

REQUEST FOR COMMENT ON THE DIRECT CLEARING OF DERIVATIVES BY RETAIL PARTICIPANTS

I. Introduction

Staff of the Commodity Futures Trading Commission (Commission) is seeking public comment to aid with better understanding potential issues related to DCOs that, either in part or in whole, provide for the clearing of derivatives to retail traders on a direct (non-intermediated) basis (“Retail Derivatives Clearing Organizations” or “Retail DCOs”).

Prior to recent history, most derivatives clearing organizations (DCOs) registered with the Commission operated on an intermediated basis, where almost all direct clearing members of the DCO are registrants, usually futures commission merchants (FCMs) that provide client-clearing services for institutions or individuals.¹ In structures of this type, most market participants are customers of an FCM, with the FCM guaranteeing the customers’ financial obligations to the DCO and engaging in other risk management tasks such as know-your-customer (KYC) and anti-money laundering (AML).

This model can provide DCOs with additional protections against individual or multiple customer defaults and relieves customers of some of the operational and financial costs of being a clearing member. In contrast, for Retail DCOs that provide direct clearing services, all market participants, including retail traders, are clearing members without intermediation, and thus the benefits provided by intermediation to both market participants and the DCO noted above are either absent or different in nature.

Retail DCOs have become more numerous, and more active, in recent years in large part due to the growing interest in, and availability of, prediction and other event-type markets. These markets provide participants an ability to trade on the outcomes of future events, often through the purchase or sale of binary-outcome contracts (binary options). These event-based markets are cleared on a fully-collateralized basis, with the Retail DCO holding, at all times, at least as much collateral as the full value of the contract; this fully-collateralized structure is designed to protect the Retail DCO against the market and counterparty credit risk associated with the underlying contract, allowing for the direct clearing structure without the risk management typically provided by the FCM in an intermediated structure such as credit risk mitigation and guarantees from default.

The fully-collateralized structure for Retail DCOs without intermediation was first approved by the Commission in 2004 and, after a period of general stasis, has rapidly increased in recent years, with, for example, three fully-collateralized Retail DCOs registered in 2024 and ten fully-collateralized Retail DCOs in total registered to date. The Commission has allowed DCOs to adopt the fully-collateralized structure on an ad-hoc basis.

More recently, a few Retail DCOs have either started providing, or are planning to provide, “hybrid” derivatives clearing models. In one such model, retail participants can choose to clear

¹ Other direct clearing members are often large traders that trade only on their own behalf, such as sophisticated proprietary trading firms or large corporations.

on a direct basis, or to clear through an intermediary as a FCM customer.² In this model, the response to the default of one or more retail traders could depend on this choice; the Retail DCO would oversee and manage default procedures in a case of retail direct clearing participants, whereas the FCM would hold these responsibilities for its FCM retail customers. Similarly, other risk management considerations, like collateral segregation rules, could differ depending on retail direct clearing or intermediated clearing.

A second example is a case where retail direct clearing is one of multiple clearing structures provided by the same registered legal entity. This hybrid Retail DCO may provide a service line which includes fully-collateralized retail direct clearing for certain products, and a separate service line which clears other products using a more traditional intermediated model (e.g. leveraged or margined). In such a hybrid model, risk management planning and oversight may be done on a service line by service line basis, given the distinct risk profiles for fully-collateralized retail direct clearing or intermediated clearing on a leveraged or margined basis. However, because these service lines fall within the same legal entity, market disruptions may result in losses that either: 1) straddle multiple business lines (e.g. when participants clear under both structures) or 2) begin in one service but shift to another due to circumstances that include but are not limited to default scenarios, bankruptcy rules, or the need for additional resources to cover excess losses.

These considerations are significant because the traditional, intermediated clearing model relies upon mutualized risk of loss amongst clearing members such as FCMs, dealers, or proprietary trading firms, but in the case of retail direct clearing, there is no FCM to guarantee customer losses. Consequently, the issue arises as to whether unguaranteed losses by retail direct participants may be imposed upon other clearing members such as FCMs, dealers, or proprietary trading firms through the mutualized loss risk structure of DCOs.

Given these significant considerations and market structure developments, the Commission may need to update its regulatory frameworks to consider the risk profiles and loss events unique to a Retail DCO that is fully collateralized or a hybrid model of both fully collateralized and intermediated clearing with leverage or margin. The following questions seek to gather further information on these potential risks and their implications for the Commission's regulations and regulatory frameworks for DCOs and clearing.

Thus, this request for comment seeks to better inform the staff's understanding of the issues presented by retail direct clearing and related matters, and seeks input on possible mitigation measures in the case of elevated risks, to either the Retail DCO or to retail traders. Comments must be received on or before February 2, 2026 to be assured of consideration.

II. Questions

² In some cases, this FCM can be an affiliate of the registered DCO. In this case, the DCO would monitor the activity, and evaluate the risks of, the FCM as a member of the DCO, while the affiliate FCM would, independently, engage in oversight and risk management of its customer base.

The staff requests comment on any or all of the below questions related to the clearing models described above, including the retail direct clearing of derivatives, or hybrid versions of the same.

- 1) The retail direct clearing of derivatives, by construction, omits any intermediation by FCMs between the clearinghouse and all active market participants. Given this, there is a gap for responsibilities usually taken on by the FCM (e.g. KYC/AML, protections and guarantees for customer funds, prohibitions against abusive sales or marketing practices, participant default management). Current regulations would require the DCO to engage in some, but not all, of these FCM responsibilities.
 - 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?
 - b) Typically, DCMs and DCOs are part of the same corporate group but do not have affiliated FCMs. The Commission's regulations impose customer protection requirements on FCMs, including for retail customers, but not on DCOs. Due to market structure developments, many Retail DCOs are or seek to adopt a vertically integrated trading and clearing structure (e.g. FCM, DCM, and DCO entities that are part of the same corporate group) and currently have affiliated FCMs. To address the gap in risk management responsibilities and customer protections provided by an FCM for retail customers in a traditional DCO with intermediation, but is absent in a direct clearing structure without FCM intermediation in a Retail DCO, 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?
 - 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?
 - 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?
- 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-collateralized model, or either an affiliated FCM or non-affiliated FCM, in a hybrid model?³
 - 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?
 - 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?
- 2) As noted earlier, a few Retail DCOs allow for a “hybrid” clearing structure in a service line or product, with retail traders able to engage in direct clearing with the DCO or intermediated clearing through an FCM (whether affiliated or non-affiliated).
- a) In the case of these hybrid models, are there additional risk management protections that Retail DCOs should engage in to either: 1) ensure that retail direct clearing activity does not place undue risk on intermediated clearing members or their customers or 2) the reverse?
 - b) Related, 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?
 - 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?
 - 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?
- 3) Also noted earlier, a few Retail DCOs provide clearing services for multiple product classes under the same legal entity, such as fully-collateralized retail direct clearing for some products like event contracts and leveraged or margined intermediated clearing for FCM retail customers.

³ In essence, this would eliminate retail direct participants and ensure that all retail traders are customers of an FCM, whether in a vertically integrated structure or not. Consequently, no amendments to CFTC regulations would be necessary to address any gaps in risk management responsibilities or customer protections (e.g. KYC/AML, protections and guarantees for customer funds, prohibitions against abusive sales or marketing practices, participant default management) that are required to be provided by FCMs but not DCOs.

- a) In the case of these structures, are there additional risk management protections that Retail DCOs should engage in to either: 1) ensure that direct clearing services do not place undue risk on intermediated services or 2) the reverse?
 - b) Relatedly, is there a need to divide either default-related resources, or other risk management protections, such that distinct resources or protections are used for each subset, such as fully-collateralized products or leveraged/margined products?
 - c) Might certain default events result in unexpected or undue “risk transfer” between collateral for fully-collateralized products, or collateral or guarantees for leveraged/margined products? Are there protections which would be needed, or desired, to mitigate these risks?
 - 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?
- 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 DCOs⁴?
- 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 collateralized or on a leveraged/margined basis?
 - b) Are there other important factors that should be considered in developing a new registration sub-category for Retail DCOs?
- 5) Commission Regulation 39.19 requires that a DCO provide detailed reports related to its exposures and resources, including daily reports on clearing member positions and associated collateral. Given noted differences between intermediated and direct clearing structures, such as the default management practices described above, is there a need for different, or additional, reporting requirements for Retail DCOs?
- 6) Are there any other requirements that Retail DCOs should be subject to beyond those of existing regulations, whether for retail protection, governance and risk management, market conduct and integrity, transparency, or anything else?

⁴ Current CFTC requirements are already applied on a differentiated basis depending on certain factors. For example, additional regulatory requirements are imposed on systemically important DCOs; in contrast, the Commission has, on an ad-hoc basis, exempted individual DCOs from certain requirements based on the mitigation or inapplicability of certain risks, as in the case of fully-collateralized clearing structures.