MYTH vs. FACT:

The FTX US Proposal before CFTC to Provide Equitable Access to Margined Products

Myth 1: CFTC licenses to amend DCO order of registration requires a rulemaking.

FACT: There is no requirement for a rulemaking process for the amendment of a derivatives clearing organization (DCO) registration. Title 17, Part 39.3 of the Federal Register states that any DCO may apply to the CFTC for an amendment of registration. Provided that the DCO submit all relevant material, the CFTC may review and either approve or deny the change in 180 days. FTX submitted its proposal and the required documentation to amend the status of LedgerX (now part of FTX US) to modify its existing disintermediated model on December 6, 2021.

Myth 2: The CFTC has not followed the proper process or given enough time to consider the FTX application.

FACT: The CFTC's rules do not require public commentary on license applications, yet the CFTC requested public input and opened a 60-day open comment period specific to the FTX proposal. The comment period for the FTX proposal was a 60-day open comment period specific to the FTX proposal. The comment period for the FTX proposal was extended from 30 to 60 days. In addition to the Public Comment Period, the CFTC will host a roundtable on disintermediation, looking at the FTX proposal as well as other proposals for disintermediation. This is an unprecedented step that will extend the process and provide additional feedback from companies, traders, academics, and all other interested members.

Myth 3: FTX is requesting its own rules from the CFTC.

FACT: The FTX application complies with the CFTC's existing regulatory regime and does not require new rules and regulations, and FTX has not requested special rules. The key features of the FTX application are already permitted by the CFTC and found in the market place today, including the direct-access market structure for clearinghouses.

Myth 4: FTX has no capital requirements for market participants.

FACT: FTX has the required amount of capital pursuant to CFTC Regulation 39.13 (g), which requires all derivatives clearing organizations (DCOs) to collect initial margin approved by the CFTC. FTX US Derivatives rules require that "Each Participant shall deposit with, pay to, or maintain with the Company unencumbered assets sufficient to satisfy the Initial Margin, Variation Margin and option premiums for each Company Contract [...]."

Myth 5: FTX model increases systemic risk.

FACT: The FTX model evaluates risk on a near real-time basis, assessing the capital that investors have on deposit (i.e., collateral) versus a minimum requirement based on the value of the contracts. If an investor suffers losses that take their collateral near the minimum requirement, they are alerted. If the collateral in the account falls below the minimum level, the system will begin de-risking small portions of the customer's trading position until the customer account is brought to balance.

The implication of this system is that it limits the ability of systemic risk to build up in a market, even over a short period of time. Risk is limited because there is no reliance on off-platform resources, which investors may not have during extreme market conditions. This benefits investors, who are not punished by suspended trading or cancelled trades worth billions, while providing greater stability to the broader financial system. This approach also limits pro-cyclicality impacts on collateral, where margin calls can increase pressure on the ability of market participants to provide more collateral in times of stress. With the FTX model, the collateral is already on the platform.

In addition, the FTX model eliminates credit risk. FTX would require investors to post collateral (margin) directly with the clearing house (FTX serves as the exchange and clearing house), thus providing full visibility to all market participants. In contrast, traditional platforms tend to base margin extension decisions on off-platform assets, or “shadow credit”, which exposes clearing organizations to significant credit risk.

With pre-funded collateral requirements and real-time de-risking of positions, the FTX model reduces contagion and systemic risks.

Myth 6: FTX application would allow for agriculture commodities derivatives trading.

FACT: The FTX application before the CFTC to amend its Order of Registration as a derivatives clearing organization (DCO) includes a risk model for bitcoin and ethereum futures only. Unless FTX submits another new risk model to the CFTC Division of Clearing and Risk for analysis, FTX cannot offer additional products.

On July 24, 2017, Ledger X (now part of FTX US) was authorized to clear fully collateralized futures and swaps pursuant to the approval of a CFTC registration as a DCO under the Commodity Exchange Act. The FTX proposal currently under review by the CFTC does not intend to offer derivatives trading on agricultural commodities at this time; it only seeks to amend the model used to clear digital currencies to offer margined products without intermediaries – directly to participants.

Myth 7: The FTX de-risking feature “is going on ‘like crazy,’ with a 5% haircut on Bitcoin and 15% margin.”

FACT: The FTX de-risking feature results in market transactions that are a small fraction of total exchange volume. For example, even on one of the most volatile trading days, March 12, 2020, when Bitcoin fell nearly 40% and Ethereum fell 44%, de-risking transactions totaled $44,946,399 against a volume of $4,441,696,624 – roughly 1.01%. On May 19, 2021, when Bitcoin fell 14% and Ethereum fell 26%, total de-risking transactions reached $1,679,839,594 compared to a total volume of $53,068,090,693 – liquidations being 3.17% of total volume.

The FTX application before the CFTC envisions only cash as permitted collateral for now. Any additional types of collateral would have appropriate haircuts for risk-management purposes as agreed to by the CFTC.

Myth 8: FTX does not maintain consumer protections maintained by DCOs and FCMs.

FACT: The FTX model is safe, conservative, transparent and offers strong investor protections. The FTX model would monitor and manage customer risk in a more stringent fashion that is required by either the risk management standards imposed on derivatives clearing organizations (DCOs) or futures commission merchants (FCMs). The FTX risk model makes improvements on traditional risk management by relying only on collateral deposited with FTX when evaluating its risk exposure, as opposed to relying on credit; measuring all participant account values in real-time, as opposed to periodic snapshots; and exchanging settlement variation margin on a near-real time basis to avoid the accumulation of large losses over time.

The FTX model contains customer protections on par or exceeding those of FCMs, as related to the protection of customer funds and collateral (including bankruptcy protections), cyber and operational risks, and trade reporting and transparency. Customers who access the FTX platform through an FCM would enjoy the specific protections provided by an FCM, but direct-access customers enjoy equal or comparable protections.

Myth 9: Making intermediation optional allows for fraud and abuse in derivatives trading.

FACT: FTX meets and exceeds CFTC requirements for exchanges, clearinghouses, and futures commission merchants (FCMs). The full panoply of requirements for exchanges and clearinghouses apply related to fraud, manipulative trading practices, trading surveillance, and conflicts of interest. In accordance with the Bank Secrecy Act, every deposit and withdrawal in both cryptocurrency and fiat currencies on FTX is subject to inspection to deter and detect money laundering.

Like FCMs, FTX provides disclosure documents, conducts know your customer (KYC) and anti-money laundering (AML) checks, and collects all other information required by the CFTC. The FTX model exceeds current investor protection standards for FCMs. Customers who have deposited less than certain amounts on the platform are required to undergo robust eligibility checks, including quizzes to demonstrate their understanding of the products they want to trade.

In addition, investors are required to undergo heightened suitability checks, including tutorials and quizzes to demonstrate understanding of the product. FTX US Derivatives has all the controls typically required by FCMs, and more, going above and beyond the industry standard.