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EUROPE
ZUG
LONDON
BUDAPEST
ST. PETERSBURG
TALLINN

Dear CME and OCC Clearing Members:

This letter is to request that you urge the CFTC, CME, CBOE Futures Exchange (CFE) and OCC not to allow clearing of bitcoin products through registered derivatives clearing organizations (DCOs) that also clear non-bitcoin futures until the CFTC has examined the risks to the clearing organizations, their members and the financial markets as a whole; and after considering public comment and the views of other interested agencies such as the SEC and the Federal Reserve Board.

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The CFTC and the clearing organizations must consider ways to limit the risk and potential contagion from large market moves in bitcoin. These could include the margining and clearing of bitcoin products only in a legally separate clearing subsidiary, or an explicit limit on the liability of the clearing organization, or the requirement that each clearing member authorized to clear bitcoin-related derivatives have a minimum regulatory capital of \$10 billion or other large amount, or any combination of these.

Please make your voice heard as soon as possible using the contact information below.

* * *

Bitcoin Clearing Poses Unique Risks to Clearing Organizations because the Price of Bitcoin Is Not Based on or Related to Anything and May Move to Any Level from One Day to the Next.

Bitcoins are an unprecedented “commodity” -- a “virtual” currency not controlled by any sovereign and the value of which is not based on any tangible commodity, security, economic measure or legal obligation of a company or government. There is thus no fundamental or economic basis for valuation of bitcoins, and they repeatedly have experienced enormous, sudden upward and downward price swings:

- From April 14 – June 8, 2011, bitcoin rose from \$1 to \$29.60 (a 2,860% increase in less than two months).
- The price then dropped from \$29.60 on June 8, 2011 to \$14.65 on June 11 (a 51% drop in three days).
- From April 9 – April 10, 2013, the closing price of bitcoin dropped from \$230 to \$165 (a one-day drop of 29%). Five days later bitcoin closed at \$83.40 (a six-day drop of 63%).
- By November 29, 2013, bitcoin had risen to \$1120.40 from \$99.81 on October 2 -- a 1,023% increase in less than two months.
- From January 11 to April 2, 2014 the price of bitcoin dropped from \$930.90 to \$437.51 (a 53% drop) after revelations that the largest bitcoin exchange (Mt. Gox) was missing over \$450 MM in bitcoins.
- 2017 has seen a skyrocketing upward move in bitcoin prices, from \$935.95 on March 24 to \$9,329.59 on November 26. This is an 897% increase in just eight months. It has been a bumpy ride, however, as bitcoin dropped roughly 35% from mid-June to mid-July.

Margining such a product in a reasonable manner is impossible. While the buyer (the long side) of a bitcoin futures contract or call option could be required to put up 100% of the value to ensure safety, determining the margin requirement for the seller (the short side) is impossible.

Instituting daily price move limits on bitcoin derivatives does not solve the problem. In a runaway upward market the price gets locked limit-up and short sellers are unable to cover.

The CFTC Must Have At Least 60 Days to Review Bitcoin Trading and Clearing, After Public Notice and Comment.

To “self-certify” bitcoin futures and begin trading them one day later, the exchanges would have to certify not only that bitcoin markets are “*not readily susceptible to manipulation*,” but if the product is cash settled based on an index of prices (as the proposed CME product is), that the bitcoin price index “*is reflective of the underlying cash market, is not readily subject to manipulation or distortion, and is based on a cash price series that is reliable, acceptable, publicly available and timely.*”

But in March of this year, the SEC declined to approve an exchange-traded bitcoin trust, finding that trading of such product would not be consistent with Exchange Act rules requiring the prevention of fraudulent and manipulative trading. The SEC stated: “***The bulk of bitcoin trading occurs in non-U.S. markets where there is little or no regulation governing trading and thus no meaningful governmental market oversight designed to detect and deter fraudulent and manipulative activity.***”

CFTC Rule 40.10 requires 60 days’ advance notice of any change to a systemically important derivatives clearing organization’s (SIDCO’s) rules, procedures or operations that “***could materially affect the nature or level of risks presented * * * including product eligibility.***” CME Clearing is a SIDCO and OCC is a DCO and a Systemically Important Financial Market Utility.¹

Clearing organizations and the CFTC must devise rules and procedures to control the risk of bitcoin clearing so that a large bitcoin price move that destabilizes clearing members does not destabilize the clearing organization itself.

As noted above, these could include the margining and clearing of bitcoin-related products only in a separate clearing subsidiary, or an explicit limit on the liability of the clearing organization, or the requirement that each clearing member authorized to clear the contract have a minimum regulatory capital of \$10 billion or other large amount, or any combination of these.

Please Communicate Your Concerns to the CFTC and Others:

If you share our concerns, please contact the relevant stakeholders and ask that:

- 1) CME, CFE and OCC provide at least 60 days’ advance notice to the CFTC before trading and clearing bitcoin-related products;
- 2) During that 60-day period (or longer if the CFTC requires), the Commission, the exchanges, the clearing organizations and their members explore concrete mechanisms to limit the risk and potential contagion from large market moves in bitcoin.

¹ Rules 40.3 and 40.5 provide for contract markets and DCOs to submit new products and rules relating to those products for Commission approval on 45 days’ advance notice.

Contact Information:

CFTC:

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CFE:

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Thank you for your time and attention.

Sincerely,



Chairman

cc: J. Christopher Giancarlo
Edward Tilly
Kimberly S. Taylor
Craig S. Donahue
Brian A. Bussey