September 28, 2023

*Via electronic submission to CFTC comments portal*

U.S. Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

Re: Request for Comment on the Impact of Affiliations of Certain CFTC-Regulated Entities

To whom it may concern:

I comment today to resoundingly echo the considerations set forth in the June 28th Statement of CFTC Commissioner Christy Goldsmith Romero on Request for Comment on the Impact of Affiliated Entities.

As troubling as it is that the CFTC would even consider an idea as disastrous as permitting vertical integration in the derivatives market, it is comforting to know that Commissioner Goldsmith Romero is keenly aware of the attendant risks.

In the interest of the Commissioner’s “twin pillars of financial stability and customer protection,” this proposed regulatory framework must not be implemented under any circumstances. The potential new vertical integration of clearinghouses with the customer facing intermediaries will not promote market stability, investor protection, and will substantially increase market risk. The proposed framework serves to place substantially more risk and leverage in the hands of what would instantly become self-interested monopolies.

While it is encouraging that the CFTC asked 37 important questions in the Request for Comment, virtually every answer will be identical: the conflict of interest within the potential vertically integrated systems will be far too great to manage, which will undoubtably lead to disastrous consequences.

The Commissioner aptly noted that the CFTC’s current 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."

With the elimination of a separate intermediary, the regulatory rules in place for clearinghouses will be woefully insufficient to protect customers. This will open the door for rampant abuse of customers, particularly retail investors.

The Commissioner wisely seeks commentors thoughts on how this proposed scheme would affect market confidence. As elucidated in her Statement, “Confidence is essential to well-functioning markets.” If vertical integration were to make its way into the derivatives market, any individual who understood their true impact would lose all confidence in the derivatives, and potentially securities as a whole. Without proper regulatory oversight and consumer protection, investors cannot have confidence in their market. Aside from the lack of confidence, the blatant conflict of interest would see the monopolies interests come first and the household investor’s interests come last.

Trade execution can no longer be guaranteed to favor or look out for the investor. Under this potential scheme, there would be dramatically less competition, and no oversight to ensure the clearinghouses abide by fair trade execution practice.

Thankfully, the Commissioner understands that vertical integration puts the power in the hands of a sole entity. Competition would no longer be available to allow the market to self-regulate:

"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 a heavily self-interested 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, will be taken. After all, what is to stop the unsupervised toddler form taking another cookie from the cookie jar?

An expert and oracle on the topic of the FTX collapse, the Commissioner pointed out: "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 incredibly vital concern. This new proposal is essentially duplicating the market structure in the unregulated crypto space, which lend catastrophic losses for unwitting victims. As we saw with FTX, the conflict of interest is too powerful to overcome and manage reasonably. If the CFTC’s goal is to ensure the derivatives market’s next Sam Bankman-Fraud is able to fleece investors, then this proposed market structure should be enacted with haste!

Romero further explained: "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 risk 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.” 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 new proposed vertically integrated market structure now brings additional risks to the market place, less regulatory oversight, 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 to financial stability or customer protection. The only benefit would be to the potentially unchecked monopolies the scheme would immediately create.

This new regulatory proposal should not be implemented in any form or fashion, as it only serves to hand more power to clearinghouses, eliminate their competition, and allow them to dominate the industry, at the expense of additional risk, contagion, and cascading losses that investors and customers will ultimately take the losses for.

Respectfully submitted,

Mitchell Fillinger