WORLD FEDERATION OF EXCHANGES

WFE Response to the CFTC's Request for Comment on the Direct Clearing of Derivatives by Retail Participants

19 January 2026

Response

The World Federation of Exchanges (WFE) welcomes the opportunity to respond to the request for comment issued by Commodity Futures Trading Commission (CFTC, or "the Commission") on direct clearing of derivatives by retail participants at derivatives clearing organisations (DCOs) ("Retail DCOs"). The WFE strongly supports the Commission's objectives of protecting retail market participants, and addressing the full set of intermediation, conduct, and risk management functions traditionally performed by futures commission merchants (FCMs).

<u>Section One - Retail direct clearing and the absence of FCM intermediation</u>

1(a) Is there a need to ensure that all FCM duties with respect to customer clearing are fulfilled by the DCO in a Retail DCO model? If so, why? If not, which duties would not need to be replicated?

In our response[1] to the Commission's 2024 Notice of Proposed Rulemaking on the Protection of Clearing Member Funds Held by Derivatives Clearing Organisations, the WFE emphasised that Retail DCO models which omit the intermediation of FCMs remove a crucial layer of regulatory protections and risk management functions that currently apply to retail customers in traditional intermediated clearing models, particularly for non-fully collateralised products. These models include broader customer protection, risk management, and conduct-related functions that an FCM performs for relative to its individual customers, which are not mirrored in existing DCO requirements. [2]

DCOs are designed to manage counterparty risk at the clearinghouse level, not to supervise retail customer conduct, suitability, or distribution practices. [3] Given the core functions of FCMs are to manage the risk of their customers and protect each individual customer for which they intermediate transactions, the WFE recommends that Retail DCOs use an affiliated or non-affiliated FCM provide these functions for non-fully collateralised products. When retail direct participants are customers of an FCM for non-fully collateralised products, such participants are subject to a comprehensive and well-understood regulatory framework that has been specifically designed to address retail customer protection, conduct, and default-related risks.

In the limited case of fully-collateralised direct retail clearing, where a Retail DCO does not utilise an FCM, the WFE considers it essential that the regulatory framework ensures outcomes equivalent to those delivered by existing FCM requirements, so that no gaps in customer protection or risk management arise.

We emphasise that the fully-intermediated model is the most time-tested model, and performs well. Thus, the WFE believes that the absence of FCM intermediation presents a significant risk and reduces essential protections, while the presence of an FCM ensures a complete regulatory framework and proper risk management. Utilisation of an FCM is the most effective means of ensuring consistent customer protections – and this is particularly true for non-fully collateralised products.

1(b) Should direct retail participants be required to become customers of the Retail DCO's affiliated FCM and therefore subject to FCM customer protections and other safeguards that DCOs are not required to provide? Why or why not?

See response to question 1(a). Retail participants of a Retail DCO clearing through an FCM, whether affiliated or non-affiliated, promotes regulatory consistency and reduces the risk of uneven protections across participants.

[1] WFE response to the CFTC's Notice of Proposed Rulemaking on the Protection of Clearing Member Funds Held by Derivatives Clearing Organisations, https://www.world-exchanges.org/our-work/articles/wfe-response-cftcs-notice-proposed-rulemaking-protection-clearing-member-funds-held-derivatives-clearing-organizations

[2] This also includes Know Your Customer (KYC) and tax-related responsibilities which are currently performed by FCMs and are critical elements that should remain under FCM oversight.

[3] While some DCOs support the traditional FCM clearing model and may also have some non-FCM clearing members, this practice is subject to strict participation requirements that apply irrespective of the type of clearing member, and these non-FCM clearing members are well-capitalised, highly sophisticated firms with the requisite risk management expertise. The same cannot be said necessarily for retail market participants accessing a Retail DCO directly.

1(c) Should a Retail DCO that does not have an affiliated FCM be required to establish one for its direct retail participants to become affiliated FCM customers, maintaining the same vertically integrated market structure but with an FCM to provide risk management responsibilities and customer protections? Why or why not? Are there cases where the costs of this structure would not necessarily balance the resulting benefits?

See response to question 1(a). We suggest that a retail DCO could use an affiliated FCM, or accept a non-affiliated FCM.

1(d) In cases where a Retail DCO chooses to, or is required to, establish an affiliated FCM:

i) What additional requirements may be necessary to address conflicts of interest between:

(1) The Retail DCO and the affiliated FCM?
(2) The Retail DCO and non-affiliated FCMs?
(3) The affiliated FCM and non-affiliated FCM clearing members?
(4) The Retail DCO and non-FCM clearing members such as dealers or proprietary trading firms?
(5) FCM clearing members and non-FCM clearing members such as dealers or proprietary trading firms?

In our response[4] to the CFTC's 2023 Request for Comment on the Impact of Affiliations of Certain CFTC-Regulated Entities, the WFE highlighted that ownership structures in which a group owns both an FCM and a DCO give rise to different conflicts of interest than those historically observed in groups owning only exchanges and clearing houses. This distinction is particularly important because an FCM is a risk-taking entity, whereas DCOs and designated contract markets (DCMs) perform market infrastructure functions that both encompass the management of risks.

The WFE's response is also relevant in the case of Retail DCO that operates within a group that also operates an FCM. We encouraged the Commission to treat the two structures distinctly from a regulatory perspective, and to consider whether additional rules or guidance are necessary to address conflicts of interest where a group owns an FCM and a DCO and DCM. Potential mitigants identified for consideration, which equally apply to a group that operates a Retail DCO and FCM, included:

- Requiring that the FCM is a separate legal entity from the DCO and DCM, but under the same parent group.
- Implementing robust information-sharing barriers between the FCM and the DCO/DCM.
- Restricting shared personnel between the FCM and the DCO/DCM where conflicts may arise.
- Maintaining transparent governance arrangements, disclosure requirements, independent oversight, and compliance frameworks to ensure that relationships and related conflicts are adequately analysed, managed, and disclosed.

These mitigants for consideration were intended to ensure that customer protections and risk management decisions, including in managing a default, are not compromised by commercial considerations where a group owns an FCM, along with a DCO and/or DCM.

The Commission should not deviate from its successful principles-based approach which has long-allowed CFTC-regulated entities to effectively address conflicts of interest and efficiently offer their services to meet clearing member and customer demands.

ii) What are the implications if all retail direct participants of a Retail DCO are required to become customers of either an affiliated FCM, in a fully-collateralised model, or either an affiliated FCM or non-affiliated FCM, in a hybrid model?

See response to question 1(a). Clearing through an FCM, whether affiliated or non-affiliated, promotes regulatory consistency for retail participants of a Retail DCO, and reduces the risk of uneven protections across participants.

iii) Should affiliated FCMs of a Retail DCO be "captive" and prohibited from clearing membership in a non-affiliated DCO? Would this address potential conflicts of interest or risk management concerns? Why or why not?

[4] WFE Response to the CFTC's Request for Comment on the Impact of Affiliations of Certain CFTC-Regulated Entities, https://www.world-exchanges.org/our-work/articles/wfe-response-cftcs-request-comment-impact-affiliations-certain-cftc-regulated-entities

The WFE does not consider mandatory captivity to be a necessary or proportionate response. Conflicts of interest and risk management concerns are better addressed through governance, supervision, and transparency requirements rather than restrictions on market participation.

iv) What additional regulations or requirements may be necessary to protect against unanticipated, and disruptive, risk transfer between a Retail DCO and an affiliated FCM?

As one would expect to occur under existing CFTC regulations, the Retail DCO and any affiliated FCM should be each independently capitalised at the individual legal entity level consistent with the requirements under CFTC regulations.

<u>Section Two - Hybrid models combining direct and intermediated clearing</u>

2(a) In the case of these hybrid models, are there additional risk management protections that Retail DCOs should engage in to either ensure that retail direct clearing activity does not place undue risk on intermediated clearing members or their customers or the reverse?

See response to question 1(a). Retail participants of a Retail DCO clearing through an FCM, whether affiliated or non-affiliated, promotes regulatory consistency and reduces the risk of uneven protections across participants.

2(b) Is there a need to divide either default-related resources, or other risk management protections, such that distinct resources or protections are used for retail direct participants or intermediated clearing members or their customers?

See response to question 1(a). Clearing through an FCM, whether affiliated or non-affiliated, provides appropriate protections for managing a default.

2(c) Might certain default events result in unexpected or undue "risk transfer" between direct and intermediated participants? Are there protections which would be needed, or desired, to mitigate these risks?

See response to question 2(b).

2(d) Are there any circumstances under which hybrid models of this type should not be permitted due to the risks they may pose? What is the nature of these circumstances and related risks?

See response to question 2(b).

<u>Section Three - Multiple product classes within the same legal entity</u>

3(a) Are there additional risk management protections that Retail DCOs should engage in to ensure that direct clearing services do not place undue risk on intermediated services, or the reverse?

See response to question 1(a). When retail DCOs operate under a model where retail participants clear non-fully collateralised products through a FCM (affiliated or non-affiliated), this provides appropriate risk management protections..

3(b) Is there a need to divide default-related resources or other risk management protections by product type?

See response to question 1(a). When retail DCOs operate under a model where retail participants clear non-fully collateralised products through a FCM (affiliated or non-affiliated), this provides appropriate protections for managing a default.

3(c) Might certain default events result in unexpected or undue risk transfer between collateral for fully-collateralised products and leveraged or margined products? Are there protections which would be needed, or desired, to mitigate these risks?

See response to question 3(b).

3(d) Are there any circumstances under which hybrid models of this type should not be permitted due to the risks they may pose? What is the nature of these circumstances and related risks?

See responses to 3(a) through 3(c).

<u>Section Four - Separate DCO registration sub-category for Retail DCOs</u>

4 Given the nature of retail trading and retail direct clearing, and the characteristics that distinguish it from other clearing structures, is there a need for, or a benefit in, establishing a separate DCO registration sub-category for Retail DCOs?

The WFE recognises that retail direct clearing raises considerations that differ from traditional intermediated clearing. However, it is our belief that when retail participants of a Retail DCO clear their non-fully collateralised exposures through an affiliated or non-affiliated FCM, this provides appropriate risk management protections, while embracing the market structure that has time and time again proved to be resilient during periods of stress, especially with regards to protecting customers. If Retail DCOs operate under a model with an FCM, then this negates the need for the Commission to pursue a separate DCO registration sub-category. The Commission should ensure that existing regulatory outcomes relating to customer protection, risk management, governance, and market conduct are met in practice, regardless of the model employed.

4(a) If so, in what ways should a registration sub-category be tailored to Retail DCOs? Which distinctions would arise from the fully, or primarily, retail trader participation and risks or considerations regarding market conduct and protections for retail traders against abusive sales or marketing practices or abusive trading practices? Which distinctions would arise from risks or considerations regarding retail direct clearing structures, whether fully collateralised or on a leveraged/margined basis?

See response to question 4.

4(b) Are there other important factors that should be considered in developing a new registration sub-category for Retail DCOs?

See response to question 4.

<u>Section Five - Reporting requirements</u>

Given noted differences between intermediated and direct clearing structures, is there a need for different, or additional, reporting requirements for Retail DCOs?

No comment.

<u>Section Six - Other requirements</u>

Are there any other requirements that Retail DCOs should be subject to beyond those of existing regulations?

No comment.

Background

Established in 1961, the World Federation of Exchanges (WFE) is the global industry association for exchanges and central counterparties (CCPs). Headquartered in London, it represents over 250 market infrastructure providers, including standalone CCPs that are not part of exchange groups. Of our members, 37% are in Asia-Pacific, 43% in EMEA, and 20% in the Americas.

The WFE's 87 member CCPs and clearing services collectively ensure that risk takers post some $1.1 trillion (equivalent) of resources to back their positions, in the form of initial margin and default fund requirements. WFE exchanges, together with other exchanges feeding into our database, are home to over 49,000 listed companies, and the market capitalisation of these entities is over $116.58 trillion; around $155 trillion (EOB) in trading annually passes through WFE members (at end 2024).

The WFE is the definitive source for exchange-traded statistics and publishes over 350 market data indicators. Its free statistics database stretches back 49 years and provides information and insight into developments on global exchanges. The WFE works with standard-setters, policy makers, regulators, and government organisations around the world to support and promote the development of fair, transparent, stable and efficient markets. The WFE shares regulatory authorities' goals of ensuring the safety and soundness of the global financial system.

With extensive experience of developing and enforcing high standards of conduct, the WFE and its members support an orderly, secure, fair, and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise the common good, consumer confidence and economic growth. And we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in a globally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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