Comments of ICLE to the CFTC on FTX Request for Amended DCO Registration Order
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Introduction

The International Center for Law & Economics (ICLE) is grateful for the opportunity to submit these comments in support of FTX's application to amend its DCO registration to allow it to clear margined products directly for retail participants.

The vast majority (some 96%[1]) of global crypto derivatives trading takes place outside the U.S., much of it on platforms operating non-intermediated retail models similar to that proposed in FTX's application—but with one crucial difference: these offshore exchanges are largely unregulated. The reason for the disparity in domestic vs. foreign trading volumes is clear: regulatory constraints and costs in the U.S. make the operation of such platforms impossible or unviable. FTX's proposal would pave the way to bring the technology and business models currently employed to facilitate virtually the entirety of the world's crypto derivatives trading into the regulated structure of U.S. derivatives markets. The only thing standing in the way is the possible inflexibility of that regulatory structure in the face of disruptive competition.

The obvious market benefits of FTX's proposal are that:

1. It would free capital that would otherwise be pledged as collateral, which could greatly expand liquidity in crypto markets or could be deployed elsewhere in the financial system;
2. It would introduce a competitive alternative to the current exchanges, thus providing investors savings on what they would otherwise pay in commissions, account origination fees, etc.; and
3. It would offer clear product differentiation: e.g., by introducing a new mechanism for counterparty risk mitigation and by offering direct access to retail investors (with inherently lower costs of participation, more and cheaper information, and technological enhancements like a direct-access mobile interface).

The latter two of these benefits (and to some extent even the first) go particularly to the enhancement of competition in U.S. derivatives markets.

Concerns that markets lack sufficient competition are at the forefront of current policy debates. Legislators are currently working on draft bills that seek to promote competition in digital markets, and President Biden recently issued an executive order advocating for a “whole of government” approach to competition.[2]

Unfortunately, the renewed focus on how governments may boost competition has a significant blindside when it comes to government-created *barriers* to competition. Rather than offering a solution, government regulations are all too often the cause of reduced competition. This is notably the case when regulation artificially narrows a market by preventing new and innovative firms from disrupting entrenched incumbents.

In other words, if the “whole-of-government” approach to promoting competition means anything, it means that regulatory agencies should work to remove state-created, artificial barriers to market entry that are not absolutely required to accomplish core regulatory functions. The CFTC has precisely that opportunity with FTX’s application.

The market for crypto (and many other) derivatives is currently a lucrative duopoly, dominated by the Chicago Mercantile Exchange (CME) and the Intercontinental Exchange (ICE). Both firms have long been shielded from robust competition by a protective, if well-intentioned, moat of government regulation. The CFTC now has a unique opportunity to open this duopoly to disruptive competition.

FTX’s application would bring both technological and business-model innovation to the derivatives market, carrying with them the promise of increased competition, reduced risk, more efficient pricing, and lower costs for investors. There is always reluctance to embrace the new, particularly in areas that deal so intrinsically with risk. But a sensible measure of caution must not be allowed to morph into costly intransigence.

FTX’s application, while ambitious in its aims, is, in fact, quite modest in its mechanisms. It is respectful of the existing, overarching regulatory paradigm implemented to protect consumers, investors, and the financial system as a whole; it contemplates significant protections and backstops to shore up any increased risk it might introduce; and it ensures that ongoing oversight by the CFTC is readily facilitated.

Indeed, approval of FTX’s application would not entail the abandonment of the CFTC’s core principles, but merely a recognition that the specific implementation of those principles may not be optimal for certain novel business models and technology. As Chairman Benham recently remarked:

> [T]he digital asset market would benefit from uniform imposition of requirements focused on ensuring certain core principles, including market integrity, customer protection, and market stability. At the CFTC, we have seen that a regulatory regime focused on core principles can be successful in overseeing a wide variety of markets, and have no reason to think those same principles cannot be applied to digital asset markets.[3]

In short, the CFTC should jump at this opportunity to introduce some well-regulated experimentation into the derivatives market: the likely social benefits of this effort significantly outweigh the potential harms.

Read the full comments here.

[1] *See, e.g.*, Philip Stafford, *Crypto industry makes push into regulated derivatives markets*, FINANCIAL TIMES (Feb. 21, 2022), https://www.ft.com/content/364dee59-fb51-400b-acd2-808d4ec41ab3.

[2] Executive Order 14036 on Promoting Competition in the American Economy, § 2(g) (Jul. 9, 2021) https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/executive-order-on-promoting-competition- inthe-american-economy ("This order recognizes that a whole-of-government approach is necessary to address overconcentration, monopolization, and unfair competition in the American economy.").

[3] CFTC Chairman Rostin Behnam, *Letter to the U.S. Senate Committee on Agriculture, Nutrition, and Forestry and House Committee on Agriculture* (Feb. 8, 2022) at 4, *available at* https://www.agriculture.senate.gov/imo/media/doc/2022%2002%2008%20Ag%20committees%20digital%20asset%20res ponse%20letter.pdf.

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