessary reform undertaken to improve customer protections and market integrity.

[2] For example, Kalshi and NADEX operate disintermediated models and only offer binary options. Further, NADEX only allows trades that are fully collateralized, meaning trades are not executed on margin. NGX also offers a disintermediated model, however, retail customers are essentially precluded from participation.

Under the current regulatory landscape, FCMs must: (A) protect customer funds through segregation; (B) provide additional customer protection through residual interest; (C) comply with strict minimum net capital requirements; (D) abide by the recently amended bankruptcy rules under Part 190; and (E) comply with various other regulations and rules enacted by the CFTC, the NFA and the FCM's designated self-regulatory organization ("DSRO") as well as by their other self-regulatory organizations ("SROs"). FCMs also provide a valuable buffer to mitigate and rectify operational errors by DCOs, many times, without the customer being aware of or burdened with such errors. Below RJO discusses specific FCM requirements including customer funds protection, residual interest, the effects of bankruptcy and Part 190, and regulatory oversight, and highlights the shortfall in the Proposal that we believe will lead to a degradation of customer protection overall.

A. The Commodity Exchange Act and the CFTC Require FCMs to Protect Customer Funds Through Segregation.

When enacted in 1936, the Commodity Exchange Act (the "Act") required FCMs to segregate customer funds. Specifically, as relevant under the Proposal, for customers trading futures listed on US futures exchanges, FCMs must maintain a customer segregated account. When maintaining a customer segregated account, customers deposit funds with an FCM to margin futures and options on futures contracts traded on futures markets located in the US, i.e., DCMs, which must be held in accordance with section 4d(a)(2) of the Act and CFTC Rule 1.20. Further, customer funds held in the customer segregated funds account may not be used to meet the obligations of the FCM or any other person, including another customer. This is one of the foundational rules governing FCMs by ensuring that the customer's funds are only used for the benefit of the customer. Though customer funds may be commingled in a single account at a bank, DCO or another FCM in an omnibus account, the omnibus account must be properly titled and acknowledged to make clear that the funds belong to and are being held for the benefit of the FCM's customers. When MF Global failed, which was the most significant futures industry failure in recent times, customers of the US FCM eventually were made whole, due in no small part to the segregated fund protections. In contrast, the customers of Peregrine Financial Group were not made whole when its CEO circumvented customer fund segregation rules and embezzled more than $215 million from its customers. As a result of Peregrine, the NFA and CME Group created a process to receive daily confirmations from all banks holding customer segregated funds. The segregation confirmation system now performs an automated comparison of that information with the daily reports filed by the FCMs and generate immediate alerts for any material discrepancies. This reinforces the importance of customer funds segregation rules and that funds belonging to customers must be kept legally segregated from proprietary assets of the FCM.

In the margined disintermediated model as proposed, all "customers" are "clearing members" or "participants" and FTX, as a DCO, is not subject to the customer asset protection regime for customers because, assuming it is not running a hybrid of disintermediated and intermediated models, FTX will not be holding "customer funds" as defined under the CFTC regulations. Clearing member property on deposit with the DCO is "member property," to which the segregation rules applicable to FCMs and DCOs with respect to customer funds do not apply. Rather, a DCO is required to hold member funds and assets "in a manner which minimizes the risk of loss or of delay in the access by the [DCO] to such funds and assets." See CFTC Regulation

39.15(c). Subject to this standard the DCO's handling of member funds and assets is entirely in its discretion. This means:

1) FTX may use, invest, and rehypothecate member/participant property (as distinct from customer property), free of the constraints set forth under CFTC Regulations 1.25 and 22.3 governing the investment of customer funds.

2) A DCO is not required to maintain member property solely with permitted depositories in accounts specifically denominated as member property, or to obtain written acknowledgment letters from such depositories conforming to the requirements set forth in CFTC Regulations 1.20, 1.26, 30.7 or 22.5.

3) FTX may hold member funds in offshore depositories, denominated in such currencies, without regard to the restrictions on holding customer funds in offshore depositories set forth under CFTC Regulations 1.49 and 22.9.

4) FTX is not required to make public disclosures concerning its rules, policies and procedures concerning segregation and portability of member property, as it is with respect to customer funds – see CFTC Regulation 39.37(d).

Under the Proposal, FTX's own rulebook clearly disregards customer segregation rules by comingling customer funds with FTX's own funds. In fact, their Rulebook unambiguously states that:

> "the Company [FTX] (i) may invest Initial Margin or Variation Margin in the form of cash in accordance with the Company's investment policies and applicable law, and (ii) may use Participant's assets constituting Initial Margin or Variation Margin in its account from time to time to meet temporary liquidity needs of the Company (whether or not such Participant is in default), in a manner consistent with the Company's liquidity policies and applicable law, including by way of assignment, transfer, pledge, repledge or creation of a lien on or security interest in such Initial Margin or Variation Margin in connection with borrowing, repurchase transactions or other liquidity arrangements to support payment obligations of the Company in respect of Company Contracts."[3]

It should be noted, member, or under the Proposal "Participant," funds at a DCO are not considered to be customer accounts and are not subject to legal segregation requirements under the CEA or CFTC rules. Therefore, separation of funds by FTX between Participants and proprietary funds is not the same as legal segregation. Internal policies do not offer the same level of protection imposed by statute and rule. This contradicts the CFTC's Regulations and intent of protecting customer funds' and would allow FTX to use customer funds for FTX operations and replace them sometime in the future.

B. The Act and the CFTC Require FCMs Provide an Added Layer of Customer Protection Through Residual Interest.

[3] See LedgerX LLC dba FTX US Derivatives-Rulebook-Margin Revisions-Final Draft 12-6-2021 at Rule 7.1.G.5.

In addition to segregating customer funds, FCMs are required to deposit their own funds in the segregated account to serve as a buffer to assure the FCM is always in compliance with the relevant provisions of the Act and CFTC rules. Such excess funds represent residual interest and are held for the exclusive benefit of the FCM's customers while held in a customer account. In fact, FCMs provide residual interest at a target beyond the minimum client obligation. RJO's target is reviewed and reassessed quarterly and made public via our public disclosure requirements. To determine the amount of residual interest an FCM deposits into its customer account, the FCM must consider factors including: (i) the nature of the FCM's customers, their general creditworthiness, and their trading activity; (ii) the type of markets and products traded by the FCM's customers and the FCM itself; (iii) the general volatility and liquidity of those markets and products; (iv) the FCM's own liquidity and capital needs; and (v) historical trends in Customer Funds balances and customer debits. The strict customer segregation rules and residual interest rule are vital to the protection of customer funds and provide the foundation of a safe and efficient marketplace.

Whereas the CFTC requires an FCM to follow strict rules regarding customer fund segregation and residual interest and further requires an FCM to notify the CFTC and its DSRO immediately if the residual interest falls below its target, accordingly, FTX's own rule book clearly disregards the segregation of customer funds and mentions residual interest only as it pertains to an FCM Participant. As a result, in a closeout upon a member default resulting in a deficit, assets of non-defaulting customers may be encumbered should FTX decline to cover that deficit with its own funds (FTX would have no obligation under the segregated funds rules applicable to FCMs to do so, since no such rules apply to DCOs with respect to member property). This means FTX would not be required to ensure that one customer's property is never encumbered by another customer's obligations, as a DCO is not required to maintain residual interest commingled with member property in order to ensure against such an encumbrance event. It would not be beneficial for the industry to have a situation in which a default resulted in customer funds being encumbered and where customers do not have a high degree of probability that they would be made whole, unlike MF Global mentioned above.

C. Additional Protections Afforded to Customers Through Minimum Capital Requirements.

As a registered DCO, FTX is not legally subject to certain obligations of registered FCMs designed to protect customers and the markets in which they operate. The minimum amount of capital that an FCM must maintain is defined by rule and constantly fluctuates. Generally, an FCM must maintain the greater of $1 million, 8% of the margin requirement (as defined in CFTC Rule 1.17(b)(8)) for positions carried by the FCMs in customer accounts and non-customer accounts, or the highest amount required by the Securities and Exchange Commission ("SEC") (for combined broker-dealers and FCMs) or any self-regulatory organization. These capital requirements ensure funding is available to backstop the trading of FCM customers and house accounts. FCMs further manage the risk of their customers as markets move and reserve the right to make intraday margin calls in excess of the required DCM margin in volatile markets. All in, FCMs typically retain capital in excess of 110% of the required amount. Further, though FCMs typically maintain adequate capital in excess of the required minimum, the CFTC and an FCM's DSRO require an FCM to provide immediate notification of any material reductions even if capital

remains above the required amount. In contrast, DCOs do not have this same obligation and are not subject to the same level of transparency. This buffer ensures stability in the marketplace, and we question whether FTX's capital requirements are sufficient to provide that same level of stability.

Further, under the traditional DCO model, a DCO may require an FCM to contribute to a guaranty fund and allows the DCO to require additional assessments from FCMs to shore up the guaranty fund as circumstances require. The Proposal indicates that FTX will maintain a guaranty fund equal to $250 million. We had the opportunity to review, and we agree with, the FIA's comments concerning FTX's default resources. As it stands, FTX proposes to size its default fund to cover a default by up three clearing members ("Cover-3") that create the largest exposure for the DCO if Cover-1 and Cover-2 do not collectively account for 10% of the initial margin on deposit. Under the Proposal, we question FTX's calculation of its $250 million guaranty fund as it does not include maintenance margin and whether Cover-1, -2, or -3 is appropriate, given that FTX may have hundreds of retail participants. It remains unclear how FTX's guaranty fund will be replenished, or if it will be increased at any time in light of any capital shortfalls. In short, FTX is not subject to the same capital requirements as FCMs, and there is no way to know whether the proposed $250 million is sufficient without further analysis of FTX's risk management practices compared to the stresses of market disruption and volatility markets will inevitably bring.

D. The Proposal Does Not Include Clear Rules in the Event of an FTX Bankruptcy.

To further customer protections, the CFTC very recently amended the robust FCM bankruptcy regime under Part 190. Part 190 makes it clear that funds of customers of a bankrupt FCM are directed back to the customer immediately. Further, by statute, the funds do not pass through the bankruptcy estate and are not subject to any claim by the FCM's creditors. Part 190 also stresses the CFTC's longstanding preference for transferring positions of public customers rather than liquidating the positions and assigns a preference to customer property over member property.

If FTX were to file for bankruptcy, the winding up process is unclear. Part 190 contains different subparts applicable to FCMs (Part 190, Subpart B) and DCOs (Part 190, Subpart C). Both relevant subparts contain differing definitions of "non-public customer," "public customer," and "customer." Thus, the protections afforded to a customer of an FCM versus being a direct member of a DCO may have important implications if FTX were to declare bankruptcy. FTX has suggested, it may operate a hybrid of margined disintermediated model and a margined intermediated model by permitting FCMs to hold omnibus accounts for customers, then, in the event of the FTX's insolvency, those customer accounts would have priority over the "member property" of disintermediated "clearing members". This may leave "clearing members" – who in many cases would in fact be retail customers – out of pocket based solely on how they onboarded to the service. This directly contradicts CFTC's goal of protecting customer funds in the event of bankruptcy. Given the apparent gaps, we request that the CFTC consider whether the Proposal can feasibly include procedures that align with the statutory requirements and spirit of Part 190 in the case of bankruptcy.

E. Degradation of Other Customer Protections.

i. *NFA's Role and Registration*

In addition to being registered with the CFTC, FCMs are required to be members of the NFA. Again, we reviewed, and we agree with, the FIA's comments concerning the role the NFA will play as it pertains to FTX's registration and applicable rules should the Proposal be approved. Further, it is unclear whether FTX will be subject to any self-regulatory organization, which is unlike any other customer facing entity offering services in the futures industry.

ii. *Disclosures and Reporting Obligations*

The Proposal presents risks to the CFTC's framework of customer protection that require additional evaluation and assessment, particularly in light of Strategic Goal 2.3 from the 2022-2026 CFTC Strategic Plan, which generally discusses the importance of educating customers, specifically retail customers, of the risk associated with trading futures through the use of disclosures. With specific guidance provided by the CFTC and relevant self-regulatory organizations, these disclosures ensure that customers and prospective customers have the information needed to appropriately assess potential transactions and relationships in view of their personal risk profile and goals. An FCM is required to make certain disclosures and provide its customers with certain information including specific risk disclosures under CFTC Rule 1.55. As a DCO/DCM, FTX would not be legally required to inform its participants of the specific risks laid out in CFTC Rule 1.55.

In addition to the required disclosures, CFTC and NFA rules require FCMs to file certain daily and semi-monthly reports. These reports provide greater transparency into the FCM's operations and are viewed to ensure FCMs maintain customer funds segregated in accordance with CFTC Rule 1.20. These filings include a Segregated Funds Statement and Segregated Investment Detail Report, among others, as applicable.[4] As a DCO, FTX is not required to make such filings which removes another level of checks and balances put in place to ensure customer protection.

F. Degradation of Customer Protection Conclusion

Overall, FCMs are required to implement and maintain a fulsome risk management program to protect customers and the overall marketplace. We believe the Proposal, if approved, will lead to a degradation of customer protections implemented by the various regulatory bodies that oversee FCMs. It is clear that FTX, as a DCO/DCM, is not subject to the same regulatory regime as FCMs, and ultimately "participants" classified as customers will suffer. We strongly urge the CFTC to carefully consider the above when evaluating whether a margined, disintermediated model in the Proposal is a viable option given the efficient, robust regulatory environment. At the very least, FTX should be subject to the same regulatory environment as FCMs because FTX desires to reap the benefits afforded to FCMs. This will promote fair competition and level the playing field in the marketplace. Further, if the Proposal is approved, we feel that the CFTC should consider requiring FTX's participants to acknowledge the lack of customer protections provided by FTX.

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[4] See CFTC R 1.32

III. The Proposal Touts the Auto-Liquidation Feature and Real-Time Margining as Innovative, Though they May Lead to Unintended Consequences Increasing Market Risk.

FTX touts its innovative efforts through the use of real-time margining ("RTM") and an auto-liquidation feature that liquidates positions of its participants in 10% increments when the participant's maintenance margin falls below an acceptable level. This technology, however, is not new to the industry, nor should it be used indelicately as a "weapon of mass destruction" aimed at participants to protect FTX's own interest. We believe liquidating a participant's positions should be considered only as a last resort to promote customer protection and market integrity. Further, FTX proposes to allow its participants' posted margin to include digital currency. We believe this would increase the frequency of auto-liquidation and the associated risks. Digital currencies are more susceptible to price fluctuations as opposed to other, stable forms of collateral, like the U.S. Dollar. If the price of a digital currency posted as margin decreases, this may lead to a participant being under-margined and ultimately lead to a participant's open positions being auto liquidated, even when the market conditions may have otherwise remained stable.

The RTM principle in the Proposal is comparable to how DCOs, in connection with their compliance with the Principles for Financial Market Infrastructures, currently monitor risk (including customer and member margin levels) in all clearing accounts intraday in real time, on at least a 24/6 basis. In addition, RJO provides its clients with access to technology that shows their position on a near-real time basis.

The Proposal indicates that FTX will initiate the auto-liquidation of a participant's positions if there is insufficient maintenance margin. During times of market volatility, many participants may experience a default due to insufficient margin. Under the traditional intermediated model, customers would have an additional buffer due to the residual interest requirement imposed on FCMs, and FCMs will likely contact its customer and request additional margin before taking any action. In fact, FCMs play a vital role in monitoring customer accounts' margin balances and identifying potential issues before they arise and pose additional risk to the market and other market participants. Even so, should an FCM choose to liquidate its customer, it may only do so by taking into account market conditions, including liquidity in the market. While FTX asserts that its auto-liquidation feature successfully handled multiple defaults on volatile days in its European entity, this model has not been tested on U.S. markets with large institutional participants. Historical data shows liquidating large market participants during a volatile market leads to a cascading effect leading to further defaults. This potentially will have a great effect on retail traders as they often trade on market momentum. While FTX touts the functionality of its objective, auto-liquidating algorithm, we believe it may, in fact, exacerbate market volatility and create unnecessary systemic risk.

In an inadequate attempt to alleviate the above concern, FTX's rulebook provides, "If the Company determines that it is not practicable or advisable under the circumstances in light of liquidity, open interest, market conditions or other relevant factors to liquidate or attempt to liquidate some or all of a Participant's open Company Contracts pursuant to Rule 14.3.A, the Company may, at its discretion, transfer a Participant's Company Contracts to a Backstop

Liquidity Provider. The Backstop Liquidity Provider shall take the open positions from the Participant's Company Contracts in such quantity as agreed between the Company and the Backstop Liquidity Providers" (*See FTX Rulebook at Rule 14.3.B*). However, the rulebook does not indicate what the requirements are to become a backstop liquidity provider ("BLP"), nor does it discuss whether BLPs are obligated to accept positions. Rather, BLPs are allotted positions based on margin on deposit. In times of volatility, hypothetically, a BLP may reduce its margin on deposit when FTX needs it most.

Further, we believe the auto-liquidation feature, which does exist today, may have unintended consequences resulting in additional risk to the overall marketplace for retail participants, commercial traders known as hedgers and lenders that provide margin financing to hedgers.

A. Unintended Consequences of Auto-Liquidation for Retail Participants.

As mentioned above, the auto-liquidation feature described in the Proposal is not innovative. In fact, a number of FCMs in the retail space routinely exercise auto-liquidation rights over accounts in margin deficit. What distinguishes the Proposal from already available technology is FTX's reliance on auto-liquidation without intermediation by clearing members. Today, the underlying crypto markets are largely unregulated. To the extent that they are monitored and surveilled for manipulative activity, including wash trades and spoofing, that monitoring and surveillance is not as comprehensive as it is for regulated futures markets. The concern is that professional traders, operating in markets that are still largely opaque, will be positioned to move prices so as to trigger automated liquidations of retail traders clearing under the proposed margined model, from which the professional traders would then be positioned to profit.

Additionally, the margined non-intermediated model may present a higher risk of cascading defaults than is present under the margined intermediated model, which would have disproportionately harmful effects on retail investors. Not only will retail customers be at risk of having their positions partially or fully liquidated, but also, auto-liquidation may increase market volatility, and highly volatile markets typically require a higher margin requirement, thereby increasing the costs to retail participants. FTX asserts that its "fully automated liquidation engine", a mechanism for automatically liquidating positions in accounts that fall below applicable maintenance margin requirements, will control the risk of cascading defaults during periods of market volatility. But frequent, smaller liquidations may in fact exacerbate the risk and normal market conditions will become stressed. In addition to reviewing the cursory explanation provided by FTX on social media, to ensure an efficient marketplace, we urge the CFTC to conduct a thorough analysis of how FTX's auto-liquidation feature operates during periods of high market volatility. In such market conditions, smaller, retail participants are likely to be disproportionately affected. CFTC and CME enforcement precedents on use of "auto-liquidation" algorithms are instructive. For example:

- In CME 15-0158-BC (March 20, 2017) CME cited Saxo Bank for disruptive practices in connection with its operation of an auto-liquidation algorithm designed to liquidate its clients' under-margined positions, which "in at least two instances, caused significant price movements in certain CME FX futures markets". Saxo Bank's futures customers are

primarily small, retail investors. This was in addition to being cited for not considering market conditions at the time of auto-liquidation.[5]

- In Matter of Interactive Brokers LLC (*CFTC Docket No. 21-19, September 28, 2021*), Interactive Brokers settled failure to supervise charges stemming in part from the failure of a system designed to auto-liquidate positions held by customers in accounts in margin deficit. These actions caused trading losses in hundreds of customer accounts, many of which likely to have been retail customer accounts.

B. Unintended Consequences of Auto-Liquidation for Hedging Participants.

Further, the auto-liquidation feature may present unintended consequences for specific market participants such as hedgers. As noted above, the Proposal is not limited to a specific product or a specific type of customer. If approved, FTX, and other exchanges, may expand their product offering beyond crypto currencies to more traditional futures contracts including, but not limited to, agriculture and energy products. As a cornerstone of the futures market, a hedger looks to buy or sell the actual physical commodity. Many hedgers are producers, wholesalers, retailers, or manufacturers and they are affected by changes in commodity prices. Unlike typical retail speculators, hedgers use the futures market to manage and offset risk. Many industries now use the futures market to protect against the risk of loss due to changing prices in the cash market through hedging. Under the traditional model, a hedger who becomes under-margined due to price movement is afforded the opportunity to provide additional funds to an FCM, typically on a T+1 basis, or, alternatively, an FCM may pay margin calls when their customers are slow to pay or in default. Under the Proposal, the auto-liquidation feature may liquidate a hedger's position, in part or ultimately in full, leaving the hedger exposed to unexpected risk.

To avoid this risk, a hedger may, in theory, carry excess margin in their account. However, FTX's Rulebook is not clear as to ownership of excess funds beyond required margin amounts in the client account as evidenced by the clear disregard of the customer segregation rules. FTX's model actually increases the cost to hedgers. In contrast, RJO has programs to wire out excess margin back to commercial hedgers as we recognize how valuable the funds are to our customers.

C. Unintended Consequences of Auto-Liquidation for Lenders that provide Margin Financing to Hedging Participants.

When further considering hedgers, it is imperative that the CFTC explore whether FTX is able to be party to a Commodity Account Control Agreement. Hedgers often rely on margin financing facilities funded by banks or other third-party lenders to provide the margin required by an FCM to support a hedger's position. This model is an integral part of risk management for the agricultural sector. In order to induce lenders to agree to such an arrangement, the hedger will provide a security interest in the collateral held in its commodity account through a Commodity Account Control Agreement, a tri-party agreement with an FCM, the hedger and the lender. If FTX is not able to be a party to a Commodity Account Control Agreement, lenders will likely be reluctant to provide margin financing and therefore, hedgers may be hindered from participation.

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[5] See Saxo Bank: https://www.cmegroup.com/notices/disciplinary/2017/03/CME-15-0158-BC-SAXO-BANK-AS.html.

Even if FTX is able to be a party to a Commodity Account Control Agreement, we urge the CFTC to consider the potential effects the auto-liquidation feature proposed may have on a lender's willingness to enter into these arrangements, given the increased risks of losing the collateral supporting the loan. To mitigate against the risks of auto-liquidation, hedgers may require increased margin financing levels to ensure commodity accounts hold sufficient excess and maintain the hedge. Any excess funds held at FTX will increase the loan on which the participant must pay additional costs.

Auto-liquidation amplifies the risk further in cases where positions are partially or fully liquidated removing the hedge and exposing the physical holding to open-ended losses. Margin finance facility lenders also typically secure an interest in the physical product to the hedge. In the event a hedger is unable to repay funds borrowed under a margin finance facility and lender has lost all security against the facility, lenders will risk large, or even multiple, defaults. This may threaten their solvency, particularly those who have more concentration risk in these arrangements.

D. Auto-Liquidation and Unintended Consequences Conclusion.

For the reasons above and others, while FTX believes it is revolutionizing the futures industry, we believe FTX is actually creating additional issues and adding risk to the marketplace. This includes creating unintended consequences for both retail and hedging participants and margin financing lenders through the use of FTX's auto-liquidation feature.

IV. RJO Joins the Commodity Markets Council ("CMC") in Expressing Its Concerns of the Proposal

RJO generally agrees with the comments and concerns issued by the CMC regarding the Proposal. Furthermore, RJO wishes to draw additional attention to two of CMC's comments. RJO echoes CMC's sentiment that eliminating intermediaries "would remove a layer of risk management that is beneficial to the function of the futures market." FCMs have entire risk management teams that routinely cover off a variety of risk issues in ways not routinely examined by the DCOs. Further, the capital FCMs hold to absorb client losses is valuable in the risk management process and incents FCMs to closely manage risk to protect their own capital. RJO strongly supports CMC's viewpoint on FTX's ability to tear up trades at any point, including before any waterfall funds have been used to cover a shortfall will not inspire confidence in the market nor are the unencumbered provisions related to tear ups an improvement to the existing market structure.

V. FTX's Ownership Structure and Operating Model.

FTX is a global, non-public firm. Its business dealings, investors and partners are not known, and it is unclear as to whether any of these companies engage in trading activity on the exchange or as a BLP thereby creating a perceived or actual conflict of interest. In addition, most of their business to-date has been off-shore, which has different legal, regulatory and governance

requirements. We encourage the CFTC to review FTX's overall business structure, partners, investments, etc., to ensure there are no perceived or actual conflicts of interest or advantages to some market participants.

VI. Conclusion and Recommendations

We appreciate the opportunity to provide our comments and recommendations on the Proposal and appreciate your consideration of our position. RJO has been in business for over 107 years and has competed in a robust marketplace throughout its history. We continue to welcome competition in the futures markets. At the same time, we reiterate our viewpoint that approving the Proposal and allowing FTX to offer a disintermediated model of derivatives trading directly to individual participants on a margined basis will lead to a degradation of robust, well-established customer protection rules, and that the auto-liquidation functionality will undoubtedly lead to unintended consequences and increased market risk. Under the Proposal, FTX has put forth a rule book that does not adequately address customer protections, as required by CFTC Regulations, nor does the Proposal promote orderly markets and transparency in the futures industry. We recommend the Proposal be tolled pending rulemaking that would permit the CFTC to more fully consider the issues presented. Alternatively, relief on the Proposal should be conditioned on measures that will mitigate risk to retail investors, including, without limitation: (1) Requiring FTX to operate the margined non-intermediated model initially as a pilot project, during which CFTC staff will be able to monitor the operation of the model under real-time market conditions; (2) Restricting access to the model to eligible contract participants; (3) Restricting the scope of contracts available to the crypto-based contracts currently listed on FTX; and (4) Requiring that FTX adopt customer protection measures equivalent to those that would apply to FCMs offering the same service on a traditional intermediated model.

Sincerely,

Gerald F. Corcoran
Chief Executive Officer
R.J. O'Brien & Associates, LLC