



**Submitted Electronically via CFTC.gov**

May 11, 2022

Mr. Christopher J. Kirkpatrick  
Secretary, Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, DC 20581

*Re: Release Number 8499-22, CFTC Seeks Public Comment on FTX Request for Amended DCO Registration Order (“**CFTC Request for Comment**”)*

Dear Mr. Kirkpatrick,

Gemini appreciates the opportunity to provide comments to the United States Commodity Futures Trading Commission (the “**CFTC**” or the “**Commission**”) in response to a formal request from Ledger X, LLC (d/b/a FTX US Derivatives) (“**FTX**”) to amend its order of registration as a derivatives clearing organization (“**DCO**”) to allow it to clear margined products for retail participants while continuing with a non-intermediated model.

We commend the CFTC’s thoughtful, public process to assess the benefits and possible risks associated with FTX’s request. In this letter, we highlight our reasons for support of FTX’s request. We also respond to certain specific questions posed by the CFTC by suggesting mechanisms through which the CFTC can ensure that the amended DCO order provides requisite protections to participants on the DCO.

In this letter we outline the following key points:

- The CFTC should embrace, and allow DCOs to use, the proposed risk management tools of transparent and real-time margining. These tools, as well as the non-intermediated access model, are permitted by the Commodity Exchange Act, as amended (the “**CEA**”), and are consistent with the CFTC’s standards for DCOs.
- The CFTC has the authority under its existing rules to impose requirements on the DCO through an amended DCO order to ensure that the DCO puts in place appropriate consumer protections, especially for retail customers. Other market participants, including designated contract markets (“**DCMs**”) and futures commission merchants (“**FCMs**”), can execute on these requirements, working in concert with the DCO.
- The paramount step that the CFTC should take is to ensure that retail customers receive appropriate disclosure about financial products, including the potential risk of loss.

## **Background and Overview of Comments**

Gemini Trust Company, LLC is a leading, regulated United States digital asset exchange and custodian with a strong conviction that blockchain technology and cryptocurrency have the potential to transform the design of the Internet, and to improve our financial system and money in a way that fosters and protects the financial rights and dignity of the individual. If developed with the right balance of innovation and regulation, digital assets can advance personal financial freedom and economic progress.

To this end, we have built our business on a foundation of regulatory compliance, and we believe that sound regulation is necessary to enhance trust in—and the integrity of—cryptocurrency markets. Gemini was founded with a security and compliance-first mentality. Gemini’s spot exchange and custodian is a New York trust company regulated by the New York State Department of Financial Services (“NYDFS”) and has been operating under the supervision of the NYDFS since 2015.<sup>1</sup> Although currently Gemini primarily operates as a digital asset spot exchange and custodian, we are committed to offering a wide range of financial products to our customers, in a safe and compliant manner, including cleared derivatives in the United States, subject to the oversight of the CFTC. Accordingly, we submit this comment letter in support of FTX’s request to amend its DCO registration order.

The core features of FTX’s proposed clearing model, *i.e.*, the ability to manage risk on derivatives positions in real-time and on a 24/7 basis, present a meaningful innovation to the derivatives market structure in the United States. These features, and the ability for customers to access derivatives directly, without the need to go through an FCM or other intermediary, reflect market practices that arose organically in the market for digital asset derivatives based on how the spot market for digital assets already operated. Consistent with the CFTC’s core values, including that the CFTC should be forward-thinking to “stay ahead of the curve,”<sup>2</sup> the CFTC should permit this innovation and use its oversight and supervisory powers to ensure that risk is appropriately managed and that customers still receive an appropriate level of protections consistent with what they receive in other, more traditional derivatives contexts. Doing so would permit certain derivatives to be offered within the CFTC’s oversight that are already being offered outside of the United States and outside of the CFTC’s jurisdiction.

Approving this order would also position the CFTC to lead the effort in shaping a digital asset regulatory framework and harmonizing it with non-U.S. regulators. The CFTC has set thoughtful precedent in global cooperation, through, for example, its substituted compliance framework and memoranda of understanding with foreign regulators. It is therefore well-positioned to also lead the effort in shaping and harmonizing the digital asset regulatory framework for derivatives. The CFTC’s response to FTX’s request will be a crucial step in this effort and can demonstrate how innovative, yet well-regulated, digital asset derivatives markets could function.

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<sup>1</sup> Gemini is also registered with the Financial Crimes Enforcement Network (“FinCEN”) as a money services business and maintains money transmitter licenses (or the statutory equivalent) in all states where this is required. As part of our oversight by the NYDFS, we are subject to capital reserve requirements, cybersecurity requirements, and banking compliance standards set forth by the NYDFS and the New York Banking Law. We are further subject to and compliant with the Bank Secrecy Act, and related FinCEN reporting requirements.

<sup>2</sup> “The Commission,” CFTC, available at <https://www.cftc.gov/About/AboutTheCommission>.

## Discussion

### ***I. We believe that FTX's proposed clearing model is appropriate for the digital asset markets and consistent with the principle of customer protection.***

*The proposed risk management framework is well suited for retail customers and promotes the principles underlying CFTC Regulations § 39.12.*

DCOs have, for a long time, permitted proprietary trading by clearing members. Thus, the main innovation in FTX's proposed model is the establishment of a risk management framework appropriate to proprietary clearing by retail customers through more transparent margining and real-time risk management. Therefore, the CFTC's decision on whether or not to approve of FTX's request should depend on its assessment of the adequacy of FTX's proposed risk management framework. In particular, the key features of FTX's proposed clearing model that distinguish it from traditional clearing market structures are that: (1) customers only post initial and maintenance margin for a position once it is executed and are not otherwise responsible for any losses on a position, *i.e.*, are not required to post additional funds in support of a position; (2) the DCO recalculates a participant's margin level every 30 seconds, marking the position to market, and then liquidating a participant's portfolio incrementally if it falls below the DCO's margin maintenance level; and (3) positions are marked-to-market automatically and on a 24/7 basis.

These features are appropriate to manage risk, especially for retail customers and for digital asset derivatives. For customers, this model ensures that they will only be at risk with respect to a derivatives position for margin that they post, in the form of initial and maintenance margin. This is an effective means to offer retail customers the ability to enter into derivatives by eliminating the possibility that customers experience unexpected losses, beyond margin they put on the platform. For the DCO, it is also an effective means to ensure that the DCO can manage risk in real-time and limits the potential to suffer losses due to a clearing member failing to post additional margin.<sup>3</sup>

This approach to risk management also meets the CFTC's objectives of ensuring that a DCO provides impartial access to derivatives. In its request for comment, the CFTC asks whether, in light of this feature, CFTC Regulations § 39.12(a), which requires a DCO to establish minimum capital requirements for clearing members, serves a risk management purpose.<sup>4</sup> Under the CFTC's rules, whether or at what level a DCO sets capital requirements for clearing members

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<sup>3</sup> In addition, the use of a real-time margining system that operates on a 24/7/365 basis and automatic liquidation are innovations that the CFTC should embrace, at least with respect to retail-focused derivatives transactions. These joint mechanisms prevent risk from building up in the system by providing market participants (and regulators) a snapshot of risk every 30-seconds and rebalancing that risk automatically. In other markets, intermediaries are permitted to carry risk for longer periods of time and during periods when the markets are not open for trading. In that circumstance, once the DCO makes a margin call, the DCO waits for clearing members to deposit additional collateral. By eliminating any accumulated risk in real-time through liquidations, the DCO is reducing overall contagion risk in the marketplace.

<sup>4</sup> See CFTC Request for Comment, Question 5.

depend on the risk that the DCO faces.<sup>5</sup> Relatedly, in the DCO Core Principles Adopting Release, the CFTC explained that “[t]o achieve fair and open access”, CFTC Regulations § 39.12(a)(1)(i) “would prohibit a DCO from adopting a particular restrictive participation requirement if it could adopt a less restrictive requirement that would not materially increase risk to the DCO or its clearing members.”<sup>6</sup> FTX’s proposed risk management model does not require clearing members to post additional margin once they enter into a position and as such, a clearing member’s capital resources should not be relevant to the DCO in assessing the risk posed by the clearing member to the DCO or its other clearing members. On the other hand, imposing capital requirements could have the effect of limiting access to customers that would otherwise be able to transact. As the CFTC explained in its DCO Core Principles Adopting Release, increased participation by clearing members is likely to be risk reducing to a DCO, noting that “[t]he Commission expects that more widespread participation will reduce the concentration of clearing member portfolios, thereby diversifying risk, increasing market liquidity, and increasing competition among clearing members.”<sup>7</sup>

In addition, however, to balance the objectives of sound risk management for the DCO, on the one hand, and customer protection, on the other hand, we do think it is important for the CFTC to ensure that DCOs and derivatives marketplaces provide appropriate disclosure and sufficient transparency about the risks involved in derivatives positions for participants. This includes clearly articulating the maximum risk of loss to retail customers from entering into derivatives positions.

*The disintermediated nature of the model, the proposed size of the guarantee fund, and the proposed margin requirements further bolster the safety and soundness of FTX’s proposed clearing model.*

We agree with FTX’s statement that “the CEA does not mandate a one-size fits all approach” and that, for digital asset derivatives, the method of managing risk proposed by FTX “will remove friction, delay, and reduce operational risk in the assessment and timely de-risking of accounts”.<sup>8</sup> We also agree that these aspects of a margining model do not require the inclusion of FCMs as intermediaries to manage risk because the DCO would have the ability to operate its risk management system without reliance on intermediaries. As we discuss in the next section of our letter, we do believe that FCMs can continue to play an important role, even in a direct-access model, and can continue to provide important customer services that customers may opt-in to receive, but we agree that the CEA does not require FCM involvement for risk management on positions and that they are not necessary in the model proposed by FTX.

We also believe that FTX’s proposed model is consistent with notions of customer protection and innovation because it reflects the market practices that have evolved in existing digital asset derivatives ecosystems. In non-U.S. jurisdictions, digital asset derivatives are offered through a direct access model and positions are managed automatically, without the use of intermediaries

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<sup>5</sup> 17 C.F.R. § 39.12(a)(1)(i).

<sup>6</sup> [DCO] General Provisions and Core Principles, 76 Fed. Reg. 69344, 69352 (Nov. 8, 2011) (“**DCO Core Principles Adopting Release**”).

<sup>7</sup> *Id.*

<sup>8</sup> See Permissibility and Benefits of Direct Clearing Model under the [CEA] and CFTC Regulations (Feb. 8, 2022), available at [https://www.cftc.gov/media/7001/ledgerx\\_dba\\_ftx\\_ltr\\_direct\\_clearing\\_model2-8-22/download](https://www.cftc.gov/media/7001/ledgerx_dba_ftx_ltr_direct_clearing_model2-8-22/download).

akin to FCMs. This model reflects key features of the digital asset markets, which are important to our customers – real-time settlement, 24/7/365 trading and risk management, and direct access through customer-friendly technology and user interfaces. The CFTC can respect these unique features of the digital asset markets but also should use the tools available to it to ensure that the DCO operating these mechanisms is capable of managing the positions as described and does not allow risk to build inappropriately.

In its request for comment, the CFTC also asks about the appropriate financial resources that a DCO should maintain in the non-intermediated model.<sup>9</sup> The CFTC’s rules articulate the legal requirement that a DCO must meet to determine applicable financial resources, which is defined in the Cover 1 standard.<sup>10</sup> As a legal matter, FTX proposes to surpass the legal minimum requirement. The concept behind the Cover 1 standard is that the credit profiles of clearing members are sufficiently heterogeneous such that one does not need to worry about more than one clearing member defaulting at the same time. In the proposed non-intermediated model, the participant profiles are even more diverse than in the traditional model. We therefore believe the existing standards for financial resources are an appropriate starting point. Given that FTX proposes to exceed the existing standards, we believe the CFTC should accept FTX’s proposed approach to meeting the financial resources requirement. The CFTC can then collect data over time as the DCO operates in this model and continually update its assessment of the DCO’s compliance with its financial resource requirements.

Further, one important protection that the CFTC should enforce is requiring the DCO to collect initial margin on positions consistent with CFTC Regulations § 39.13(g)(2), which FTX proposes to do. Under that rule, for futures, the DCO will collect initial margin based on a one-day margin period of risk (“MPOR”). FTX proposes to monitor participant positions on a near real-time basis which enables it to determine, at all times, whether a participant’s account has sufficient cash and collateral to meet its margin obligations to the DCO. As such, requiring the DCO to collect margin for a one-day MPOR provides a sufficiently high level of collateral to further insulate the DCO from losses due to volatile price movement over a longer period between a member default and liquidation of a defaulting member’s portfolio.

***II. The non-intermediated clearing model can provide the same level of customer protections that are provided pursuant to the FCM-intermediated clearing model.<sup>11</sup>***

In its request for comment, the CFTC asks specifically about issues presented by the non-intermediated model, which does not involve any FCMs. In particular, in Questions 7 and 8, the CFTC sets out requirements imposed on FCMs that are intended to ensure an adequate level of customer protections and that are not currently applicable to DCOs. In Question 7, the CFTC asks about the treatment of participants’ collateral in the event of a bankruptcy, under the

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<sup>9</sup> See CFTC Request for Comment, Question 1(a), (b), (c), and (d).

<sup>10</sup> A DCO is required to possess financial resources that, “at a minimum, exceed the total amount that would – (I) enable the organization to meet its financial obligations to its members and participants notwithstanding a default by the member or participant creating the largest financial exposure for that organization in extreme but plausible market conditions . . . .” (*i.e.*, the Cover 1 standard). CEA § 5b(c)(2)(B)(ii).

<sup>11</sup> This Section II assumes that the non-intermediated model that FTX is proposing will not have any FCM intermediation.

segregation requirements of CEA Section 4d applicable to FCMs and that ensure customer preference in the event of an FCM bankruptcy, and under the member property regime applicable to DCOs. In Question 8, the CFTC highlights customer protections that FCMs (but not DCOs) are required to provide, including risk disclosures and customer statements.

We recommend that the CFTC includes in its DCO order for any DCO operating a non-intermediated model for retail customers, that the DCO must ensure that (1) in the event of a DCO insolvency or resolution, participants' member property receives the same priority as it would if it was maintained by an FCM subject to the Section 4d segregation regime and (2) customers receive appropriate disclosures about derivatives positions, the DCO's risk management model and liquidation waterfall, and that account statements and account information be made available to customers. We discuss each in greater detail below.

We believe that the CFTC has highlighted elements of its regulatory regime that provide important consumer protections and that should be retained, regardless of whether customers access derivatives through an intermediary or directly as DCO members. Importantly, the CFTC has the means through its oversight of DCOs and its existing rules and regulations to ensure that these consumer protections are provided, even in a non-intermediated model. Although these functions are traditionally performed by an FCM, and required to be performed by an FCM, we believe a DCO in the non-intermediated model can ensure that a customer still receives the benefit of the intended protection. This can be done either by requiring that these functions be performed by the DCO, by the DCM, or by an FCM that participates on the market, for example, as an executing broker but not as a clearing FCM.

*The CFTC Part 190 rules and member property regime can provide the same level of protection for participants' collateral as if such collateral is held by an FCM subject to the segregation requirements under Section 4d of the CEA.*

The CFTC can ensure that participants in a non-intermediated clearing model are in the same position vis-à-vis a DCO default scenario as they would be in an FCM default scenario if they were an FCM customer and therefore benefited from the segregation provisions contained in Section 4d of the CEA. First, CFTC Regulations § 39.15(a) requires a DCO to “establish standards and procedures that are designed to protect and ensure the safety of funds and assets belonging to clearing members and their customers.” Further, CFTC Regulations § 39.15(c) requires a DCO to “hold funds and assets belonging to clearing members and their customers in a manner which minimizes the risk of loss or of delay in the access by the [DCO] to such funds and assets.” In addition, FTX's current DCO registration order provides that “[FTX] shall at all times maintain funds of its clearing members separate and distinct from its own funds.”<sup>12</sup> Therefore, the CFTC already has regulations and requirements via the existing DCO registration order in place to ensure that funds and assets of the DCO's direct participants are adequately protected and segregated. Further, as described below, if the CFTC wanted to impose some of the more specific segregation requirements that apply to FCMs, such as requirements regarding permissible depositories and investment of customer collateral, it could do so by imposing these requirements on the DCO through the DCO order.

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<sup>12</sup> See “In the Matter of the Application of Ledger X, LLC for Registration as a [DCO],” CFTC, *available at* <https://www.cftc.gov/media/4556/ledgerxllcamendeddcoorder9-2-2020/download> (the “FTX DCO Order”).

In addition, DCO customers already benefit from protections in the event of a DCO insolvency. Under the U.S. Bankruptcy Code (the “**Code**”), and its interaction with the CFTC’s rules under Part 190, in the event of a DCO insolvency, a trustee would allocate member property to clearing members ratably based on members’ net equity claims based on their house accounts.<sup>13</sup> This regime approximates what happens to FCM customers in an FCM insolvency pursuant to the Code and Part 190 whereby FCM customers are allocated customer property ratably based on customers’ net equity claims based on their customer accounts. In addition, CFTC Regulations § 190.15(b) provides that “[i]n administering a proceeding under [the subpart of Part 190 that governs DCO insolvencies], the trustee shall implement, in consultation with the Commission, the default rules and procedures maintained by the debtor . . . and any termination, close-out and liquidation provisions included in the rules of the debtor, subject to the reasonable discretion of the trustee and to the extent that implementation of such default rules and procedures is practicable.” These aspects of Part 190 provide discretion to a DCO in designing liquidation and loss allocation rules, and therefore provide a means for a DCO to establish the rules in a way to ensure the interests of public customers, especially retail participants, are adequately protected and also provide the CFTC oversight over such rules to ensure a resolution proceeding meets customer protection goals. The CFTC should use this authority to review a DCO’s rulebook to ensure that it sufficiently meets such customer protection goals.

*The CFTC can require DCOs to ensure that participants receive equivalent protections in a non-intermediated model as they would from an FCM in the intermediated model.*

In Question 8, the CFTC identifies several requirements applicable to FCMs but not DCOs. For functions that are traditionally performed by FCMs, the DCO can meet these objectives in several ways and we encourage the CFTC to permit the DCO and other market participants flexibility to determine the best way to perform these functions for each product that is listed on a DCM and cleared by the DCO. For example, for a given product, the DCO and DCM can allocate responsibilities between themselves to determine who performs a given activity (even though the DCO would remain ultimately responsible). In addition, the non-intermediated model does not necessarily exclude the participation of FCMs. FCMs can still participate in this model (e.g., as executing brokers but not clearing brokers) and perform some of the key customer protective functions articulated by the CFTC in its Question 8 even if they are not involved in managing the risk of derivatives positions in the non-intermediated model.

For instance, the amended DCO order could require that the DCO provide participants with the standard customer risk disclosure statements contained in CFTC Regulations § 1.55 as well as require the DCO to make certain financial information publicly available on its website consistent with CFTC Regulations § 1.55.<sup>14</sup> In imposing these additional requirements, the CFTC

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<sup>13</sup> CFTC Regulations § 190.01 defines member property as “in connection with a [DCO] bankruptcy, the property which may be used to pay that portion of the net equity claim of a member which is based on the member’s house account” and the CFTC’s DCO orders for DCOs operating a non-intermediated model require the DCOs to hold property as member property. Section 766(i)(2) of the Code further provides that “[i]f the debtor is a [DCO], the trustee shall distribute . . . member property ratably to customers on the basis and to the extent of such customers’ allowed net equity claims based on such customers’ proprietary accounts, and in priority to all other claims . . .”.

<sup>14</sup> However, the content of the statements and requisite financial information would need to be revised to account for the non-intermediated clearing structure and unique default waterfall features.

could build off of FTX’s current obligation to “disclose to any potential clearing member, in plain language, material risks associated with the clearing of fully collateralized digital asset contracts, including, without limitation, the theft, loss, or hacking of the underlying digital asset.”<sup>15</sup> Alternatively, a DCM or FCM could also provide such disclosure statements and financial information to participants. Similarly, the DCO could be required to provide (1) regulatory notices pursuant to CFTC Regulations § 1.12; (2) daily reporting of the holding of participant funds in a manner similar to CFTC Regulations § 1.32; and (3) daily trade confirmations and monthly account statements in the form and manner specified in CFTC Regulations § 1.33. With respect to the investment and use of participant funds, if it does not find the protections in CFTC Regulations § 39.15(e) to be sufficient with respect to the scope of permissible investments, the CFTC could consider extending CFTC Regulations §§ 1.20 and 1.25 to DCOs that operate non-intermediated clearing models in order to ensure that adequate customer protections are in place.

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Please do not hesitate to contact us with any further questions related to FTX’s request to amend its DCO order of registration. We appreciate your consideration and hope for the opportunity to engage in further dialogue.

Sincerely,



Fran Kenck  
Chief Regulatory Officer  
Gemini Titan, LLC

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<sup>15</sup> See FTX DCO Order.