CX Futures Exchange, L.P.
Rule Amendment Submission #2020-02
March 6, 2020

1. The text of the rule changes to the CX Futures Exchange L.P. ("Exchange" or "CX") Rulebook is attached. Additions are underlined and deletions are stricken through. This rule has been approved by the Exchange. Capitalized terms, unless otherwise defined herein shall possess the meaning(s) ascribed in Exchange Rulebook.

2. The proposed effective date is ten business days after receipt by the Commodity Futures Trading Commission ("CFTC" or "Commission") of this submission.

3. Attached, please find a certification that: (1) these rules comply with the Commodity Exchange Act and the Commission's regulations thereunder; and (2) concurrent with this submission, CX Futures Exchange, L.P. posted on its website: (i) a notice of pending certification of the rule submissions with the Commission; and (ii) a copy of this submission.

4. A concise explanation and analysis of the operation, purpose, and effect of the amended rule appears below.

5. There were no opposing views expressed regarding these amended rules.

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CONCISE EXPLANATION AND ANALYSIS OF THE OPERATION, PURPOSE, AND EFFECT OF THE CERTIFIED RULE AND ITS COMPLIANCE WITH APPLICABLE PROVISIONS OF THE ACT, INCLUDING CORE PRINCIPLES AND THE COMMISSION'S REGULATIONS THEREUNDER

Pursuant to Commission Rule 40.6(a)(7)(vi), the following is a concise explanation and analysis of the operation, purpose, and effect of the amended rules.

I. Current Structure of CX Weather Contracts

CX uses an asynchronous one-sided call market for most, if not all, of its weather-related contracts. An asynchronous one-sided call market enables each participant to submit bids that are matched at the end of the call market period. This enhances liquidity in otherwise low volume markets.[1]

CX examined both the typical synchronous, two-side market and the asynchronous one-sided call market types of pricing systems and determined that the asynchronous, single-sided call market mechanism offers greater potential benefits for participants in the weather-related markets. This

[1] This operational difference is reflected in market terminology. In the case of a synchronous market, a "buyer" and "seller" must be present simultaneously and agree on price. In an asynchronous market, all participants can be referred to as "buyers," even though at settlement, some will have in-the-money positions and others will be out-of-the money, that is, have opposing settlement outcomes.

market structure is especially efficacious where there is no tradeable underlying instrument such as contingent claims for economic statistics releases and meteorological measurements such as rainfall or snowfall. Specifically, the advantages of this market mechanism for contingent claims includes: (1) the premiums paid are sufficient to satisfy all Final Settlement payments back to Participants; (2) liquidity is enhanced because there is no requirement for a simultaneous order match between at least one buyer and one seller; (3) market efficiency is increased as liquidity providers (i.e. "market makers") are not able to extract a liquidity premium from market participants; (4) there is no opportunity for riskless arbitrage between Strike Levels due to uninformed or nefarious trading.

As currently implemented for the CX weather contracts, the asynchronous one-sided call market provides participants an opportunity to place bids into the market (and at that time depositing Original Margin equal to the maximum at-risk amount) with all bids converted into contract positions upon Termination of Trading. Once accepted by the CX Direct System, bids may not be withdrawn and a contract position, once established, can be liquidated only by final cash settlement.[2]

All contract positions open at the time of Final Settlement are automatically exercised through book entry with no action necessary on the part of the holder. The current value of each Strike Level, based on current bids in the market, are displayed on CX's web-based trading interface. The bid contract price is a function of time remaining until Termination of Trading and is set forth in the rules. Because the forecast accuracy of expected weather events improves significantly as the expiration date draws closer, the contracts provide for an increasing contract premium price per contract, and corresponding Original Margin deposit, the closer to Termination of Trading it is. The premium is set at a specified value set forth in the rules.

After placing a bid, market participants may adjust their positions by switching from the current position's Strike Level to another Strike Level for the same delivery day and location by depositing any additional margin that may be required for the contract. This will enable participants to fine-tune their hedges after they obtain a position at a given Strike Level and shift their positions between Strike Levels over time. This ability to modify bid Strike Levels assists the price discovery process and further hedging efficacy.

The Final Settlement Price of the positions at various Strike Levels is a function of how many positions are aggregated at each Strike Level versus the total number of positions. Strike Levels that are in-the-money and closer to the final strike value will have a higher Final Settlement Price than positions that are in-the-money but further from that value.

As described above, the current structure implicitly treats each bid entered into the CX Direct System as a Market Order. Specifically, Exchange rule IX-3301(c) currently provides that Bids may be entered for the DARI contract "by specifying the Ticker Symbol of the contract," and at the

[2] Because of the asynchronous nature of the single-sided call auction mechanism, once a position is established, it may only be exited via the DARI contract's Final Settlement process. This is designed to mitigate the detrimental effects on market information and pricing of traders placing large bids in the market and then cancelling such bids.

contract premium price specified in Table 1. And, as described above, the Final Settlement Price is determined as a function of how many positions are aggregated at each Strike Level. Currently, the DARI contract only offers market participants the alternative to enter bids as Market Orders.

The current asynchronous, one-sided call market structure has proven to be particularly efficacious for these weather-related contracts. This market structure has found increasing support among market participants, reflected in strong growth in contract open interest since their introduction. Some potential commercial users of the market, however, have noted that unlike a traditional two-sided market structure, participants in the asynchronous one-sided call market lack certainty when entering a bid into the market with respect to the ultimate price level that an in-the-money market position will have. This complicates hedging calculations. Such business users have advised the Exchange that a structure that includes greater pay-out predictability would facilitate their ability to use these contracts for hedging purposes.

Fortunately, greater predictability with respect to the value of in-the-money positions can be achieved within the current structure through the addition of Limit Orders to the currently available framework. The addition of Limit Orders will facilitate the use of the contracts for hedging or risk management by commercial participants, without detracting from the current uses of the contract. Moreover, the addition of Limit Orders will promote further the contract as a price discovery mechanism. Finally, Limit Orders will in many ways operate similarly to more traditional two-sided markets without sacrificing the particular benefits of the one-sided call market.

The specific proposed amendments will add Limit Orders into the current framework, differentiating their operation from the current structure, and will make explicit the currently implicit operation of Market Orders under the contract terms and conditions.

II. Proposed Operation of Limit Orders Within the DARI Contract

The proposed amendments amend CX Rule IX-3301(c) to provide procedures for placing both Market Orders and Limit Orders, which are defined terms under CX Rule I-1. As explained above, Market Orders are bids for a particular Strike Level without reference to a specified price for in-the-money positions. Market Orders may be for any quantity, the price of which are determined by the Exchange upon Termination of Trading. Market Orders are accepted by the CX Direct System as soon as such orders pass the automated funding filter. Once accepted by the CX Direct System, a Market Order bid may not be withdrawn, although the Strike Level may be modified.

Under the proposed amendments, “Limit Orders,” which are bids for a particular Strike Level that specify a minimum acceptable Final Settlement Price for an in-the-money position, may only be entered in lots of 100 contracts or more. The Strike Level of the Limit Order will be specified by the participant. All Limit Order bids will be at the per-contract premium price at the time that the Limit Order is matched by the CX Direct System and require Original Margin to be deposited with CX Clearinghouse when matched. At Final Settlement, matched Limit Order bids will receive a settlement price that is equal to or greater than the order’s specified price times the DARI Conversion Factor for the order’s Strike Level.

Like in the two-sided market, Limit Orders, after submission through the CX Direct System, will be displayed in the central order book. A Limit Order is only matched by the CX Direct System when it can be matched with one or more counterparty Limit Order bid(s) such that each counterparty order's limit price will be satisfied or exceeded if the DARI Conversion Factor for that order's Strike Level is 1.00.[3] The matching of counterparty Limit Orders results in the execution of a trade where each Limit Order is a buyer at its Strike Level versus the collective orders at other Strike Levels. Limit Orders will result in a Final Settlement Price for each matched order that equals or exceeds the price specified on the Order times the DARI Conversion Factor as determined at Final Settlement.

Because Limit Order bids must be matched with one or more Limit Order bids, unmatched Limit Order bids will remain open in the CX Direct System and displayed on the order book until matched or until the Limit Order is withdrawn.

Limit Order bids will be matched for the maximum possible quantity, with any balance to remain as an open Order until it is matched, cancelled, or expires at the Termination of Trading. Limit Orders will be matched using price/time priority. Limit Order bids may be matched with other Limit Order bids at any time prior to the Termination of Trading whenever, for each Strike Level in such orders, the Final Settlement Price will equal or exceed the specified price on the order given a Conversion Factor of 1.00 at that order's Strike Level. Once Limit Order bids are matched, the number of contracts matched and the minimum settlement price for the corresponding Strike Levels will be displayed by the Exchange.

All Limit Order bids that remain open at Termination of Trading will be matched with a Market Order, to the extent possible. That is, unmatched Limit Order bids on the order book for each Strike Level will be matched with Market Orders when, and to the extent that, the Final Settlement Price will equal or exceed the specified price on the Limit Order bid given a Conversion Factor of 1.00 at that order's Strike Level. Any Limit Orders that still remain unmatched will expire. Market Order bids will be settled at Final Settlement as a function of the Residual Bid Interest calculation in the contract rules.

III. Consideration of Core Principles

A. Core Principles 3 and 4

Core Principles 3 and 4 provide, respectively, that contracts are not readily susceptible to manipulation and that designated contract markets provide for the prevention of market disruption. In this case, the addition of Limit Orders will not affect the ability of CX to adhere to these requirements in respect of the DARI contract. In this regard, the underlying contract is for weather, and as such clearly is not readily subject to manipulation. The addition of Limit Orders to the contract will alter the calculation of the Final Settlement values for those orders, but CX is not

[3] Note that unlike a two-sided market, matching counterparties are not long and short for the same price and quantity in a given Strike Level; rather in this one-sided call market, matching counterparties must be at different Strike Levels.

aware that anything related to the use of Limit Orders, which is a widely accepted order type among futures exchanges, would introduce any conditions that would make the DARI contract readily susceptible to manipulation.

With regard to prevention of market disruption, the nature of the contract and the pre-funding of original margin make market disruption difficult. The addition of Limit Orders will not alter those characteristics of the contract.

B. Core Principle 9—Execution of Transactions

As noted above, the trading mechanics for the DARI contract are the same as for CX's other daily weather contracts. The addition of Limit Orders will alter certain of the mechanics of trading but will not depart from the current concept of a one-sided call market currently successfully in use by CX.

Core Principle 9 provides that, "The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade . . ." Limit Orders are a well-accepted feature of the trading mechanics of designated contract markets. Their operation is similar to traditional two-sided markets, including the display of open bids on an order book. Limit Orders are a means of facilitating trading in the DARI contract by commercial participants and businesses that would use the contracts for risk management or hedging purposes. Indeed, the use of this feature likely will increase liquidity in the market.

Core Principle 9 and CFTC Rule 38.500 provide that a designated contract market shall provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market. The DARI contract provides for trading on a centralized, open and competitive market in that all prices are derived from trading on CX, a centralized market that is a "trading facility," and not through pre-arrangement or the private negotiation of two parties. That is equally true for Limit Orders as it is for Market Orders.

C. Core Principle 11—Financial Integrity of Transactions

Core Principle 11 and Rule 38.601 require that a contract be subject to mandatory clearing. The DARI Contracts are subject to mandatory clearing on the same terms as all other contracts cleared by CX Clearinghouse, regardless of whether positions are formed via Market Orders or Limit Orders.

Based on the above analysis, CX Futures Exchange has considered the Core Principles, in particular, Core Principles 3,4, 9 and 11, and has determined that the amendments certified herein will make the Contract more readily usable by market participants, particularly commercial participants. It is likely that these amendments will encourage greater use of the Contract for hedging and risk management purposes.

CERTIFICATIONS PURSUANT TO SECTION 5c OF THE COMMODITY EXCHANGE ACT, 7 U.S.C. §7A-2 AND COMMODITY FUTURES TRADING COMMISSION RULE 40.6, 17 C.F.R. §40.6

I hereby certify that:

(1) the amended Rules below comply with the Commodity Exchange Act, and the Commodity Futures Trading Commission's regulations thereunder; and

(2) concurrent with this submission, CX Futures Exchange, L.P. posted on its website: (a) a notice of pending certification of the above Rules with the Commission; and (b) a copy of this submission.

Nolan Glantz

By: Nolan Glantz
Title: COO
Date: 3/6/2020