Title: Never Gonna Give You Up: What do Hedge Funds want to do with FTX Stocks and Embed Clearing LLC?
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Permalink: /r/TheGloryHodl/comments/xdevpn/never_gonna_give_you_up_what_do_hedge_funds_want/
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Follow up post to my first ever [DD](https://www.reddit.com/r/Superstonk/comments/wdzlf8/who_are_ftx_capital_markets_llc_and_why_citadel/) that I did not expect to get attention, when a [surprise partnership between FTX and the NFT marketplace was announced.](https://investor.gamestop.com/news-releases/news-release-details/gamestop-forms-partnership-ftx) The purpose of the DD was to expose that companies like Citadel Securities have a vested interest in what FTX is doing. This post will elaborate by helping better explain their business model, and how tokenized stocks come into play.

Additionally, I want to know more about FTX's acquisition of Embed, a NASDAQ, DTC, FINRA and IEX participant that seemed to [appear out of thin air this year.](https://embed.com)

There is little-to-no information about Embed at face value. So here we go down the internet hole!

[\\"We're no strangers to crime...\\"](https://preview.redd.it/5zso3b43c2n91.png?width=948&format;=png&auto;=webp&s;=4e157d61ee07e89f0bbb150fe9a4e296ea9a66bf)

Tokenized Stocks

If you are like me, you wanted to know more about this company that offers tokenized stocks in an over-the-counter exchange as soon as you heard about it.

What is a tokenized stock [according to FTX](https://help.ftx.com/hc/en-us/articles/360051229472-Tokenized-Stocks)? Well, a brokerage can custody shares of the stock. These tokens related to the held stock can be redeemed for the underlying shares, if desired. Brokerage services for tokenized stocks are provided internationally by FTX Switzerland (Canco GmbH) while an unnamed 3rd party provides custody services. For the US launch, it appears that Embed is providing both clearing and custody services (the latter is NOT clear based on available information). FTX US is offering brokerage and market-making API via its trading platform.

At a glance, FTX Stocks is now available in the US, allowing both traditional USD and USDC purchases of tokenized stock. And they are potentially positioning themselves as a destination to digitally trade with high-speed settlement, at the cost of low-basis-point brokerage fees.

The benefits of tokenized stocks are:

* A single broker to keep ledgers and provide clearing services, instead of two
* Near-instant settlement (T+0)
* Fractional trades
* Foreign trading
* FTX specifically provides 24/7 trading of tokenized stocks and no PFOF, as well as one of the largest number of available tokenized stocks

So, what you are probably thinking is that this is GameStop's solution to naked shorting? NOPE!

The Rick Roll

Let's talk about the state of things – the moment in time we are in right now with traditional finance, before getting into this newfangled token technology.

If you have seen me post, watched my music video, or read any of my Superstonk comments, you will know that I, like many of you, read "Naked, Short, and Greedy". If you have read it, you know that naked shorting is a symptom of a much greater problem: TRADE SETTLEMENT FAILURE.

`Note: This DD is not intended to antagonize or counter the efforts of passionate individuals fighting against PFOF and naked shorting, but I do intend to point out the error in focusing on these challenges.`

What is trade settlement failure? The securities world is filled with institutions whose purpose is to clear and settle trades. In fact, every DTC participant must have a "settling bank" to act on its behalf, themselves needing to be a DTC participant with an account at the Federal Reserve.

Look at this chart:

[DTC in cyan and Alternative Trading Systems \(CEX\) in green](https://preview.redd.it/wp58ubfqb2n91.png?width=2866&format;=png&auto;=webp&s;=4a8ca7dcd3dc4b352de4e7061d1c2a7a349c2e77)

Notice how many Security Depositories there are in the US. Just one. The goddamn DTC.

The DTC has two major functions, one of which is keeping an accurate account of who owns what stock. In order to do this, they need to do their other job: settling trades. Simply put, they suck at their job. They have a mile-long list of failure-to-delivers. And because of this, brokerages can avoid settlement while successfully clearing their books to make the trade within T+2. And when a brokerage gets to the top of the DTC's daily settlement list, there are plenty of ways to effectively say "check is in the mail", and back down the list they go...

Failure's-to-Deliver lack of regulation and inefficiencies are the root cause of DTC failing to settle the buying and selling of real shares. The DTC has demonstrated with the GME stock split dividend event that it is incapable of successfully resolving a problem their incompetence helped create. Here's a breakdown of contextual points:

1. T+2, T+1, T+0, etc. settlement time has little if anything to do with the above problem. Settlement time is not the issue but the ease of covering or delaying requirements.
2. PFOF has nothing to do with the above problem. That is merely a profit model for counter-parties.
3. ETFs, dark pools, and OTC trades have little to do with the above problem. These are simply the nature of the business, and they are incidental problems to solve not related to DTC settlement.
4. **A lack of transparency of FTDs IS a major part of the problem.** DTC should allow themselves to be held accountable, at the very least to regulators if not investors.
5. **The ability for institutions to use leverage to cover obligations IS a major part of the problem.** If I can use margin gained from shorting an ETF to short that ETF's underlying security... that's crime? Really though, NO unsettled transactions should be allowed to be used as leverage! Theoretical capital is not capital. But this is America, the land of debt and deregulation.
6. **A potential conflict of interest resulting in the delaying/stopping margin calls from occurring IS a major part of the problem.** We know DTC has fucked up. They know they fucked up. Brokers know they know they fucked up too. And everyone knows that market makers are fucking everyone. Also, the market makers are not actually banks and therefore aren't making markets. They are making tons of profit for their investors.

In summary: it is solely the responsibility of the DTC to settle trades in a reasonable amount of time without allowing the can to be kicked. They are unable or unwilling to do this. Does FTX Stocks solve this problem (looking at bullets 4-6)?

No.

What is a Stock, anyway?

A stock is a fraction of company ownership, ownership with limited liabilities, meaning that you don't OWN a % of the company itself, just the shares, which have specific value based on market price. So what rights do you have?

1. The right to vote in shareholder meetings.
2. The right to receive company dividends.

3. The right to sell your shares.

Here's a neat trick. If you buy shares from a broker, your terms and conditions likely includes a clause that they can, without your permission, borrow your shares and sell them. No worries! They can just buy those shares back (or maybe borrow from another client) within the T+2 days settlement period, should you desire to exercise your perceived right to sell your shares. Oh, but **you don't get the right to vote, and you do not receive dividends while the shares are borrowed.**

Sure, the broker will send you voting materials and give you the ability to vote by proxy. Those proxy votes will either not be passed along to the company's board or necessarily discarded when 100% shareholder participation has already been reached. And the dividend? Oh, you don't get a dividend. The dividend goes to the person who ACTUALLY has your share. You get a cash equivalent with worse tax benefits. Isn't investing in stocks fun?

(You may be skeptical about the voting bit. But proxy voting is actually an entire clusterfuck that no one knows how to solve. It has become normal for companies to receive 100% voter participation at shareholder meetings... Remember, only shareholders can vote, and your shares were sold to a SHF (temporarily). So do you both get to vote? Nope. Just the SHF. #DRSISTHEWAY)

Back to tokenized stocks...

If you buy a stock on a CEX, you aren't actually buying stock as defined above. You are buying a chip tracking equal value with the market price for that share, a coupon for a stock. So you get:

1. No right to vote in shareholder meetings.
2. No right to receive dividends.
3. No right to sell your shares (you can sell your chip).
4. No ownership at all.

So what about stock ownership settlement? You didn't buy stock, but FTX intends to buy it in the same way that a broker would, with settlement being managed by the DTC. You can see now how even with tokenization, naked shorting and ETF shorting will still occur. DTC is still managing all GME stocks.

After researching for a couple of days, I see no evidence that the US onboarding to FTX Stocks includes a new paradigm shift where FTX they are supplanting the DTC as a custodian of the underlying shares. If you exercise an option to buy or sell a share, where is the share coming from? How is FTX able to clear the settlement near-instantaneously if they do not already have custody of that asset? Wouldn't they have to execute the trade on the regular exchange at T+2?

While tokenization does not solve the FTD problem, it does potentially restore trust in retail investors who have lost faith with the broker-to-broker system that has existed for hundreds of years.

But the fact of the matter is that it DECREASES transparency of share ownership by providing a smoke-and-mirrors overlay via digital currency, wowing customers with T+0 settlement while DTC issues remain. FTX claims that your tokens represent real shares that are in custody, but WHERE and WHEN? HOW are they settled so quickly? This is the million-dollar question.

Enter Embed.

Who are you Embed with?

[Embedded Financial Technologies](https://www.crunchbase.com/organization/embedfi) (Embed Clearing is a subsidiary) is a startup, working with other startups, recently acquired by FTX US. It was founded by [Michael Giles](https://www.linkedin.com/in/mhgiles/), who will remains CEO post-acquisition. Fun fact: his first job was at Computershare!

In May, Embed announced its [partnership](https://medium.com/@harland/ftx-us-launches-stocks-with-embed-f1a94bb2ad5f) with FTX, with a commitment to:

>*provide transparent trade execution and fair pricing, FTX Stocks will initially route all orders through Nasdaq, and will not receive any payment for order flow.*

This is likely a decentralized ledger, taking the place of a traditional T+2 clearinghouse. If this ledger is on the Ethereum blockchain, then a whole business day is no longer necessary. It could take seconds, or less, to clear a trade. This is what FTX claims it can do with Embed.

So when you buy your token, the order is routed via Nasdaq and cleared same-day. **The DTC is already capable of** [**same-day settlement**](https://www.dtcc.com/dtcc-connection/articles/2021/november/09/the-road-to-t0-and-the-future-of-settlement)**.** I know, right? But how this is accomplished to acquire stock from the real stock market remains obtuse, as T+2 settlement is still standard.

Fun Reference: [2018: Gary Gensler explains Clearing & Settlement](https://www.youtube.com/watch?v=-cZPoqnRZq4)

Predictions

I do not believe, at this time, that GameStop's partnership is an indication of support or sponsorship of their CEX or their tokenized stocks, especially GME. Tokenized stocks are not stocks, and therefore is the opposite of DRS. If anything, it's WORSE than buying stock from a broker, because at least the whales affect GME price action in that case. If you buy a token and an underlying security isn't purchased, it does NOTHING for the price or the company. What does GameStop get from you buying a GME token? Nothing. What do you get? Nothing.

For now, my original thinking that FTX could supplant the DTC seems like a complete pipe-dream. I'm not saying it's impossible in the future, but there is a huge list of questions about what executing something like a 100%-OTC stock ownership model supported by tokens might look like.

Questions for FTX

There is an upcoming AMA with Brett Harrison. Here is a list of suggested questions, based on my findings.

1. If a token stock is purchased on FTX, is Embed clearing and settling the trade of an underlying security? If not, what function is Embed Clearing serving in your business model?
2. What changes to the app or regulations allowed FTX Stocks to become available in the US this year, apparently around the time Embed was acquired?
3. Embed describes itself as providing custody of token shares? Can you elaborate on what this means?
4. How does FTX accomplish T+0 settlement for all trades? Do you intend to court brokers and market makers to participate in this settlement approach? What is their incentive to do so?
5. If I wish to exchange a token for a real stock in order to take advantage of the rights of a true shareholder, how does FTX deliver the stock?
6. How does FTX intend to manage custody of stock? Will it allow borrowing of shares held with a token by other brokers?
7. Superstonk users have a vested interest in acquiring real shares with the advantages of trading on-exchange or OTC and then direct-registering those shares with GameStop's transfer agent for long-term custody. How does FTX plan to support/facilitate this need?

TL;DR Look at the above questions. Bring them up at the AMA, because DRS appears to STILL BE THE WAY.

I may consider a follow-up DD about how market makers and brokerages migrating to FTX will impact retail traders. Thanks all! This was a fun, challenging write-up!