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**VIA ELECTRONIC DELIVERY**

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

Ladies and Gentlemen:

We greatly appreciate having a second opportunity to comment on the captioned proposal (**Proposal**), which was filed by LedgerX LLC, d/b/a FTX US Derivatives (**Applicant**), on December 6, 2021 and made available by the Commission for public comment on March 10, 2022. As we stated in our first letter, the Commission should be applauded for undertaking such a deliberate and open process in evaluating whether to approve the Proposal.[1] The Commission's subsequent decisions to extend the original comment period and to host a public roundtable on the Proposal are also welcome, as they further the statutory purpose of promoting responsible innovation in the derivatives markets.[2]

We continue to believe that approving the Proposal is appropriate as a matter of sound regulatory policy, and that the Commodity Exchange Act **(CEA)** provides the Commission with a firm legal basis for doing so. In the time since we filed our first letter, we have learned that many other participants in the derivatives and digital assets industries also support the Proposal. Like us, they think that permitting direct clearing of retail transactions in digital asset derivatives is an important market evolution. However, this development raises another important issue for the Commission's consideration—namely, how to ensure competitive and procedural fairness for moving forward in an orderly and efficient manner.

If derivatives were an unregulated market, a company like the Applicant would be free to be first past the post in implementing an innovative approach. In a regulated market like derivatives, however, there are several considerations that support a measured, more inclusive phase-in of innovation. ***First***, where the responsible agency is subject to the Administrative

[1] March 17, 2022 Letter of Jones Day to the Commission at 1.

[2] *See* Section 3(b) of the Commodity Exchange Act, 7 U.S.C § 5(b).

Procedure Act (**APA**), that agency must balance the first-mover advantage against competing procedural priorities to promote fair treatment. ***Second***, direct clearing is an important innovation, and many key stakeholders are watching how it develops—including Congress. The success of this model, therefore, should not depend upon the efforts of a single industry participant. That remains true, no matter how well-intentioned and well-resourced the first mover is, and no matter how thoroughly the first mover has thought through and addressed all the relevant issues. ***Third***, the CEA requires the Commission to consider the competitive impact of its decision in furthering statutory objectives like promoting responsible innovation.

For these reasons, the Commission should afford all similarly situated industry participants—including other derivatives clearing organizations (**DCOs**)—with a fair opportunity to offer direct clearing of digital asset derivatives. As we explain below, this means the Commission should institute and publicly announce a uniform process for DCOs to seek approval to offer direct clearing through their platforms. This should be done before the Commission approves direct clearing for any single DCO, so that a competitive and fair market for direct clearing can more readily develop. This process need not involve a notice-and-comment rulemaking, nor should it, as the Commission can proceed more efficiently, and with adequate deliberation, through the process we suggest below.

## I. The Commission Should Consider the Procedural and Competitive Implications of How It Promotes the Development of Direct Retail Clearing for Digital Asset Derivatives.

In considering the Proposal, the Commission is subject to two overarching principles—a principle of procedural fairness under the APA, and a principle of competitive fairness under the CEA. These principles can be summarized as follows:

### *A. Procedural Fairness.*

The APA requires an administrative agency, like the CFTC, to reasonably explain its decisions and to avoid arbitrary and capricious decision making.[3] In addition, an agency like the CFTC "must treat similar cases in a similar manner unless it can provide a legitimate reason for failing to do so."[4] "Where an agency applies different standards to similarly situated entities and fails to support this disparate treatment with a reasoned explanation and substantial evidence in

[3] *See* 5 U.S.C. § 706(2); Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).

[4] Indep. Petroleum Ass'n of Am. v. Babbitt, 92 F.3d 1248, 1258 (D.C. Cir. 1996).

the record, its action is arbitrary and capricious and cannot be upheld."[5] Indeed, a federal agency "'can be said to be at its most arbitrary'" when it "'treat[s] similar situations dissimilarly.'"[6]

***B. Competitive Fairness.***

The CEA requires the Commission to "take the least anticompetitive means of achieving [the statute's] objectives . . . as well as [the statute's] policies and purposes" into consideration when "issuing any order or adopting any Commission rule or regulation. . . ."[7] This principle of competitive fairness also applies when "requiring or approving any bylaw, rule, or regulation of a [designated] contract market [(**DCM**)] . . . ."[8] Courts have echoed this obligation, stating that the CFTC "must design its rules and regulations after taking into consideration the competitiveness of the futures markets and the interests of the antitrust laws generally."[9]

***C. How Principles of Procedural and Competitive Fairness Bear on Permitting Direct Retail Clearing.***

The Proposal comes at a time when other DCOs and DCMS are offering digital asset derivatives. Much like the Applicant, some of those DCOs and DCMs are affiliated with "spot" digital asset platforms that permit digital asset trading on a margined basis. There are DCOs and DCMs that offer digital asset derivatives even though they are unaffiliated with a spot market; they too may be interested in offering direct clearing of those transactions, in addition to providing retail access through established brokerage channels. To a greater or lesser degree, therefore, the Commission may find that these industry participants are all similarly situated to the Applicant.

It follows that Commission approval of the Proposal would substantially affect the interests of those industry participants in developing direct retail clearing of digital asset derivatives transactions. Indeed, such an approval will likely create even more interest in direct clearing. It takes no great foresight, then, to predict that the first mover in direct clearing will likely gain a dominant market position. If other industry participants were to follow the same path later, they would likely struggle to gain any traction of their own. A single provider of direct clearing services —or a dominant provider among many smaller actors in the market—would have no meaningful

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[5] Burlington N. & Santa Fe Ry. Co. v. Surface Transp. Bd., 403 F.3d 771, 776 (D.C. Cir. 2005).

[6] Kirk v. Comm'r SSA, 987 F.3d 314, 321 (4th Cir. 2021), *quoting* Steger v. Def. Inv. Serv. Dep't of Def., 717 F.2d 1402, 1406 (D.C. Cir. 1983).

[7] Section 15(b) of the Commodity Exchange Act, 7 U.S.C. § 19(b).

[8] *Id.*

[9] N.Y. Mercantile Exch., Inc. v. Intercontinental Exchange, Inc., 323 F. Supp. 2d 559, 570 (S.D.N.Y. 2004).

competition, which could be to the detriment of participants in the markets for digital asset derivatives. In such a scenario, the Commission's action to approve the Proposal would prove not to have been undertaken in the least anticompetitive way.

The principles of procedural fairness under the APA and competitive fairness under the CEA require that the Commission take these foreseeable consequences into consideration when acting on the Proposal. To do so, the Commission should draw on its history of successfully applying those principles in responding to other market innovations.

**II. The Commission's Orderly Processes to Ensure Fair and Competitive Trading on SEFs and for Provisional Swap Dealer Registration Are Useful Precedents Here.**

The Dodd-Frank Act called upon the Commission to re-wire the swaps markets, notably through the creation of a new category of registered entity, swap execution facility **(SEF)**, and the imposition of mandatory clearing and on-facility trading of swaps. Dodd-Frank also created a new category of registrant, swap dealer, for which the Commission imposed a corresponding registration and oversight regime over several years. In both of these cases, the Commission took great care to ensure that these legally-mandated changes to the swaps markets did not give rise to unfair or anticompetitive conditions.

***A. SEF Registration and Mandatory On-Facility Swap Trading.***

Dodd-Frank required a trading platform to be a SEF or a DCM in order to trade swaps.[10] These requirements, together with the CFTC's implementing regulations, created incentives for new entrants to register as SEFs quickly in order to capture meaningful transaction flows in mandatorily cleared swaps that the Commission determined had been "made available to trade" (**MAT**) on such a platform.[11]

The regulatory structure that the Commission adopted led to an orderly process for SEF registration, identification of swap classes subject to mandatory clearing, the timing of MAT determinations, and the start of on-facility swap trading. That rule structure, as well as other Commission and Staff action in early 2014, resulted in mandatory on-facility trading of certain interest rate swaps commencing on multiple SEFs in early 2014.[12] The SEFs that had registered

[10] *See* Section 5h(a)(1) of the Commodity Exchange Act, 7 U.S.C. § 7b-3(a)(1).

[11] *See* Sections 2(h)(8)(A) and 5h(a)(1) of the Commodity Exchange Act, 7 U.S.C. §§ 2(h)(8)(A), 7b-3(a)(1); Commission Regulation 37.10(c), 17 C.F.R. § 37.10(c).

[12] *See* Commission Press Rel. No. 6853-14 (Feb. 10, 2014). According to the Commission's website, there were five different SEFs that made MAT determination filings with respect to interest rate swaps in late 2013. *See* https://sirt.cftc.gov/sirt/sirt.aspx?Topic=+SwapsMadeAvailableToTradeDetermination (last visited May 9, 2022).

and made the necessary filings with the Commission to offer those products on their platforms by that time were not at a significant competitive disadvantage to each other solely based on when each of the relevant SEFs started preparing to trade those swaps.

The Commission did not impose a uniform start date by fiat. But its overall process ensured that SEFs had a good understanding of the approximate timeframe within which mandatory on-facility trading would commence. SEFs were thus able to react accordingly, which resulted in approximately the same start date for then-existing SEFs.

***B. Swap Dealer Registration.***

Dodd-Frank required the Commission to adopt rules mandating registration of swap dealers and compliance with substantive regulations governing their swap dealing activities.[13] The Commission implemented this new regime using provisional registration, recognizing that it would take more time to finalize rules imposing the substantive requirements of Dodd-Frank on swap dealers.[14] This provisional registration process had many benefits, including allowing existing and new market participants to obtain registration and build out the necessary systems for Dodd-Frank compliance as those requirements came online through the Commission's rulemaking process.

While perhaps not a primary motivation for provisional registration, this approach has resulted in there being 107 swap dealers serving the needs of customers and counterparties in the swaps markets today.[15] As a result, whether particular dealers have a leading role in certain markets resulted less from their incumbency before Dodd-Frank than from their ability to continue operating at a high level under the new regulatory regime.

**III. The Commission Should Consider Implementing Clear Guidance and a Provisional Permitting Process to Promote Competitive and Procedural Fairness.**

The Commission should consider this recent history in designing a fair and competitive process for moving forward with the Proposal. For instance, the Commission may wish to issue an advisory or other publication on direct retail clearing of digital asset derivatives transactions that:

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[13] *See generally* Section 4s of the Commodity Exchange Act, 7 U.S.C. § 6s; *see also generally* Part 23 of the Commission's Regulation, 17 C.F.R. pt. 23.

[14] *See* 77 Fed. Reg. 2613, 2616 (Jan. 19, 2012).

[15] *See* https://www.nfa.futures.org/registration-membership/membership-and-directories.html (last visited May 9, 2022).

a. Identifies the issues that must be addressed by a DCO in a filing that seeks modification of its registration order to permit direct clearing;

b. Describes the factors that the Commission will evaluate in determining whether to approve such an amendment; and

c. Establishes the general process for considering whether approval will be granted, such as the length of public comment periods or whether consultations will be undertaken—whether through public fora or any interagency dialogue.

Such a process would satisfy procedural fairness because, under it, similarly situated parties would be treated the same under a well-defined, publicly disclosed process. It would satisfy competitive fairness because interested, qualifying participants would not struggle to compete because they lacked sufficient notice about the requirements or the approximate timeline for the Commission to complete its review and approval process.

Moreover, approving any such amendment on a provisional basis, akin to swap dealer registration, could be an effective manner of providing a clear signal that the Commission will continue to monitor how direct retail clearing of digital asset derivatives transactions affects both the trading markets and the clearinghouse system. This would be superior to a "pilot" program which, as the name connotes, would likely be of limited duration and scope. A pilot program could frustrate the development of direct retail clearing because participants would lack legal certainty around new systems and processes to which they would have to devote substantial capital, personnel, and other business resources.

Similarly, a pilot program would require the conditions of the pilot to be known ex ante. Yet, those conditions would not be based on robust data given the novel nature of the Proposal. In this sense, they would be arbitrary and would risk unfairly limiting the growth and direction of market innovation. Provisional approval, in contrast, would not seek to define the precise contours of innovation but would give the Commission a useful "handbrake" to pull as the market for direct retail clearing unfolds and it gathers useful information about its impact on DCOs and DCMs.

In this case, we think the Commission is sufficiently familiar with the existing regulations governing clearing that a rulemaking is unwarranted. As explained previously, the Commission has adequate tools short of rulemaking to permit direct retail clearing while seeking to address what it currently understands to be the key associated risks in keeping with currently applicable

requirements. Such tools are adequate (as evidenced by recent history) to further the Commission's obligations to promote procedural and competitive fairness in an orderly and efficient manner.

Once the Commission gains more experience with direct retail clearing, it can entertain the need for potential rulemaking at a later time. For now, the Commission has received—and will continue to receive—ample input from interested stakeholders and the public on this subject. In fact, the Commission will likely learn more about direct retail clearing sufficient to inform rulemaking only after a decision to approve the Proposal (and any other filings by similarly situated persons). If this is a paradox, then it simply reveals the higher truth that the current facts around direct retail clearing are not ripe for rulemaking.

We continue to believe there are sound reasons for the Commission to approve the Proposal, but the Commission should do so in a way that comports with the principles of procedural and competitive fairness. The Commission's own history implementing Dodd-Frank demonstrates its facility with designing and implementing fair processes that promote responsible innovation in accordance with those principles. Given its many merits, the Proposal requires no less.

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We thank the Commission again for undertaking such an open and thoughtful process with regard to the Proposal. The Commission has always taken seriously its responsibility to regulate the most liquid, transparent, and reliable derivatives markets in the world. The vibrancy and strength of those markets is a testament to the Commission's steadfast leadership and willingness to be forward-thinking when presented with innovations like the Proposal.

Very truly yours,

Joshua B. Sterling

Brett A. Shumate

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
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