

## Bitcoin Futures Trading Kicks Off; CFTC to Monitor Risk



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Tuesday, December 12, 2017

CBOE Global Markets Inc. (CBOE) began trading CFTC-approved bitcoin futures on December 10<sup>th</sup>, and CME Group Inc. (CME) will begin trading them on December 18<sup>th</sup>. Bitcoin futures have generated significant attention as the first cryptocurrency-based derivative products to be traded on major U.S. exchanges. Bitcoin futures provide institutional and retail investors increased exposure to the asset class, allow existing market participants to hedge their exposure, enable short sales, and facilitate price discovery. Bitcoin futures mark a significant development in cryptocurrency's movement toward mainstream acceptance and may pave the way for additional, more sophisticated financial instruments in the future.

The Commodities Futures Trading Commission (CFTC) [found](#) in 2015 that Bitcoin and other cryptocurrencies are properly defined as commodities. On this basis, the CFTC's jurisdiction is implicated where cryptocurrencies are used in derivatives contracts such as commodity futures, or if there is fraud or manipulation involving cryptocurrencies traded in interstate commerce. The CFTC has anti-fraud and anti-manipulation enforcement authority, as well as oversight authority, over such markets, which it exercises through registration and regulation of brokers and other intermediaries of derivative products and ongoing risk-monitoring procedures.

CFTC requirements dictate that prior to listing a new futures contract, exchanges must either (i) submit a written self-certification to the CFTC that the contract complies with the Commodity Exchange Act (CEA) and CFTC regulations, or (ii) voluntarily submit the contract for CFTC approval. In accordance with accepted

listing procedures, both CME and CBOE submitted written self-certifications to the CFTC that their proposed futures contracts comply with CEA and CFTC regulations. They also provided the CFTC with advanced draft contract terms and conditions for their proposed futures contracts, a measure that, [according to](#) CFTC Commissioner Brian Quintenz, is sometimes adopted by exchanges proposing to list particularly novel financial instruments. This gave the CFTC staff an opportunity to review information and evaluate compliance with the CEA and CFTC regulations.

The CFTC worked closely with both CBOE and CME in the run-up to the launch of their bitcoin futures. As explained in a CFTC [press release](#), the staff “held rigorous discussions with CME over the course of six weeks [and with CBOE] over the course of four months.”

CFTC rules prohibit exchanges from listing derivative contracts that are readily susceptible to manipulation and impose an affirmative duty on exchanges to monitor market activity on an ongoing basis to detect and prevent manipulation, price distortions, and disruptions in the cash settlement process. Presumably, CME and CBOE have satisfied any threshold concerns with regard to their Bitcoin futures products. Nevertheless, there are unique concerns with respect to the potential for fraud or manipulation in cryptocurrencies themselves. We expect these issues to come under close scrutiny as the market evolves.

For the time being, CME, CBOE and the CFTC will work on parallel tracks to ensure the integrity of the Bitcoin futures market. As Andrew Busch, the CFTC’s chief market intelligence officer, [noted](#) on CNBC, “the exchanges – they are the ones looking at the underlying cash contract to make sure it’s not manipulated. Our role as a derivatives regulator is to make sure the futures contract is not manipulated.”

The CFTC has indicated that it will rely on its oversight authority, which includes market surveillance, rule enforcement reviews, and enforcement actions. Risk-monitoring activities will include analyzing the size and development of the market, positions and changes in positions over time, open interest, initial margin requirements, and variation margin payments, as well as stress testing positions. CFTC staff will also conduct reviews of designated contract markets, derivatives clearing organizations, clearing firms and individual traders involved in trading and clearing bitcoin futures. The CFTC will also work with self-regulatory organizations such as the National Futures Association, which will monitor its member firms trading Bitcoin futures.

In spite of the measures the CFTC has taken to oversee the process of bringing bitcoin futures to market, it has its fair share of critics. Among them are some of the world’s biggest derivatives brokerages who comprise the Futures Industry Association (FIA). The FIA released an [open letter](#) to CFTC Chair Christopher Giancarlo, criticizing the process by which cryptocurrency futures have come to market. Among the FIA’s concerns are that the exchanges failed to acquire adequate feedback from market participants on margin levels, trading limits, stress tests and clearing. The FIA calls for a public discussion on how to improve the process going forward and how the CFTC should oversee these derivatives contracts.

Bitcoin futures trading saw a first day of frenzy that included high volume and two temporary trading halts to calm the market. All eyes, including the CFTC’s, will

remain on bitcoin futures trading activity in the coming weeks. We will follow the CFTC's efforts to monitor the market.

This post was written by Divya Taneja.

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