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Retail Trading in the Digital Age

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I. **How should the CFTC regulate derivative clearing organizations that cater to retail traders?**

There is currently a debate going on at the CFTC about whether derivative clearing organizations (DCOs) that cater to retail traders should be regulated using a new category of registered entity. Proposals fall into roughly three different categories: 1) registration category for retail-facing DCOs with retail-specific safeguards; 2) same activity, same regulation; 3) require intermediation through and FCM for retail traders.

In December of 2025, the CFTC issued a request for comment for proposed rulemaking on this topic. Caroline Pham, then the Chairman, made the following statement on the issue:

"Since 2022, I have repeatedly called for the CFTC to increase its focus on retail protection as our markets continue to evolve, with new technology providing direct access for retail traders that would have been unimaginable just a few years ago," said Acting Chairman Caroline D. Pham. "For example, there has been an exponential increase in direct clearing for retail traders, where there are no brokers such as CFTC registered futures commission merchants that protect customer funds and protect against abusive sales and marketing practices. In 2023, I proposed a tailored registration framework for Retail DCOs that would address risks and potential retail binary options fraud. It is incumbent upon the Commission to consider how to update our regulations for market structure developments, because innovation thrives when there are clear rules and safeguards for all participants, from retail traders to the biggest market makers."

Previously, in 2023, Commissioner Kristin Johnson made a statement articulating her policy views on this matter:

In internal and public remarks, I have repeatedly called for the Commission to begin a rulemaking process to ensure that the same customer protection, risk management, and market stability measures embedded in our regulation for intermediated DCOs apply to all DCOs.[2] Part 39 of our regulations includes specific customer and market integrity protections for certain—but not all—clearing activities.

As the Staff Advisory indicates, we observe increased registration activity for crypto-commodity derivatives clearing and note that several proposed models adopt a non-intermediated market structure. Unless we introduce parallel regulation, these crypto-commodity derivatives clearing models may not be subject to the most rigorous regulatory standards. It is also imperative to note that these models may solicit or market products to retail or individual investors.

In other words, we may be exposing the most vulnerable investors—investors entering our markets with hard-earned cash from a long day's work—to platforms with the higher risk management exposures and lower customer protections.

Based on the history of market structure in DCO markets, and the absence of significant retail or individual investor activity in particular, our regulations must be refined to sufficiently ensure parallel application and a single, robust regulatory framework designed to prevent misuse or misappropriation of customers' funds, abuse of customers resulting from the absence of effective conflicts of interest policies, and excessive risk taking that may disrupt market stability and undermine market integrity. We must apply one set of rules across the board. Same activity. Same risks. Same regulation.

An Advanced Notice of Proposed Rulemaking (ANPRM)

Following this staff advisory, I propose that the Commission initiate an Advanced Notice of Proposed Rulemaking on Crypto or Digital Commodity DCO Clearing Activities. This approach acknowledges the innovative features of novel crypto-commodity derivative products and the platforms that clear and settle these transactions and addresses potential heightened risks described in the Staff Advisory. Such an approach would enable the Commission to engage in a comprehensive review of the new or potential risks that arise from clearing activities in the crypto-markets and formulate a proposed rule that effectively responds to the identified concerns.

In thinking of the ANPRM process, one may recall the initiatives adopted to gather information and develop a regulatory framework for implementing Title VII of the Dodd-Frank Act. Beginning with an Advance Notice of Proposed Rulemaking may enable a multi-faceted and highly-collaborative process that includes diverse stakeholders influencing regulation through Requests for Information, formal Roundtables, and the development of Guidance from the Commission ahead of drafting formal regulations.

To be exceptionally clear, a rulemaking limited to ensuring parallel protections for the crypto-clearing activities outlined in the Staff Advisory is expressly within the Commission's existing authority. Market participants operating as DCOs, designated contract markets, swap execution facilities, and registered derivatives intermediaries are subject to the Commission's jurisdiction.

The Staff Advisory keenly focuses on entities *that are registered* or *seek to register with the CFTC* to offer derivatives clearing services. In other words, by their own indications in submitted applications, these entities are consenting to the CFTC's jurisdiction and employing a market structure predominantly adopted in commodity derivatives markets.

As I have noted on a number of recent occasions, persistent volatility, inflationary pressures, and other challenging macroeconomic conditions have challenged our markets significantly since the onset of the COVID-19 pandemic. Our markets have demonstrated resilience and, at least in part, this effective resilience is the result of careful, well-calibrated regulation designed to enable our markets and market participants to respond to remarkable market conditions. One could conclude that our preparation through rulemaking and enforcement has fostered markets that are orderly, transparent, and fair. We should apply these lessons to every asset class permitted within our markets.

As noted above, proposed rules may address a number of areas where the Commission has refined regulations in intermediated DCO markets over the last several years including conflicts of interest; segregation of customer funds and treatment of customer assets; operational and technological risk, specifically cyber-risks; and market manipulation and fraud.

II. **Risks to retail customers invested in commodity pool operators.**

Retail customers who invest with commodity pool operators are vulnerable to a practice known as "cherry picking," in which the fund's manager allocates profitable trades to its own book and losing trades to investors' book. This scheme is difficult for a retail customer to detect because retail customers do not have visibility into how a fund manager is allocating trades.

17 C.F.R. § 1.35(b)(5) sets forth a regulation requiring commodity pool operators to allocate trades fairly. The CFTC has on several occasions taken enforcement against commodity pool operators who violated this rule and the Justice Department has filed criminal charges. The pertinent parts of the regulation are as follows:

> **(iv)** ***Allocation.*** Orders eligible for post-execution allocation must be allocated by an eligible account manager in accordance with the following:
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> **(A)** Allocations must be made as soon as practicable after the entire transaction is executed, but in any event no later than the following times: For cleared trades, account managers must provide allocation information to futures commission merchants no later than a time sufficiently before the end of the day the order is executed to ensure that clearing records identify the ultimate customer for each trade. For uncleared trades, account managers must provide allocation information to the counterparty no later than the end of the calendar day that the swap was executed.
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> **(B)** Allocations must be fair and equitable. No account or group of accounts may receive consistently favorable or unfavorable treatment.
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> **(C)** The allocation methodology must be sufficiently objective and specific to permit independent verification of the fairness of the allocations using that methodology by appropriate regulatory and self-regulatory authorities and by outside auditors.

A press release announcing CFTC charges against a commodity pool operator named Peter Kambolin for allegedly cherry-picking described the charges as such:

As alleged in the complaint, Kambolin proclaimed SAM as a CTA and CPO that offered customers automatic, algorithm-based trading strategies involving futures, which customers could participate in either through commodity pools or managed accounts SAM traded. Between January 2019 and November 2021, the defendants operated at least two commodity pools, one they claimed focused on trading various exchange-listed cryptocurrency futures contracts and another they claimed focused on trading various exchange-listed foreign exchange (FX) futures contracts. The defendants also traded for at least four individual managed accounts. The defendants often executed trades for these commodity pools and managed accounts together with trades they executed on behalf of their proprietary accounts, and then allocated the trades among all of the accounts at the end of each trading day.

As further alleged in the complaint, between January 2019 and November 2021, the defendants unfairly and inequitably allocated trades between the commodity pools and managed accounts and their proprietary accounts. The defendants consistently allocated trades they knew were profitable to their proprietary accounts, while allocating unprofitable or less profitable trades to the commodity pools and managed accounts. By trading in this manner, the defendants defrauded pool participants and managed account customers, caused the commodity pools and managed accounts to incur net trading losses of more than $1.5 million, and generated more than $1.4 million in profits for their proprietary accounts.

In addition, according to the complaint, the defendants misrepresented to pool participants and to some managed account customers that they would allocate trades fairly and equitably among all the accounts the defendants traded for, and they misrepresented that the cryptocurrency futures pool and the FX futures pool would primarily trade cryptocurrency futures and FX futures, respectively. The complaint also alleges the defendants violated the CFTC regulations that require allocations of trades for multiple customer accounts be fair and equitable.