

I firmly take the perspective of Chairman Christy Romero's comment posted at the following link.

<https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement062823>

The potential new vertical integration of clearinghouses with customer-facing intermediaries will not promote market stability, investor protection, or reduced market risk. This new regulatory framework should not be implemented under any circumstances. It only serves to hand over the ability of substantially more risk and leverage to a vertically integrated (see: monopoly) clearinghouse, with a significant reduction in seeing both the level of risk and the ability of a naturally occurring disciplinary feedback mechanism to be in place.

Again, this new market structure and regulatory proposal should not be implemented in any fashion.

A quote from Romero's comment is especially prescient: "Our clearinghouse rules were not set up to protect customers, because they were written with the idea of a separate intermediary that interacted with customers and had regulatory obligations for customer protections."

Now that the intermediary is being eliminated, the regulatory rules in place for clearinghouses reduce protection for customers and allow abuse of investors through lack of investor protection. Without regulatory oversight and consumer protection, investors cannot have confidence in their market, which is essential for functioning markets. Aside from the lack of confidence, I believe we all understand that clearinghouses are not looking out for the customers and investors first.

Trade execution can no longer be guaranteed to favor or look out for the investor. There is now less competition, less regulatory oversight here, and no need for the clearinghouses to abide by fair trade execution practices.

Per Romero's next comment, a vertically integrated market eliminates competition. Not only are investors no longer protected under regulatory constraints imposed on the clearinghouses for this purpose, but vertical integration puts the power in the hands of a sole entity. Competition can no longer be used for the market to self-regulate to the degree that it is able. This is also outlined in her comment here as well:

"The traditional market structure contains inherent bumper guards—market discipline resulting from differing interests of different entities—that promote financial stability. Expanding to a novel vertically integrated market structure for example, for clearinghouses raises particular concern because the resilience of our clearing system depends in significant part on the disciplining effect that clearing members can have on clearinghouses. Because clearing members may be asked to mutualize losses and accept risks in a default waterfall, they have much at stake in the decisions made by clearinghouses. They often have a different perspective and do not always have fully aligned interests with the clearinghouses. What happens to that disciplining effect where the clearing member (the futures commission merchant (FCM)) is owned by the same parent company as the clearinghouse?"

The answer is that there will be no disciplining effect, and accepted risks and potential losses will be set by the new clearinghouse monopoly. There will be no regulatory oversight, competition, or disciplining effect. As much risk can be taken as desired by the new vertically integrated system, with no ability by outside entities to intervene or set risk limits. In a similar fashion, we saw the result of the then-novel credit default swaps and mortgage-backed securities - where the risk of these assets was ill-understood

and virtually unregulated. If we fail to remember history, it will repeat itself. I hope we remember 2008, and what the result was of blinding ourselves to increased risks through lack of regulation lead us towards. This new vertically integrated clearinghouse environment is obviously not an ill-packaged security, but the lack of insight into the risks it poses, the ability of the clearinghouse to leverage risk substantially more (and without any risk insight, disciplinary feedback loop, or competition) is an ill-advised and potentially disastrous market environment.

Another comment by Romero that I would like to bring forth: "Conspicuously absent from this request for comment is a discussion of vertical integration of crypto platforms. This market structure has come up the most in that context, given that many crypto companies are vertically integrated in the unregulated space. Appropriate regulation does not mean that we automatically port over to regulated markets a structure that exists in the unregulated space."

This is an incredibly important concern. This new proposal simply mimics the market structure in the unregulated crypto space, which has significantly fewer protections for investors. As we saw with FTX, it was completely fraudulent. I do not believe following the market structure of an unregulated space that has proven to become fraudulent when and where possible is a wise course of action.

Romero also said the following, in a speech prior to the fall of FTX: "Crypto-related companies may serve multiple functions that are separated into different entities in traditional finance. An exchange may also be a market maker, clearinghouse, lender, and/or custodian. These conflicts present significant risks that in a regulated environment would be disclosed and resolved. In an unregulated environment, the full extent of these conflicts may not be disclosed or resolved, which could lead to cascading losses and contagion risk."

It is incredibly prescient that the risks she laid out in this speech immediately came to fruition in the binance space. Now we are changing our own regulatory structure to mimic the market structure of binance - which has clearly shown massive risks in their space. By the nature of the commodities space, the risk of cascading losses and contagion is far, far greater.

Romero also testified to Congress in 2009, addressing the 2008 financial crisis: "In my Congressional testimony, I cited to then-Treasury Secretary Timothy Geithner who told Congress on June 18, 2009, that the rise of new financial instruments "that were almost entirely outside of the Government's supervisory framework left regulators largely blind to emerging dangers." [11] The same could be true of a vertically integrated market structure. Without visibility into the risks, we would be largely blind as to emerging dangers to customers and financial stability. Public comment can help give visibility. However, we may still lack visibility into unregulated affiliates."

This newly proposed vertically integrated market structure now brings additional risks to the marketplace, less regulatory oversight, and less visibility and reporting from these consolidated clearinghouses. As history has clearly shown - as identified in my comments here - any leverage and risk that can be taken to make more money - will absolutely be taken.

This vertical integration poses additional risks with absolutely no benefit.

This new regulatory proposal should not be implemented in any fashion and only serves to hand over more power to clearinghouses, eliminate their competition, and allow them to make more money through poor trade fulfillment and questionable margin requirements or structure, at the expense of additional risk, contagion, and cascading losses that investors and customers will ultimately take the losses for.

Thank you,

Dr. Paul Pritchard