

Clear Skies Ahead? Predicting the Use of the Floor Trader Exemption in Event Contract Markets to Avoid Swap Dealer Registration

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The availability of prediction markets has exploded for American consumers, as contracts that allowed people to bet on the outcome of the 2024 presidential election gained popularity.[1] Prediction markets are generally "platforms where participants buy and sell contracts based on the outcomes of future events."[2] These contracts cover a wide variety of events, from the outcome of sports games and the weather to political elections.

Event Contracts and Binary Options

Typically, event contracts are offered by prediction markets designated as contract markets (DCMs) by the Commodity Futures Trading Commission (CFTC)[3]. The CFTC views the event contracts as "binary options,"[4] which the agency states is a type of options contract "in which the payout will depend entirely on the outcome of a yes/no proposition." Binary options, in turn, are also considered "swaps" under the Commodity Exchange Act (CEA) because they "provide for [a] payment… that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence."[5] Retail investors and institutional investors alike can access DCMs to trade these event contracts.

Given that these markets are very nascent, building market volume and liquidity in an event contract will require participants willing to take either side of a binary contract to meet the trading demand of other counterparties. That is, there is a real need for dealers to enter these markets to provide liquidity, price discovery and efficient market operations.

Since event contracts are considered to be swaps under the CEA, however, dealers in these contracts may find themselves quickly bumping into the requirement to register as swap dealers with the CFTC. For participants wishing to provide liquidity in these contracts, is there an alternative approach that would not require swap dealer registration?

This advisory refreshes an old debate about whether the CFTC's floor trader exemption offers a viable pathway for market makers looking to provide liquidity in prediction markets.

Swap Dealer Registration and the Floor Trader Exemption

A swap dealer is defined as any person who (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in swaps, unless such person enters into swaps for their own account (but not as part of a *regular business*).[6] There is also a *de minimis* exemption from being considered a swap dealer, which requires that the gross notional amount of such person's swap dealing activity be less than $8 billion over a 12-month period.[7] Under the current $8 billion *de minimis* threshold, CFTC staff estimated that 99.95 percent of the baseline $221 trillion swaps market is subject to swap dealer regulation.[8]

Swap dealers must register with the CFTC and become members of the National Futures Association (NFA).[9] Swap dealers are subject to various regulatory requirements, including annual requirements, maintaining books and records, swap data reporting requirements under Part 45 of the CFTC's regulations, and more.[10] Because these are relatively onerous regulatory requirements, there are exemptions from registering as a swap dealer, which will be discussed below.

One such exemption is the floor trader provision (referred to herein as the "Floor Trader Exemption"), which provides that a registered floor trader need not consider cleared swaps executed on or subject to the rules of a DCM or swap execution facility (SEF) from the calculation of the *de minimis* exception described above. As a result, a registered floor trader can trade any amount of cleared swaps executed on, or subject to the rules of, a DCM or SEF without needing to register as a swap dealer, as they are not counted towards an individual's $8 billion-dollar notional limit under the *de minimis* exception, provided certain conditions in the rule are met, such as not participating in any market making program offered by a DCM or SEF.[11]

CFTC No Action Letter 19-14[12] provides additional relief to registered floor traders from certain provisions listed in the Floor Trader Exemption. The relief clarified that a floor trader is allowed to (i) enter into swaps other than those traded on DCMs and SEFs and (ii) use an affiliated person to negotiate the terms of such non-DCM/SEF swaps while still claiming the Floor Trader Exemption. In addition, the Floor Trader Exemption relieves floor traders from having to file periodic risk reports required by CFTC Regulation 23.600(c)(2).[13]

Dealer/Trader Distinction

One key item that participants should consider is whether their activity would be considered dealing or whether it is considered trading— the former results in a participant having to register as a swap dealer.[14]

Participants can refer to the distinction between dealer and trader in the Securities Exchange Act of 1934, as amended (the "Exchange Act"), for guidance on whether their activity constitutes "dealing."[15] The Exchange Act defines the term "dealer" as "any person engaged in the business of buying and selling securities . . . for such person's own account through a broker or otherwise."[16] But the Exchange Act also excludes from the dealer definition a "trader," defined as "any person that buys or sells securities for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business."[17] Dealers must also register with the Securities and Exchange Commission (SEC) as a broker-dealer, become a member of the Financial Industry Regulatory Authority (FINRA) and comply with additional federal securities laws.

In the past, the SEC and the courts have identified some activities that are typical for dealers, but are not usually engaged in by ordinary traders, including but not limited to the following:

1. purchasing or selling securities as principal from or to customers;
2. carrying a dealer inventory in securities (or any portion of an affiliated broker-dealer's inventory);
3. quoting a market in or publishing quotes for securities (other than quotes on one side of the market on a quotations system generally available to non-broker-dealers, such as a retail screen broker for government securities) in connection with the purchase or sale of securities permitted under Rule 15a-1;
4. holding itself out as a dealer or market-maker or as being otherwise willing to buy or sell one or more securities on a continuous basis;
5. engaging in trading in securities for the benefit of others (including any affiliate), rather than solely for the purpose of the OTC derivatives dealer's investment, liquidity, or other permissible trading objective;
6. providing incidental investment advice with respect to securities;
7. participating in a selling group or underwriting with respect to securities; or
8. engaging in purchases or sales of securities from or to an affiliated broker-dealer except at prevailing market prices.[18]

Market participants typically characterize on-exchange trading for a proprietary account as "trader" activity rather than as "dealer" activity, so long as the trading does not meet any of the abovementioned characteristics.

Likewise, activity that is conducted on-exchange (e.g., a DCM) for a proprietary account tends to fall within the "trader" exception to the dealer definition because it is seen as "not as part of a regular business". However, suppose an individual is conducting a significant amount of swaps activity off-exchange. In that case, the SEC is more likely to view such activity as "dealing" since it can be viewed as "part of a regular business." As such, individuals who are seeking to avoid swap dealer registration and claim the Floor Trader Exemption should limit the amount of swaps trading they conduct off-exchange.

Floor Trader Exemption – Regulatory Requirements

Even if the Floor Trader Exemption is claimed, floor traders are still subject to compliance with other swap dealer regulations. These include CFTC Regulations "23.201, 23.202, 23.203, and 23.600 (other than 23.600(c)(2)) with respect to each of [the floor trader's] swaps (including swaps that are not DCM and SEF cleared swaps) as if it were a swap dealer."[19] These provisions relate to recordkeeping (and keeping such records open to CFTC inspection) and risk management (excluding periodic risk exposure reports). In addition, floor traders must comply with affiliate aggregation requirements for swaps other than those traded on a DCM or SEF to determine whether such floor trader otherwise qualifies as a swap dealer.

The following chart highlights regulatory requirements for swap dealers compared to floor traders.

CFTC/NFA Requirement	Applicable to Swap Dealers	Applicable to Floor Traders
CFTC Registration	☒	☒
NFA Registration	☒	☒
NFA Annual Dues/Member Questionnaire	☒	☒
Registered Principals	☒	☒
Affiliate Aggregation	☒	☒

CFTC/NFA Requirement	Applicable to Swap Dealers	Applicable to Floor Traders
Business Conduct Standards	☒	☒*
Recordkeeping	☒	☒
Risk Management Program	☒	☒
Third-Party Service Providers	☒	☒*
AML Program	☒	☐
Associated Persons	☒	☐
Business Continuity/Disaster Recovery	☒	☐*
Capital and Financial Requirements	☒	☐
Supervision and Compliance	☒	☐*
Swap Data Reporting	☒	☐
Swap Documentation	☒	☐

*An asterisk denotes general CFTC/NFA requirements or Interpretive Notices that may be relevant for general compliance with CFTC Regulations or NFA rules.

Could Floor Trader Registration Solve the Liquidity Problem?

The CFTC issued the Floor Trader Exemption and later relief to "encourage new liquidity providers to trade cleared swaps on registered venues without regulatory uncertainty, benefiting market

participants seeking to access liquid, competitive cleared swaps markets"[20] and noted that relief may encourage "floor traders to provide liquidity to exchanges in non-dealing capacities, such as proprietary trading."[21]

The Floor Trader Exemption has seen little uptake since the relief was issued in 2019. We posit that as predictive markets and other markets that operate as DCMs continue to expand their offerings of event contracts, which are considered swaps as described above, the Floor Trader Exemption could provide important relief for market participants who may otherwise need to register as a swap dealer.

Conclusion

The Floor Trader Exemption could provide a unique opportunity for individuals seeking to trade large amounts of event contracts or other cleared swaps on a DCM. By using the Floor Trader Exemption, individuals could avoid the full onerous requirements of registering as a swap dealer while still being able to trade any amount of DCM cleared swaps, including event contracts.

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1 Mark Hayes, Predicting the Future of Prediction Markets, FIA (Apr. 17, 2025), available at: https://www.fia.org/marketvoice/articles/predicting-future-prediction-markets.

2 Can Prediction Markets Become Bigger Than the Stock Market?, Certuity (July 16, 2025), available at: https://certuity.com/insights/prediction-markets/.

3 See e.g., How is Kalshi Regulated?, available at: https://help.kalshi.com/kalshi-101/how-is-kalshi-regulated.

4 CFTC/SEC Investor Alert: Binary Options and Fraud, CFTC, available at: https://www.cftc.gov/LearnAndProtect/AdvisoriesAndArticles/fraudadv_binaryoptions.html

5 7 U.S.C. § 1a(47)(A); see also Nadex Contracts Categorized as 'Swaps' Under Dodd-Frank (2013), available at: https://www.nadex.com/notices/nadex-amends-fix-connection-fees/.

6 *See 7* U.S.C. § 1a(49).

7 *Id.*

8 Statement of Commissioner Brian D. Quintenz Regarding DSIO Staff Report on the Swap Dealer De Minimis Exception (July 8, 2019), available at: https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement070819.

9 *See* 17 C.F.R § 23.21; see also Swap Dealer (SD) Registration, NFA, available at: https://www.nfa.futures.org/registration-membership/who-has-to-register/sd-msp.html.

10 See generally Swap Dealer (SD) Regulatory Obligations, NFA, available at: https://www.nfa.futures.org/members/sd/regulatory-obligations/index.html.

11 See paragraph 6(iv) of the "swap dealer" definition in 17 C.F.R. §1.3.

12 CFC Letter No. 19-14, No-Action Relief for Certain Conditions of the Floor Trader Provision (June 27, 2019), available at: https://www.cftc.gov/system/files/csl/final/pdfs/19/1561667900/19-14.pdf.

13 *Id.*

14 As discussed above, the swap dealer definition includes any person who "[e]ngages in any activity causing it to be commonly known in the trade as a dealer or market maker in swaps." See paragraph 1(iv) to the swap dealer definition in 17 C.F.R. § 1.3.

15 See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant and "Eligible Contract Participant." Release No. 34-66868, Commodity Futures Trading Commission and Securities and Exchange Commission, 77 FR 30596, 30607 (May 23, 2012) ("the dealer-trader distinction… in general provides an appropriate framework for interpreting the statutory definition of the term 'swap dealer.'").

16 15 U.S.C § 78c(a)(5).

17 15 U.S.C § 78c(a)(5)(B).

18 Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, Exchange Act Release No. 47,364, 68 Fed. Reg. 8686 (Feb. 24, 2003) (quoting OTC Derivatives Dealers, Exchange Act Release No. 40,594, 63 Fed. Reg. 59362 (Nov. 3, 1998)).

19 *Id.*

20 CFTC Staff Issues No-Action Relief for Floor Traders Engaged in Swaps Activity, CFTC (June 27, 2019), available at: https://www.cftc.gov/PressRoom/PressReleases/7950-19.

21 83 Fed. Reg. 27444, 27469 (June 12, 2018).

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