

May 11, 2022

Christopher J. Kirkpatrick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street NW  
Washington, DC 20581

Via CFTC Comments Portal: <https://comments.cftc.gov>

Re: Request for Comment on FTX Request for Amended DCO Registration Order

Dear Mr. Kirkpatrick:

Nodal Clear, LLC (“Nodal Clear” or “Nodal”) appreciates the opportunity to respond to the Commodity Futures Trading Commission’s (“CFTC” or “Commission”) request for comment on FTX’s<sup>1</sup> Request for Amended DCO Registration Order (the “Proposal”). As background, Nodal Clear is a registered DCO and the clearinghouse for Nodal Exchange, LLC (“Nodal Exchange”) and LMX Labs (d/b/a Coinbase Derivatives) which are both CFTC designated contract markets (“DCMs”). Nodal Clear is a wholly owned subsidiary of Nodal Exchange, itself ultimately wholly owned by the European Energy Exchange (“EEX”). Nodal Clear is a “Subpart C” DCO, having elected to comply with the requirements applicable to DCOs that have been designated systemically important (“SIDCOs”) by the Financial Stability Oversight Council. Nodal Clear respectfully submits the following comments regarding the Proposal.<sup>2</sup>

### **A) Introduction**

Nodal Clear received its DCO registration order in 2015. As a relatively new intermediated and margined DCO, Nodal Clear has sought to be innovative in its approach to clearing. For example, Nodal Clear employs an expected shortfall, full portfolio-based methodology for its initial margin calculations where most other margined DCOs rely on traditional SPAN based models. Nodal appreciates the Commission’s willingness to consider alternative forms of compliance with the regulations. We welcome innovation and new approaches to clearing, so long as those approaches provide for sound risk management practices and are held to the same regulatory standards as

---

<sup>1</sup> LedgerX LLC, d/b/a FTX US Derivatives (“FTX”).

<sup>2</sup> Nodal Clear also participates in The Global Association of Central Counterparties (“CCP12”) and supports the comment letter submitted by CCP12 regarding the Proposal.

existing DCOs.<sup>3</sup> Of particular importance to existing sound risk management practices is the role of clearing members. Clearing members provide a valuable second layer of informed risk monitoring and risk absorption, and enhance a CCP's rules, operations, and risk management practices, among other things, by challenging the assumptions of DCOs. These important features and functions would be lost under the Proposal. While it was difficult to conduct a comprehensive evaluation of the Proposal based on the limited publicly available documentation, the Proposal raised a number of concerns highlighted below. As such, Nodal Clear cannot support the Proposal in its current form.

## **B) Customer Protection**

**Tear-up prior to use of guaranty fund** – FTX Rulebook provision 14.3(c) appears to provide for discretionary contract tear-up prior to use of the guaranty fund, liquidity providers, and the auto liquidation process. This means that a customer, who is in good standing, would be exposed to counterparty risk (i.e., a counterparty defaults and the contract of a non-defaulting customer is torn up), without knowing the identity of the counterparty or being able to manage such risk. If FTX chooses to preempt the use of the guaranty fund by conducting tear-up pursuant to 14(c), customers would get little value from “clearing” at FTX and would be better off executing their trades bilaterally off-exchange where they know their counterparty and can try to manage their counterparty credit risk.

**Automated liquidation** – Featured prominently in the Proposal is the fully automated liquidation engine that is to be used to liquidate customer accounts in instances where the customer's account falls below the maintenance margin requirement. The effectiveness of this process is not validated in the Proposal and raises concerns as to the feasibility of automated liquidation. For example, can automated liquidation be done effectively during periods of low liquidity? It seems that an exchange operating 24/7 would experience many periods of low liquidity and if an auto liquidation were required during such a period, it could impact prices and cause a cascade of defaults/liquidations.

**Liquidity providers/sufficiency of default waterfall** – Liquidity providers play a central role in the proposed default waterfall but are not adequately described in order to be considered a reliable layer of the waterfall. For example, what are the contractual obligations of the liquidity providers? How much open interest are liquidity providers required to absorb? How can FTX be certain that the liquidity providers will perform their obligations? Are the liquidity providers subject to credit monitoring? Are the liquidity providers affiliated with FTX? Given the limited information available regarding liquidity providers, it is also difficult to evaluate the sufficiency of the default waterfall.

**Customer disclosures** – As provided in Section VI. Q of the FTX Participant Agreement, FTX customers/participants agree that they are responsible for the payment of any deficiency remaining

---

<sup>3</sup> Nodal is pleased that Chairman Benham shares this sentiment, as he stated on Bloomberg TV on May 9, 2022, that the CFTC will “need to treat everyone fairly,” provide for a “level playing field,” and “follow the law.”

in their account should their account be liquidated or terminated. Therefore, FTX’s customers bear the risk of loss arising from any shortcomings in FTX’s margin model, liquidation process, default fund sizing, and default management process.<sup>4</sup> In an intermediated clearing model, clearing members dedicate teams of attorneys and risk professionals to evaluate and manage the risks arising from a DCO before connecting to the DCO and giving access to their customers. This evaluation process continues after a clearing member connects to a DCO and involves the clearing member providing feedback on the DCO’s rules, policies, and procedures on a regular basis. Such feedback is well received, in part, because a clearing member represents a group of customers and has a degree of bargaining power as it seeks to have a DCO enhance its practices. Under the Proposal, participants are now responsible for assessing these risks and likely have little power, on an individual basis, to push for changes at FTX.

### **C) Other Considerations**

**Principles for financial market infrastructures (“PFMI”)**<sup>5</sup> – The Proposal does not seem to meet the risk management standards set forth in the PFMI. For example, the Proposal does not provide for: the monitoring of clearing member credit quality;<sup>6</sup> minimum capital requirements; financial resources sized to cover “extreme but plausible market conditions”;<sup>7</sup> or guaranty fund replenishment. If the Commission permits the Proposal to move forward as currently constructed, it would validate a model that fails to meet many of the PFMIs and general risk management best practices. This seems contrary to the Commission’s mission and could have negative implications for global financial market stability.

**Cross border equivalence** – The Commission should consider whether the acceptance of the Proposal might imperil equivalence decisions with other jurisdictions. The Commission might have to revisit equivalence decisions that took considerable time and effort for the Commission to negotiate with third countries and could result in U.S. DCOs losing their recognition status in the European Union (“EU”) and United Kingdom (“UK”), and thus no longer being able to effectively serve clearing members with EU- and UK-based participants and participants with parent companies in these jurisdictions.

**AML/KYC** – Under the current U.S. AML/KYC structure, FCMs are responsible for these obligations. However, DCOs employing a non-intermediated model are subject to Commission

---

<sup>4</sup> Section XIV of the Participant Agreement states that participant positions will be closed out if they are under margined, but does not mention that such a liquidation could result in the participant owing more if the liquidation costs exceed its margin.

<sup>5</sup> CPMI, IOSCO, Principles for financial market infrastructures (April 2012).

<sup>6</sup> FTX Letter, Permissibility and Benefits of Direct Clearing Member under the Commodity Exchange Act and CFTC Regulations (Feb. 2022), at pg. 5 (noting, “FTX will rely only on collateral deposited with FTX when evaluating its risk exposure, as opposed to holistic credit checks that rely on information, such as a person’s worth, occupation, credit score, and other information that may be stale at any particular point in time.”). CFTC Rule 39.12(a)

<sup>7</sup> FTX Letter, Financial Resources under Core Principle B and CFTC Regulation 39.11(a)(1) in Absence of Clearing Futures Commission Merchants (“FCMs”) (Feb. 2022), at pg. 3.

Orders that require the DCOs to adhere to AML/KYC obligations as if the DCOs were FCMs.<sup>8</sup> The Commission should consider whether the financial institution definition provided for in Part 160 of the Commission's Regulations should be revised to include non-intermediated DCOs to more fully capture a non-intermediated DCO's AML/KYC obligations.

#### **D) Conclusion**

Nodal Clear supports innovative approaches to risk management and clearing. However, the Proposal raises a number of concerns that must be thoughtfully considered and addressed. Accordingly, Nodal Clear cannot support the Proposal in its current form. Nodal Clear would welcome the opportunity to review and comment on a revised Proposal or related rulemaking that addresses the issues highlighted herein.

\* \* \* \* \*

Nodal Clear appreciates the opportunity to comment on the Proposal.

Respectfully submitted,

/s/ Cody Alvarez

Cody Alvarez  
Chief Compliance Officer &  
Corporate Counsel

---

<sup>8</sup> See, for example, current FTX order.