

## THE CFTC'S FOCUS ON RETAIL MARKETS

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Financial regulators constantly consider retail market participants. A growing number of people engage with the financial markets and their engagement has broadened in scope. These participants look not only to traditional stocks and mutual funds to seek returns, but also to the more complex products regulated by the Commodity Futures Trading Commission (CFTC). These products include various commodities, such as precious metals and the newest class of commodities—digital assets such as Bitcoin and Ethereum—as well as products known as binary options. These products are offered to retail market participants in different packages. Sometimes the product is relatively straightforward, such as the ability to purchase gold on a spot market. Sometimes the products are offered with leverage and the opportunity (and risk) to multiply gains and losses. These products are here to stay and the CFTC has always sought to prevent manipulative and fraudulent practices that can harm retail market participants. Chairman Behnam recently remarked that he is “committed to ensuring that the rise of retail participation and the exchanges, intermediaries and innovators who are ea-

ger to meet demand for products and services are appropriately brought into the regulatory fold.”<sup>2</sup>

In approaching the issue of retail market participants, the CFTC operates with several key statutory objectives. The CFTC, for example, has a statutory responsibility to “deter and prevent price manipulation” in the markets that it regulates.<sup>3</sup> The CFTC must also “protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets.”<sup>4</sup> At the same time, the agency must “promote responsible innovation and fair competition among boards of trade, other markets and market participants.”<sup>5</sup> Markets bear little resemblance to how they operated 20 years ago. One can only imagine what changes and developments can occur in the next 20 years to enhance the transparency, reduce trading costs, and bring more options to retail market participants. The CFTC continues to balance these various priorities regarding retail market participants.

Indeed, the CFTC has a renewed opportunity to assess its various roles regarding retail market participants. In January 2022, Rostin Behnam was sworn in as the permanent Chairman of the CFTC, after serving for the past year as Acting Chairman.<sup>6</sup> Commissioner Dawn Stump,

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the only other currently serving Commissioner at the CFTC, has announced that she will not seek an additional term after her current term expires in April of this year.<sup>7</sup> In the meantime, President Biden has nominated four individuals to fill the four CFTC Commissioner spots that will be available once Commissioner Stump concludes her term: Kristin Johnson, Christy Goldsmith Romero, Summer Mersinger, and Caroline Pham.<sup>8</sup> Although it is always a risky business knowing if and when these four nominees will receive Senate confirmation and take their places at the Commission, it seems likely that they may make it through the confirmation process by this summer. Thus, the CFTC will go through nearly a complete change in its composition in the course of the past year. When in place, this newly constituted Commission will have to continue assessing what role it will play in the development, regulation, and monitoring of markets for retail participants, balancing the need to deter market abuses with encouraging responsible innovation. This article will discuss three areas where the CFTC must perform this balancing act: retail commodity transactions, social media, and binary options and some of the key regulatory provisions and background regarding each area and discuss the CFTC's recent activity in each.

## RETAIL COMMODITY TRANSACTIONS

The CFTC has anti-fraud and anti-manipulation authority over swaps, futures, and “any commodity in interstate commerce.”<sup>9</sup> The CFTC's regulatory authority—the authority to require registration, subject entities to core principles, and conduct exams—does not extend as far as its anti-fraud and anti-manipulation authority. The agency, however, has long asserted

that it has regulatory authority over retail commodity transactions that are leveraged or margined. The argument goes that these types of transactions are functionally similar to, and directly compete with, the futures transactions that are at the core of the CFTC's jurisdiction. After court cases regarding this question,<sup>10</sup> Congress as part of the Dodd-Frank Act formally extended the CFTC's regulatory authority to certain “retail commodity transactions.” In other words, the CFTC could apply certain registration requirements to commodity transactions involving margin, leverage, or financing that were offered to retail persons.<sup>11</sup>

The CFTC has been active in the retail commodity transaction space. On the regulatory front, in 2020 the agency published “final interpretive guidance”<sup>12</sup> on one key aspect of retail commodity transactions—actual delivery of digital assets. Under the CEA, a “retail commodity transaction” does not come within CFTC regulatory jurisdiction if the sale “results in actual delivery within 28 days or such other longer period as the Commission may determine . . .”<sup>13</sup> In the context of digital assets, the Commission suggested in the Final Interpretive Guidance that “actual delivery” would occur only if (1) the customer secures possession *and* control of the commodity; (2) the customer can use the entire quantity of the commodity freely in commerce; and (3) the offeror and counterparty seller do not retain *any* interest in or legal right over the commodity.<sup>14</sup>

The agency's guidance relied in part on two recent and informative cases regarding the meaning of actual delivery with respect to precious metals commodities: *CFTC v. Hunter Wise Commodities, LLC*, (“*Hunter Wise*”)<sup>15</sup> and *CFTC v.*

*Monex Credit Company*, (“*Monex*”).<sup>16</sup> In *Hunter Wise*, the defendants ran a precious metals trading enterprise in which retail customers could trade metals on margin, i.e., they “typically made a down payment of 25% and then received a loan for the balance of the purported purchase price.”<sup>17</sup> The CFTC brought an enforcement action and a preliminary injunction claiming that the precious metals trading enterprise was within CFTC jurisdiction and that the defendants should have registered with the CFTC. The district court granted the preliminary injunction, concluding that the transactions “were subject to the Commission’s enforcement authority under 7 U.S.C. § 2(c)(2)(D) because they were financed commodity transactions made with retail customers.”<sup>18</sup>

The defendants appealed the district court’s decision and the Eleventh Circuit affirmed. The court first rejected the defendants’ arguments claiming the transactions were not leveraged or margined or financed. The court explained that “leveraging refers generally to the ability to control high-value amounts of a commodity or a security with a comparatively small value of capital, known as the margin,”<sup>19</sup> and that the district court did not err in concluding that the defendants’ business model involved leverage.<sup>20</sup>

Furthermore, the court agreed with the CFTC that the defendants had not satisfied the actual delivery exception. The court began by looking to the dictionary definition of those terms:

“Delivery” is “[t]he formal act of transferring something”; it denotes a transfer of possession and control. *Black’s Law Dictionary* 494 (9th ed. 2009). “Actual delivery” denotes “[t]he act of giving real and immediate possession to the buyer or the buyer’s agent.” *Id.* “Actual” is that

which “exist[s] in fact” and is “real,” rather than constructive.” *Id.* at 40.<sup>21</sup>

The Eleventh Circuit agreed with the district court that “the electronic transfer of documents indicating control or possession . . . without physical transfer of the commodity” did not satisfy the actual delivery standard.

The Ninth Circuit addressed similar issues in *Monex*. In that case, the defendants also offered retail customers precious metals—such as gold, silver, platinum, and palladium—through leverage.<sup>22</sup> As relevant here for this article, the district court dismissed the CFTC’s complaint in part because *Monex* met the terms of the actual delivery exception.<sup>23</sup> The Ninth Circuit, however, reversed the district court on this point, building off the rationale in *Hunter Wise*:

Thus, the plain language tells us that actual delivery requires at least some meaningful degree of possession or control by the customer. It is possible for this exception to be satisfied when the commodity sits in a third-party depository, but not when, as here, metals are in the broker’s chosen depository, never exchange hands, and are subject to the broker’s exclusive control, and customers have no substantial, non-contingent interests.<sup>24</sup>

The Ninth Circuit found that other canons of statutory construction supported that view, and sent the case back to district court.

The combination of *Hunter Wise*, *Monex*, and the Final Interpretive Guidance suggest that if a business wants to offer retail commodity transactions on leveraged basis, and it does not want to register with the CFTC, it will need to consider strongly the actual delivery exception. If it wishes to use the exception, it will need to give the retail customer full possession and control of the com-

modity and not retain any interest or legal right to the commodity. Constructive delivery is not sufficient. The Commission's approach in its enforcement strategy (discussed further below) and the Final Interpretive Guidance suggests that it thinks these limitations on leveraged retail commodity transactions mitigates the risk of manipulating retail customers while promoting innovation.

The CFTC has advanced its view of retail commodity transactions through enforcement actions. For example, in September 2021, the CFTC settled a case with a digital asset platform for allegedly offering margined retail commodity transactions in digital assets (particularly Bitcoin).<sup>25</sup> Of note, the CFTC did not rely on the Actual Delivery Final Interpretive Guidance in resolving this enforcement action. As Commissioner Stump explained in a concurring statement, the guidance itself could not be enforced. The CFTC would first need "to undertake a rulemaking proceeding to supersede the [Actual Delivery Final Interpretive] Guidance by adopting binding and enforceable rules that will provide certainty to the marketplace and a shared understanding of the 'rules of the road.'" <sup>26</sup> Thus, it would not be surprising if the agency decides to take up this and other issues of guidance in a rulemaking process to make the Commission's specific views on actual delivery enforceable.

## SOCIAL MEDIA

Retail market participants also increasingly look to social media as part of the mix of information they consider when making investment decisions. As a result, promoting digital assets on social media has also drawn the interest of the CFTC.<sup>27</sup> In March 2021, the CFTC brought a

complaint in federal court against two individuals who allegedly engaged in a social media "pump and dump" scheme regarding digital assets.<sup>28</sup> The complaint alleges that the defendants:

- (1) "identified digital assets with respect to which they believed that [a defendant's] promotional efforts could move the market;"
- (2) "secretly accumulated positions in the digital assets in anticipation of deceptively promoting the digital assets online in order to cause price spikes;"
- (3) "falsely and misleadingly endorsed the digital assets via Twitter and other media as recommended long-term investments that would 'change the world,' thereby exploiting the broad reach of [one defendant's] public Twitter account, while concealing Defendants' true holdings and plan to liquidate the digital assets quickly;" and
- (4) "secretly sold off most or all of Defendants' holding in these digital assets as prices rose sharply following [one defendant's] endorsements."<sup>29</sup>

The complaint seeks an injunction, civil monetary penalties and disgorgement of any benefits received from the allegedly improper activity.<sup>30</sup> This case suggests that the CFTC is concerned about the impact of social media on retail investors and is monitoring social media activity with activity in CFTC markets to assess whether any fraudulent or manipulative conduct is occurring.

## BINARY OPTIONS

The CFTC has also taken an interest in entities offering "binary options" based on foreign currencies and cryptocurrencies to retail customers. Binary options, as the name suggests, is an investment with a yes/no outcome, such as, on February 1, 2022, will the price of Bitcoin be above \$50,000? "The payoff to a winning investment is

a fixed monetary amount or an announced percentage of the initial investment.”<sup>31</sup> A losing outcome, however, usually results in the total loss of the investment.<sup>32</sup> Binary options offered in the United States can be done only by registered entities (called Futures Commission Merchants, or “FCMs”)<sup>33</sup> and must be traded on a regulated exchange (called Designated Contract Markets, or “DCMs”). The CFTC has raised concerns about binary options being traded through online trading platforms,<sup>34</sup> and in September 2021 the CFTC brought actions against 14 entities for failing to register as FCMs or falsely claiming to be registered as an FCM with the CFTC.<sup>35</sup> The CFTC recently settled another important action in this space against Blockatize, Inc., d/b/a Polymarket.com.<sup>36</sup>

As described in the settlement order:

Polymarket is an online trading platform that offers binary options in the form of winner-take-all “event contracts,” allowing customers to bid on whether a given event will occur. During the Relevant Period, Polymarket has offered over 900 event-based binary option contract markets and, at any given time, offers dozens of such markets on its website that are operated from the U.S. and/or are accessible for trading to U.S. persons.<sup>37</sup>

“To operate its markets, Polymarket deploys so-called smart contracts, which are hosted on a blockchain.”<sup>38</sup> Since June 2020, Polymarket has generated over \$130 million in trading volume.<sup>39</sup>

In the settlement order, the CFTC concluded that “[t]he products traded on Polymarket are swaps as defined by Section 1a(47) of the Act.”<sup>40</sup> Because Polymarket failed to register as a designated contract market or a swap execution facility, the CFTC concluded that Polymarket had of-

fered contracts in violation of the CEA.<sup>41</sup> As a result, the CFTC ordered Polymarket to pay a civil monetary of \$1.4 million, to cease and desist from violating the CEA, and that Polymarket, by January 14, 2022, “cease offering access to trading in markets displayed on Polymarkets.com, unless such offering, solicitation or trading complies with the [Commodity Exchange] Act and applicable Commission Regulations.”<sup>42</sup> Polymarket must certify to the CFTC by January 24, 2022, that it has complied with these conditions.<sup>43</sup>

Although Polymarket may have tried to position itself as a decentralized finance (“DeFi”) platform, the presence of the website and the manner in which traffic flowed through that website would have likely made it difficult for Polymarket to argue that it was a pure decentralized application. Previous CFTC Commissioners have expressed concerns about such applications and their compliance with the CEA.<sup>44</sup> One would expect that the CFTC will continue to monitor closely the development of the DeFi space with binary options and other products that may be derivatives as it seeks to interact with the retail investing public.

## CONCLUSION

These are just some of the areas in which the CFTC has taken actions to protect retail investors. One can expect that the CFTC will continue to diligently pursue claims when entities have either failed to register or are making material misrepresentations to the investing public. Chairman Behnam has recently said as much. In remarks to the ABA in January, he noted that the “Commission’s exercise of enforcement authority and resulting judicial interpretation has provided a meaningful, albeit sometimes imperfect,

means of protecting customers and market integrity.”<sup>45</sup> Retail investors themselves can be aware of signs of improper conduct or suspicious investments and act accordingly.<sup>46</sup>

At the same time, the CFTC must be aware that with technological development comes the opportunity for markets to better serve the retail investing public. Chairman Behnam noted that his “goal in this regard is to work collaboratively with all stakeholders to establish appropriate principles and structures in furtherance of well-reasoned and targeted regulation.”<sup>47</sup> The agency must be ever cognizant of its statutory obligation to “promote responsible innovation” so more efficient and beneficial markets can thrive in the United States.

#### ENDNOTES:

<sup>2</sup>Chairman Rostin Behnam, Keynote Address of Chairman Rostin Behnam at the ABA Business Law Section Derivatives & Futures Law Committee Virtual Winter Meeting (January 27, 2022) (available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabeenam19>).

<sup>3</sup>7 U.S.C.A. § 5(b).

<sup>4</sup>*Id.*

<sup>5</sup>*Id.*

<sup>6</sup>See <https://www.cftc.gov/About/Commissioners/CommissionerRostinBehnam.htm> (announcing that Chairman Behnam was sworn in as the CFTC’s 15th Chairman on January 4, 2022).

<sup>7</sup>See Statement of Commissioner Dawn D. Stump (December 9, 2021), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement120921>.

<sup>8</sup>See President Biden Announces 10 Key Nominations (Sept. 13, 2021) (“Sept. 13 Nominations”) (available at <https://www.whitehouse.gov/briefing-room/statements-releases/2021/09/13/>

[president-biden-announces-10-key-nominations-2/](https://www.whitehouse.gov/briefing-room/statements-releases/2021/12/15/president-biden-announces-key-nominees-and-an-appointee-to-board-and-commission-roles/)) (announcing the President’s intent to nominate Kristin Johnson and Christy Goldsmith Romero to the CFTC); President Biden Announces Key Nominees and an Appointee to Board and Commission Roles (December 15, 2021) (“December 15 Nominations”) (available at <https://www.whitehouse.gov/briefing-room/statements-releases/2021/12/15/president-biden-announces-key-nominees-and-an-appointee-to-board-and-commission-roles/>) (announcing the President’s intent to nominate Summer Mersinger and Caroline Pham to the CFTC). Kristin Johnson is the Asa Griggs Candler Professor of Law at Emory University School of Law where she “works on financial markets risk management law and policy with specialization in the regulation of complex financial products.” Sept. 13 Nominations. Christy Goldsmith Romero currently serves as the Special Inspector General for the Troubled Asset Relief Program (SIGTARP). *Id.* Summer Mersinger “has over 17 years of federal government service, spending the last two years at the [CFTC] where she served as Chief of Staff to Commissioner Dawn D. Stump and as the director of Legislative and Intergovernmental Affairs.” December 15 Nominations. Caroline Pham “is currently head of market structure for strategic initiatives in Citi’s Institutional Clients Group and represents Citi on the Executive Committee of the Chamber of Digital Commerce.” *Id.* She previously served at the CFTC as Special Counsel and Policy Advisor to former CFTC Commissioner Scott O’Malia.

<sup>9</sup>7 U.S.C.A. § 9(1).

<sup>10</sup>See, e.g., *Commodity Futures Trading Com’n v. Zelener*, 373 F.3d 861, Comm. Fut. L. Rep. (CCH) P 29785 (7th Cir. 2004).

<sup>11</sup>See Section 742 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. 111-203, 123 Stat. 1376 (2010), codified at 7 U.S.C.A. § 2(c)(2)(D).

<sup>12</sup>*Retail Commodity Transactions Involving Certain Digital Assets*, 85 Fed. Reg. 37,734 (June 24, 2020) (“Actual Delivery Final Interpretive Guidance”).

<sup>13</sup>7 U.S.C.A. § 2(c)(2)(D)(ii)(III)(aa).

<sup>14</sup>Actual Delivery Final Interpretive Guidance, 85 Fed. Reg. at 37,742-43.

<sup>15</sup>*U.S. Commodity Futures Trading Com'n v. Hunter Wise Commodities, LLC*, 749 F.3d 967, Comm. Fut. L. Rep. (CCH) P 33102 (11th Cir. 2014).

<sup>16</sup>*U.S. Commodity Futures Trading Commission v. Monex Credit Company*, 931 F.3d 966, Comm. Fut. L. Rep. (CCH) P 34538 (9th Cir. 2019), cert. denied, 141 S. Ct. 158, 207 L. Ed. 2d 1096 (2020). Full disclosure, I was one of the counsel for the CFTC in *Monex* when I served as General Counsel of the CFTC.

<sup>17</sup>*Hunter Wise*, 749 F.3d at 972.

<sup>18</sup>*Id.* at 973.

<sup>19</sup>*Id.* at 976.

<sup>20</sup>*Id.* at 978 (“Review of the evidence presented at this stage does not leave us with a definite and firm conviction that the district court erred in its factual findings regarding the nature of the transactions, and after *de novo* review, we confirm its legal conclusion that § 2(c)(2)(D) covers the transactions.”).

<sup>21</sup>*Id.* at 978-79; *see also id.* at 979 (“[W]e cannot interpret the [actual delivery] exception with a myopic focus on the term ‘delivery’ at the expense of other language. If ‘actual delivery’ means anything, it means something other than simply ‘delivery,’ for we must attach meaning to Congress’s use of the modifier ‘actual.’ ”).

<sup>22</sup>931 F.3d at 969.

<sup>23</sup>*Id.* at 972. The district court also concluded that, for the CFTC’s anti-fraud statute, the CFTC could bring only a fraud-based manipulation claim. *Id.* The Ninth Circuit reversed that ruling by the district court as well. *Id.* at 975-77.

<sup>24</sup>*Id.* at 974.

<sup>25</sup>*In re Payward Ventures, Inc. (d/b/a Kraken)*, CFTC Docket No. 21-20 (Sept. 28, 2021) (available at <https://www.cftc.gov/PressRoom/PressReleases/8433-21>).

<sup>26</sup>Concurring Statement of Commissioner Dawn D. Stump Regarding Enforcement Action Against Payward Ventures, Inc. (d/b/a Kraken)

(Sept. 28, 2021) (available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatemnt092821b>).

<sup>27</sup>The Securities and Exchange Commission has expressed interest in this area as well. After the well-publicized activities in the markets and social media regarding entities like GameStop and AMC, the SEC issued a request for information and comment on digital engagement practices. *Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology To Develop and Provide Investment Advice*, 86 Fed. Reg. 49,067 (Sept. 1, 2021).

<sup>28</sup>Complaint in *CFTC v. McAfee and Watson*, Case No. 1:21-cv-01919, Doc. 1 (S.D.N.Y. March 5, 2021).

<sup>29</sup>*Id.* at 1.

<sup>30</sup>*Id.* at 16-18.

<sup>31</sup>CFTC, *Beware of Off-Exchange Binary Options Trades* (available at [https://www.cftc.gov/LearnAndProtect/AdvisoriesAndArticles/beware\\_of\\_off\\_exchange\\_binary\\_options.htm](https://www.cftc.gov/LearnAndProtect/AdvisoriesAndArticles/beware_of_off_exchange_binary_options.htm)).

<sup>32</sup>*Id.*

<sup>33</sup>7 U.S.C.A. § 1a(28); *see also id.* § 6d(1) (making it unlawful to act as an FCM without registering with the CFTC).

<sup>34</sup>CFTC, *Beware of Off-Exchange Binary Options Trades* (available at [https://www.cftc.gov/LearnAndProtect/AdvisoriesAndArticles/beware\\_of\\_off\\_exchange\\_binary\\_options.htm](https://www.cftc.gov/LearnAndProtect/AdvisoriesAndArticles/beware_of_off_exchange_binary_options.htm)).

<sup>35</sup>CFTC *Charges 14 Entities for Failing to Register as FCMs or Falsely Claiming to be Registered*, CFTC Release No. 8434-21 (Sept. 29, 2021) (available at <https://www.cftc.gov/PressRoom/PressReleases/8434-21>).

<sup>36</sup>CFTC *Orders Event-Based Binary Options Markets Operator to Pay \$1.4 Million Penalty*, CFTC Release No. 8478-22 (January 3, 2022) (available at <https://www.cftc.gov/PressRoom/PressReleases/8478-22>).

<sup>37</sup>Polymarket Order at 2-3.

<sup>38</sup>*Id.* at 3.

<sup>39</sup>*Id.* at 4.

<sup>40</sup>*Id.* at 7.

<sup>41</sup>*Id.* at 7-8.

<sup>42</sup>*Id.* at 10.

<sup>43</sup>*Id.*

<sup>44</sup>*See, e.g., Keynote Address of Commissioner Dan M. Berkovitz Before FIA and SIFMA-AMG, Asset Management Derivatives Forum 2021* (June 8, 2021) (available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opaberkovitz7>) (former CFTC Commissioner Berkovitz (now General Counsel of the SEC) expressing that he “do[es] not see how [unlicensed DeFi markets for derivatives instruments] are legal under the CEA.”).

<sup>45</sup>*Chairman Rostin Behnam, Keynote Address of Chairman Rostin Behnam at the ABA Business Law Section Derivatives & Futures Law Committee Virtual Winter Meeting* (January 27, 2022) (available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam19>).

[peechesTestimony/opabehnam19](https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam19)). He went on to say, “I view the use of our enforcement authority to crystallize our law through judicial interpretation more as a feature of the system than a bug. Our Federal Court system is built on the idea of finding the truth of the matter—it is a proven process both for protecting customers and for giving accused wrongdoers the opportunity to be heard. The process provides certainty, not uncertainty.” *Id.*

<sup>46</sup>*See, e.g., Daniel J. Davis, Crypto Scams Like ‘Squid’ Coins Usually Raise Red Flags* (November 22, 2021) (available at <https://news.bloomberglaw.com/securities-law/crypto-scams-like-squid-coins-usually-raise-red-flags>).

<sup>47</sup>*Chairman Rostin Behnam, Keynote Address of Chairman Rostin Behnam at the ABA Business Law Section Derivatives & Futures Law Committee Virtual Winter Meeting* (January 27, 2022) (available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam19>).