



# BETTER MARKETS

By Electronic Submission

March 18, 2024

Christopher Kirkpatrick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington, DC 20581

Re: Protection of Clearing Member Funds Held by Derivatives Clearing Organizations (RIN 3038-AF39)

Dear Mr. Kirkpatrick:

Better Markets<sup>1</sup> appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (“CFTC” or “Commission”) proposed rulemaking<sup>2</sup> (“Proposed Rulemaking”), which aims to establish rules that safeguard the funds and assets of clearing members in the event of a derivatives clearing organization (DCO) declaring bankruptcy. The protection is intended to be achieved by requiring the funds of clearing members be kept separate from those of the DCO and deposited with a depository that has formally acknowledged in writing that these funds belong to the clearing members, and not to the DCO.

The Proposed Rulemaking refers to the assets or funds on deposit at a DCO from a customer of a Futures Commission Merchant (FCM) as “customer funds.”<sup>3</sup> The Proposed Rulemaking adopts the term “clearing member” to describe customers directly interacting with the DCOs and “proprietary funds” to describe clearing members’ assets or funds on deposit at DCOs.<sup>4</sup> Certain safeguards designed to protect customers and applicable to FCMs are also relevant

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<sup>1</sup> Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans’ jobs, savings, retirements, and more.

<sup>2</sup> Protection of Clearing Member Funds Held by Derivatives Clearing Organizations; 89 Fed. Reg. 286 (January 3, 2024).

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at 288.

for DCOs that handle customer funds received from their FCM clearing members. However, these safeguards do not apply to the clearing members of the DCOs. Thus, the Proposed Rulemaking attempts to provide parallel protections for both the customers of FCMs and the clearing members of DCOs.<sup>5</sup>

For example, the primary objective of the Proposed Rule is to provide safeguards for the assets and funds of clearing members in the event of a DCO bankruptcy. This is to be achieved by mandating the segregation of clearing member funds from those of the DCO, ensuring these funds are deposited in an institution that formally recognizes the ownership of these funds as belonging to the clearing members, rather than the DCO itself. Furthermore, the Proposed Rule proposes new measures concerning the comingling of clearing member or proprietary funds. This includes restrictions on how these funds can be utilized and confines the investment of such funds to those investment avenues that are permitted for customer funds under Regulation §1.25.<sup>6</sup>

While the Proposed Rulemaking seeks to provide parallel protections for customers of FCMs and clearing members of DCOs, it falls short of assuring that all accounts of DCO clearing members are monitored both directly and indirectly through a comprehensive oversight system. For instance, under the Bank Secrecy Act (BSA), FCMs are required to carry out standardized due diligence processes for verifying customer identities and assessing both new and existing risks, serving as crucial functions in their Anti-Money Laundering (AML) screening efforts.<sup>7</sup> Given that some DCOs are replacing FCMs in a disintermediated market, it is vital for these DCOs to also adhere to AML requirements in order to prevent illicit criminal activity. This necessity was confirmed by Chairman Behnam's recent testimony to the U.S. House Committee on Agriculture regarding the adherence to agency regulations, including KYC, AML, and CIP procedures, to mitigate fraud, money laundering, and other financial crimes.<sup>8</sup> Despite his advocacy for stringent regulatory compliance, particularly in the context of digital assets and related technologies, the CFTC's response has been slow. This is evident in the rapidly evolving world of disintermediated DCOs involved in crypto derivatives contracts, where regulatory updates have not kept pace with market evolution. This delay highlights the fact that the CFTC should have engaged with the Financial Crimes Enforcement Network (FinCEN) years earlier to officially designate DCOs as a "financial institution" that is covered under the BSA.<sup>9</sup> Moreover, considering the protracted nature of the CFTC's rule-making process, this Proposed Rulemaking represents a missed opportunity

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<sup>5</sup> Statement of Commissioner Kristin N. Johnson: Closing a Gap, Preserving Market Integrity and Protecting Clearing Member Funds Held by Derivatives Clearing Organizations, available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement121823b>

<sup>6</sup> 89 Fed. Reg. at 289.

<sup>7</sup> 31 CFR Section 5318

<sup>8</sup> See Testimony of Chairman Rostin Behnam: U.S. House Committee on Agriculture, available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabeznam42>

<sup>9</sup> 31 CFR Section 5312(a)(2)(Y). The statute empowers FinCEN to consider any business or agency a "financial institution" if it engages in any activity similar to, related to, or a substitute for any activity in which any business described in this paragraph is authorized to engage.

for a more comprehensive analysis of whether DCOs should be subject to BSA. Unfortunately, the Proposed Rulemaking skirts around this pivotal issue, relegating it to a mere question for further commentary, almost as an afterthought.<sup>10</sup>

Notwithstanding, Better Markets acknowledges the CFTC's efforts to address the aftermath of the FTX bankruptcy by aiming to provide bankruptcy protections for clearing members' proprietary funds.<sup>11</sup> However, the Proposed Rule offers a singular form of protection in the disintermediated model, which reduces or eliminates to varying degrees customer, investor, and financial stability protections. This neglects the comprehensive array of protections, or checks and balances, that exist within the intermediated model facilitated by FCMs. In this context, Better Markets advocates that the CFTC should mandate that disintermediated DCOs, which directly interact with customers, be required to join the National Futures Association (NFA). This is essential because FCMs, which are already subject to NFA audits, adhere to a comprehensive set of NFA rules aimed at ensuring customer safety—a standard of scrutiny and protection that should equally apply to DCOs participating in a disintermediated market structure.

Better Markets also believes that the CFTC should have undertaken a meticulous analysis comparing the full spectrum of protections offered by FCMs to their customers against those provided by DCOs to their clearing members.<sup>12</sup> Such an analysis is vital for ensuring that regulatory frameworks keep pace with market innovations and adequately protect all market participants. The Proposed Rulemaking represents a missed opportunity for the CFTC to comprehensively address these critical issues in a single action. By focusing on a single narrow aspect of the broader regulatory challenge, the CFTC has bypassed the chance to take a significant step forward, opting instead for a fragmented approach that may necessitate multiple future adjustments. Additionally, while Better Markets has concerns with, among other things, the concept of a fully collateralized disintermediated marketplace without the necessary customer protections, we believe that additional statutory authority is needed before the CFTC can permit leveraged or margined transactions within such a framework for retail customers.

I. **Given the critical role of AML in safeguarding national security and other criminal activities, the CFTC should have undertaken a comprehensive analysis to explore its authority to require AML requirements on DCOs in the Proposed Rulemaking.**

The increasing prevalence of digital assets in financial transactions has heightened the risks of various forms of financial crimes, as evidenced by numerous cases and regulatory actions across the globe. Digital assets due to their technological features and the anonymity they can provide, have been leveraged in a wide array of illicit activities, including but not limited to

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<sup>10</sup> 89 Fed. Reg. at 292.

<sup>11</sup> See Dissenting Statement of Commissioner Christy Goldsmith Romero on Rushed Rulemaking Related to FTX's Direct-to-Retail Market Structure, available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement121823c>

<sup>12</sup> See Dissenting Statement of Commissioner Christy Goldsmith Romero.

money laundering, terrorist financing, fraud, tax evasion, cyberattacks, and human trafficking.<sup>13</sup> Recognizing these risks, President Biden issued an Executive Order in March 2022, advocating a comprehensive approach to address both the opportunities and challenges posed by digital assets.<sup>14</sup> This directive emphasized the "significant illicit finance risks" associated with digital technologies, including money laundering, cybercrime, and ransomware, and called for enhanced interagency collaboration to bolster knowledge-sharing and law enforcement capabilities against such threats.<sup>15</sup> Moreover, the Treasury's Action Plan delineates a series of priorities, such as monitoring emerging risks and strengthening AML/CFT supervision, which are crucial for addressing the challenges posed by digital assets.<sup>16</sup> This includes engaging with private sector entities and enhancing public-private information sharing to identify and mitigate illicit finance risks effectively.

Nevertheless, the use of digital assets for criminal activities underscores the complexities and challenges in the digital financial ecosystem.<sup>17</sup> Criminal groups, including terrorist networks and drug cartels, are leveraging digital currencies for their ability to transfer and launder money discreetly. The appeal of digital currencies for these organizations lies in their capacity to offer anonymity, along with the means to circumvent international banking systems and evade sanctions.<sup>18</sup> By leveraging digital currencies, criminals are able to bypass the stringent oversight, sanctions, and regulatory controls typically imposed by traditional banking systems. This method allows for financial transactions to be made in a manner that is difficult for governmental and financial institutions to trace or block, thereby circumventing established mechanisms designed to prevent financial support to entities designated as terrorist organizations or subject to international sanctions.<sup>19</sup>

Given the significant security implications tied to the misuse of digital assets for financing terrorist activities and other illicit operations, it is imperative for regulatory bodies like the Commodity Futures Trading Commission (CFTC) to rigorously assess their regulatory

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<sup>13</sup> U.S. Treasury, *Action Plan to Address Illicit Financing Risks of Digital Assets* (September 20, 2022), available at <https://home.treasury.gov/system/files/136/Digital-Asset-Action-Plan.pdf>

<sup>14</sup> Executive Order. No. 14067, *Ensuring Responsible Development of Digital Assets* (2022), available at <https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/>

<sup>15</sup> *Id.*

<sup>16</sup> See U.S. Treasury, *Action Plan to Address Illicit Financing Risks of Digital Assets* (September 20, 2022).

<sup>17</sup> Sara Mosqueda, *Follow the Money: How Digital Currency is Changing Crime*, *Asis International* (August 21, 2023), available at <https://www.asisonline.org/security-management-magazine/articles/2023/08/cryptocurrency/How-digital-currency-changes-crime/>

<sup>18</sup> *Id.*

<sup>19</sup> U.S. Government Accountability Office, *Agency Efforts Help Mitigate Some of the Risks Posed by Digital Assets* (December 2023), available at <https://www.gao.gov/assets/d24106178.pdf>

frameworks in light of these evolving threats. The alarming use of cryptocurrencies by criminal organizations to secure funding underlines a critical gap in the current regulatory oversight. Such entities exploit the anonymity afforded by digital assets to evade global sanctions and financial controls, underscoring the urgency for enhanced Anti-Money Laundering (AML) measures within digital financial ecosystems.

The CFTC, in its Proposed Rulemaking, had a prime opportunity to conduct a thorough analysis of its authority to enforce AML requirements on Derivatives Clearing Organizations (DCOs). This analysis would not only assess the feasibility of integrating stringent AML protocols within the operational frameworks of DCOs but also evaluate the potential to extend these requirements to encompass all facets of digital asset transactions processed by these entities. The need for such an in-depth examination is underscored by the increasing sophistication of digital financial transactions and the corresponding rise in their use for nefarious purposes.

Implementing comprehensive AML requirements for DCOs would serve multiple critical functions. Firstly, it would significantly hamper the ability of egregious lawbreakers worldwide to utilize digital assets as a conduit for funding their operations, thereby contributing to national and international security and law enforcement efforts. Secondly, it would align the digital asset transactions processed by DCOs with the appropriately stringent compliance standards applied to traditional financial institutions, ensuring a level playing field, closing loopholes for regulatory arbitrage, and presenting a unified front against money laundering and terrorist financing across all financial platforms. Furthermore, the integration of robust AML measures would enhance the integrity of the digital asset market, fostering greater trust among investors, participants, and regulators. It would also ensure that DCOs operate within a regulatory framework that is both conducive to innovation and stringent in preventing the misuse of digital financial technologies.

The discussion at the open meeting, where the possibility of imposing AML requirements on clearinghouses was acknowledged but deferred for future consideration, further indicates a missed opportunity to address these concerns within the current proposal. The decision to postpone the inclusion of AML requirements was not a collective policy decision by the Commission, reflecting a lack of consensus on how to proceed with this critical issue.<sup>20</sup>

Given these considerations, it's evident that the CFTC should undertake a more comprehensive analysis to explore its authority to mandate AML requirements for DCOs. Such an analysis would not only strengthen the regulatory framework against criminal activity but also protect the integrity of the financial system and safeguard retail and other participants from the risks associated with the commingling of funds with illicit actors. Addressing this gap is essential for ensuring that the digital asset derivatives market is secure, transparent, and resistant to exploitation by illicit entities.

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<sup>20</sup> See Dissenting Statement of Commissioner Christy Goldsmith Romero.

**CONCLUSION**

We hope these comments are helpful as the Commission finalizes its Proposed Rulemaking.

Sincerely,

A handwritten signature in black ink, appearing to read "Cantrell Dumas". The signature is fluid and cursive, with the first name being the most prominent.

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