United States House of Representatives
Committee on Agriculture
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FIA

Chairman David Scott, Republican Leader G.T. Thompson, and Members of the Committee, thank you for the opportunity to testify about the US derivatives market structure and the unique proposal set forth by FTX US.

I am President and CEO of the FIA, a leading global trade organization for the futures, options and centrally cleared derivatives markets. As someone who also served on the Commission for many years, I am proud of the CFTC's long history of supporting innovation and competition in the derivatives markets.

In fact, Congress wisely instructed the CFTC in its mission to, not only uphold strong protections for customers and police the integrity of the markets, but also "promote responsible innovation and fair competition" among market participants. In crafting this balanced mission, this Committee was careful in making sure innovation and competition were advanced responsibly and fairly without jeopardizing the integrity or financial stability of the markets or the protections afforded to customers.

Today, we are at an inflection point that requires us to carefully consider the benefits of an alternative clearing structure and ensure it does not compromise the battle-tested protections and checks of the existing structure afforded to customers and markets. The CFTC is now considering a proposal by FTX that would replace the traditional distributed risk clearing model that utilizes Futures Commission Merchants (FCMs) with a more automated and centralized one that does not utilize intermediation.

Specifically, the FTX direct clearing proposal would, for the first time, combine margined futures with near real-time margining, 24/7 auto liquidation of defaulting customers, and a self-funded CCP default fund without the benefit of FCM's risk management processes.

It is important to point out that FTX's proposal would permit futures trading in any underlying asset class transacted by any type of customer, including commercial hedgers. This requires us to view this proposal with an eye beyond retail cryptocurrencies. We must also consider the core users of our markets, including farmers, refiners, pension funds, and other main street businesses that use futures to hedge price risk in the real economy.

When contemplating such transformative change, FIA encourages policymakers to consider the fundamental guiding framework articulated in President Biden's recent Executive Order on digital assets: Same Business, Same Risks, Same Rules. FIA believes the CFTC must analyze FTX's proposal against the many important customer protections and risk management functions that registered FCMs currently provide the marketplace.

As agents for their customers, FCMs hold various regulatory responsibilities including vetting customers on the appropriateness of these leveraged products, policing clients for money laundering, segregating customer funds, guaranteeing customer trades, holding significant regulatory capital against those trades, contributing their own "skin in the game" capital to the central counterparty ("CCP") default fund, and agreeing to further assessments should the CCP default fund need replenishment.

Today U.S. registered FCMs hold roughly $175 billion in regulatory capital that backstops their guaranty of customer trades and serves as a first line of defense against a more serious contagion event that could spread to a CCP and beyond. Additionally, these FCMs contribute another $15 billion to clearinghouse default funds that serves to incentivize careful risk management and distribute risk among highly capitalized institutions during a stressed market crisis.

FIA also believes there needs to be further analysis of the FTX risk model in extreme but plausible scenarios, especially for large commercial participants in other asset classes beyond retail digital currencies. Given the model relies on continuous liquid markets that are open 24/7, questions remain around the market impact of the auto-liquidation feature for the close-out of large positions in less liquid markets. We must ensure that the model does not trigger a broader fire sale in the central price discovery market that harms hedgers and exacerbates further market disruption.

Conclusion

FIA supports the efforts of FTX to further advance real-time risk management in clearing and bring greater competition to our markets. Their proposal has advanced a healthy debate in our industry. However, we believe that further analysis and information are needed on the FTX proposal, and we look forward to the deliberative process of the CFTC that will help bring additional clarity and information to this unique clearing model.