



U.S. COMMODITY FUTURES TRADING COMMISSION

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CFTC Letter No. 17-32
No-Action
June 30, 2017
Division of Clearing and Risk
Division of Market Oversight

Re: No-Action Relief from Commission Regulations 38.8(b), 38.10, 38.951 (in part) and 39.20(b)(2) and Parts 43 and 45 for Binary Options Traded on or Pursuant to the Rules of Cantor Futures Exchange, L.P. (“CX”) and Cleared by Cantor Clearinghouse, L.P. (“CC”)

Introduction

The Division of Market Oversight (“DMO”) and the Division of Clearing and Risk (“DCR” and, together with DMO, the “Divisions”) of the Commodity Futures Trading Commission (“CFTC” or “Commission”) are issuing this letter in response to a request from CX and CC (“Request”).¹ CX and CC requested relief from the swap data reporting and recordkeeping requirements of Commission Regulations 38.8(b), 38.10, 38.951 and 39.20 and Parts 43 and 45 of the Commission’s regulations (collectively, the “Specified Regulations”) with respect to binary options traded on or pursuant to CX’s rules and cleared by CC (“CX Binary Options”). CX and CC also requested relief from the requirements of Commission Regulations 45.3(e)(i)(B),² 45.5(d)(2) and 45.14(b) on behalf of CX’s participants. CX is a designated contract market (“DCM”). CC is a registered derivatives clearing organization (“DCO”). The Divisions have considered the Request and are granting no-action relief subject to conditions, as described below.

Background

CX stated in the Request that it lists for trading binary options on foreign currency, gold, and weather. CX describes its binary options in the Request as generally characterized at expiration by “the payment of an absolute amount to the holder of one side of the option and no payment to the counterparty, depending upon the value of the underlying commodity at contract expiration compared to the strike price or strike value of the option[.]”³ Furthermore, CX stated

¹ May 11, 2017 letter from Paul M. Architzel of WilmerHale, on behalf of CX and its participants, to DMO Director Amir Zaidi, as amended and supplemented by June 5, 2017 letter from Paul M. Architzel, on behalf of CX, its participants and CC to Amir Zaidi and DCR Acting Director John Lawton.

² Because § 45.3(e)(i) has no paragraph “(B),” the Divisions considered the request a request for relief from § 45.3(e)(ii)(B) (duties of the reporting counterparty).

³ The Request noted that “[i]n CX’s FX and Metals markets, if the index value at expiry is exactly equal to the strike level, then both sides split the payment evenly.”

that “[t]he settlement obligation does not vary based upon the amplitude by which the price at expiration exceeds the strike or strike price.”

As options, binary options fall within the Commission’s plenary options authority under Commodity Exchange Act (“CEA”) § 4c(b).⁴ CEA § 4c(b), in relevant part, prohibits any person from offering, entering into or confirming the execution of a transaction involving any commodity regulated under the CEA that “is of the character of, or is commonly known to the trade as, an ‘option’ . . .” contrary to any Commission rule prohibiting the transaction or allowing it pursuant to specified terms and conditions. When promulgating Commission Regulation 32.2, the Commission stated that “the swap definition . . . includes options . . . (whether or not traded on a DCM)[.]”⁵ Commission Regulation 32.2 states, in relevant part, that commodity option transactions must be conducted in compliance with the CEA and the Commission’s swap rules.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)⁶ amended the CEA by adding a definition of “swap.”⁷ The Dodd-Frank Act required the Commission and the Securities and Exchange Commission to further define jointly the term “swap.” In jointly adopting such further definition, the Commissions stated that “the statutory swap definition explicitly provides that commodity options are swaps[.]”⁸

Pursuant to the Dodd-Frank Act, the Commission promulgated various regulations applicable to swaps, including the Specified Regulations. The Specified Regulations impose swap reporting and recordkeeping obligations on DCMs, DCOs and market participants.

Relief Requested

CX and CC requested that the Divisions not recommend that the Commission take enforcement action against CC, CX or CX’s participants for failure to report CX Binary Options to a swap data repository (“SDR”) or to fulfill any of the other requirements of the Specified Regulations. In support of its position, CX and CC argued or represented, among other things, that:

- the CX Binary Options are required to be fully margined;⁹

⁴ 7 U.S.C. § 6c(b).

⁵ Commodity Options, 77 FR 25320, 25321, n.6 (Apr. 27, 2012).

⁶ Public Law 111–203, 124 Stat. 1376 (2010).

⁷ CEA § 1a(47), 7 U.S.C. § 1a(47).

⁸ Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48207, 48236 (Aug. 13, 2012). See also CFTC v. Banc de Binary Ltd., et al., Case No. 2:13-cv-00992-MMD-VCF at 18, ¶65, (D. Nev., Feb. 26, 2016) (Consent Order for Permanent Injunction), available at <http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enforderbancdebinary022916.pdf> (noting that “Dodd-Frank defined an option as a swap . . .”).

⁹ The Request states that “all participants must be fully margined.” Request at 2.

- CC provides, and is obligated to continue providing, DCR with daily margin and end-of-day position information pursuant to Commission Regulation 39.19(c)(1);
- CX already makes publicly available on its web-site near-real-time transaction information regarding each transaction on the exchange;
- if granted the relief requested, CX will continue to make transactional information publicly available in near-real-time;
- CX provides transactional information to DMO pursuant to Commission Regulation 16.02 and as a condition of its DCM Designation Order; and
- these reporting obligations and undertakings provide information to the Commission (and the public) similar, but not identical, to that currently required to be provided to an SDR under Parts 43 and 45 of the Commission’s regulations.

No-Action Relief and Related Conditions

The Divisions have decided to grant part of the requested relief, subject to certain conditions described below. Thus, the Divisions will not recommend that the Commission initiate an enforcement action against CX, CX’s participants or CC, in each case for failure to comply with Commission Regulations 38.8(b), 38.10, 38.951 (only to the extent it requires compliance with Part 45 of the CFTC’s regulations)¹⁰ and 39.20(b)(2)¹¹ and Parts 43 and 45 of the CFTC’s regulations (the “Relevant Regulations”), each as applicable, or the related CEA provisions pursuant to which the Relevant Regulations were promulgated, with respect to current or future CX Binary Options, subject to the following conditions:¹²

- (1) CC and CX continue to require all CX Binary Options to be fully margined;¹³

¹⁰ Although the Request sought relief from § 38.951 in its entirety, § 38.951 requires DCMs to maintain certain records in accordance with both § 1.31 and, if applicable, Part 45 of the CFTC’s regulations. The Divisions are providing relief from § 38.951 only to the extent that it requires compliance with Part 45’s recordkeeping requirements.

¹¹ Although the Request sought relief from § 39.20 in its entirety, § 39.20(a) requires DCOs to maintain all records related to its business as a DCO and specifies certain categories of such records by way of example, and § 39.20(b)(1) requires DCOs to maintain its records in accordance with § 1.31; § 39.20(b)(2) requires maintaining swap data in accordance with Part 45. With respect to the aspect of the Request seeking relief from § 39.20, the Divisions are providing relief only from § 39.20(b)(2). That is, CC must continue complying with the recordkeeping requirements of § 39.20(a) and (b)(1).

¹² Some of these conditions regarding no-action relief would constitute a collection of information, as that term is defined in the Paperwork Reduction Act, 44 U.S.C. §§ 3501 *et. seq.* The Office of Management and Budget (“OMB”)—in accordance with 44 U.S.C. § 3507(d) and 5 C.F.R. §§ 1320.8 and 1320.10—has approved collection—3038-0049—entitled “Procedural requirements for requests for interpretative, no-action and exemptive letters,” for such purposes. This collection would encompass collections made as part of exemptive or no-action relief from the Commission. The public is not required to respond to a collection of information that does not have a valid OMB control number.

¹³ For purposes of this relief, “fully margined” means CC and CX require, at all times, initial margin (called “original margin” in the CC Rules and the CX Rules) in an amount not less than 100% of the at-risk amount for any CX Binary Options that CC clears (both long and short positions), and CC otherwise complies with the terms of condition (4) of CC’s DCO Registration Order, which states that:

- (2) CC continues to clear all of the CX Binary Options and clears only CX Binary Options;
- (3) CX continues to publish on its website the following information on all CX Binary Options transactions promptly after execution thereof: trade timestamp; contract; quantity; and price;¹⁴
- (4) CX continues to provide DMO with transactional information as described in Commission Regulation 16.02;
- (5) CX and CC continue to comply with all swap reporting and recordkeeping requirements of the CEA and Commission regulations applicable to each in their respective capacities as a DCM or a DCO, other than the Relevant Regulations, including, but not limited to, the applicable requirements of Parts 38 and 39 of the CFTC's regulations (the records required to be retained by this condition (5) are referred to below as the "Required Records");¹⁵
- (6) no CX participant clears a CX Binary Option through a third party clearing member; and
- (7) CX and CC shall keep the Required Records open to inspection upon request by any representative of the Commission, the United States Department of Justice, or the Securities and Exchange Commission, or by any representative of a prudential regulator as authorized by the Commission. Copies of all such records shall be provided, at the expense of CX or CC, as applicable, to any representative of the Commission upon request. CX and CC shall provide copies of the Required Records either by electronic means, in hard copy, or both, as requested by the Commission, with the sole exception that copies of records originally created and exclusively maintained in paper form may be provided in hard copy only.

This letter expresses a staff position with respect to enforcement only and does not purport to state any legal conclusion regarding CX Binary Options or the conduct of any person covered by the no-action relief provided herein. This letter and the no-action position taken

Cantor shall require, at all times, initial margin in an amount not less than 100% of the at-risk amount for any contract that it clears (both long and short positions); and Cantor shall perform a real-time credit check to confirm the availability of funds in a Participant's account each time the Participant has placed a bid or offer that is matched by the Cantor Exchange, and Cantor shall not clear any transaction for which it is unable to confirm the availability of adequate funds[.]

See also, e.g., CX Rules IX-1000(h)(i), IX-2000(h)(i) and IX-3000(j) (each requiring posting 100% of the at-risk amount as original margin).

¹⁴ CX currently publishes these data at <https://trading.cantorexchange.com/reporting/trades.php>.

¹⁵ This includes all information that CX represented in its application for contract market designation that it would publish on its website. For example, CX states that it currently "publish[es] information regarding settlement prices, volume, open interest and opening and closing ranges for actively traded Contracts on a timely basis on its website . . ." at: <http://www.cantorexchange.com/Rules---Regulatory-Info/Daily-Activity-Report.aspx>.

herein represent the views of the Divisions only, and do not necessarily represent the positions or views of the Commission or of any other Commission division or office. This letter and the no-action position taken herein also are not binding on the Commission.¹⁶ Except as explicitly provided in this letter, the no-action positions taken herein do not excuse persons from compliance with any applicable requirements of the CEA or Commission regulations. Further, this letter, and the no-action position contained herein, is based upon the representations made to the Divisions. Any different, changed, or omitted material facts or circumstances might render this letter void. As with all no-action letters, the Divisions retain the authority to, in their discretion, further condition, modify, suspend, terminate or otherwise restrict the terms of the no-action relief provided herein. The Divisions expect to periodically review the relief provided and the associated conditions.

If you have any questions concerning this letter, please contact: Dan Bucsa, Deputy Director, DMO—Data and Reporting Branch (“DAR”) at (202) 418-5435 or dbucsa@cftc.gov; David E. Aron, Special Counsel, DMO—DAR at (202) 418-6621 or daron@cftc.gov; Philip W. Raimondi, Special Counsel, DMO—Office of the Chief Counsel at (202) 418-5717 or praimondi@cftc.gov; or Andrea Musalem, Special Counsel, DCR at (202) 418-5167 or amusalem@cftc.gov.

Sincerely,

Amir Zaidi
Director
Division of Market Oversight

John C. Lawton
Acting Director
Division of Clearing and Risk

¹⁶ See Commission Regulation 140.99(a)(2) (stating that “[a] no-action letter binds only the issuing Division . . . and not the Commission or other Commission staff.”).