

# CFTC Enforcement and Regulatory Developments

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# Agenda

## CFTC Regulatory Developments

- Dodd-Frank Act Continuing Implementation
- Other Regulatory Initiatives
- Closer Look at Selected Final and Proposed Rules
- Commission composition

## CFTC Enforcement Developments

- New Dodd-Frank Violations
- Criminalization of Futures Violations
- Reporting cases
- Whistleblower program developments



# CFTC Regulatory Developments



# Dodd-Frank Act Implementation

Completed 2016	Pending 2016	Not yet started
Permanent SEF Registrations		
Margin for Uncleared Swaps		
Clearinghouse Comparability Determination		
Trade Option Exemption Modified		
	Extend the Clearing Mandate	
	Lowering of De Minimis SD Threshold	
	Improve Data Reporting	
	Capital Requirements for SDs	
	Arrange, Negotiate or Execute	
	Position Limits	
	Whistleblower Awards Process	
		Made Available to Trade Process
		SEF Market Structure
		Cross-border Market Harmonization



# Other Regulatory Initiatives

Completed 2016	Pending 2016	Not yet started
Clearinghouse Resiliency (staff Guidance)		
Cybersecurity		
	Automated Trading	
	Implementation of Ownership/Control Reporting Regime	



# Closer Look at Selected Final and Proposed Rules

- Margin for Uncleared Swaps
- Clearinghouse resiliency (Staff Guidance)
- Extend clearing mandate
- Cybersecurity



# Margin for Uncleared Swaps

- The rules apply to SD and MSPs that are not subject to regulation by a Prudential Regulator
- The rules apply to
  - (i) trades between CSEs and SDs or MSPs and
  - (ii) trades between CSEs and financial end users
- Commercial End Users are exempt
- Inter-affiliate trades: VM must be exchanged.
- Phased-in implementation began September 2016 for the largest participants.
  - Initial margin: Four-year phase-in period, starting on September 1, 2016 and ending on September 1, 2020.
  - Variation margin: Six-month phase-in period, beginning on September 1, 2016 and ending on March 1, 2017.



# Clearing house Resiliency

## CCP Recovery or Resolution

- Financial regulators have turned attention to systemic risk posed by possible clearinghouse failure
  - All financial regulators have an interest
  - CFTC has quickly moved to assert itself in this space through round-tables and other thought leadership
  - Staff Letter No 16-61—guidance on required Recovery and Resolution Plans
    - identifies the issues that should be addressed





# CCP Recovery or Resolution

## Issues to be addressed

- Stress-test scenarios
  - Enabling comparisons across all CCPs
  - Area of international regulatory cooperation
- Governance Transparency – What should be disclosed?
  - How CCPs determine whether wind-down or recovery is appropriate
  - CCP's recovery or resolution process, including use of emergency powers
  - Re-establishing a matched book following a participant default
    - Auction, forced allocation, complete or partial tear-up

## CCP Recovery or Resolution (issues)

- Default waterfall
  - DCO v. Clearing Member contribution levels and location in the waterfall.
- End of default waterfall
  - How to allocate losses (e.g., haircutting, capped assessments, etc.)
- Recovery Tools

Staff Guidance identifies issues, but not solutions

- Important first step



# Cybersecurity Final Rule

- Narrower scope of testing and assessment requirement
  - Strict liability replaced with reasonable standard-generally accepted best practices
  - But no safe harbors
- Expanded categories of risk analysis and oversight for Exchanges
  - Adds enterprise risk management for exchanges
- Broader books and records obligations
  - Includes parent company where the oversight program of parent is shared with a registered entity
- Narrower scope of requirement to remediate vulnerabilities and deficiencies
  - Substitutes reasonable standard
- Unlike exchanges and SDRs, no reduced requirements for DCOs

## Proposal to Extend Clearing Mandate

- Proposal to extend mandate to clear IRS denominated in 9 additional currencies
- Comment period expired July 18.
- Issue--coordinate implementation schedule with non-US jurisdictions.



## Proposed Regulation AT

- Proposed Major CFTC initiative
- Would impose risk controls and other regulatory requirements on:
  - AT Persons, which are
    - CFTC registrants engaged in “Algorithmic Trading” and
    - Proprietary traders who have direct access to DCMs and are engaged in Algorithmic Trading
  - Clearing member FCMs whose customers are AT Persons; and
  - DCMs executing orders from AT persons.



# Proposed Regulation AT

## Pre-trade Risk Controls

## Source Code Repositories (Only AT Persons)

- Required to make all of the information in the source code repository available to any representative of the CFTC or the U.S. DOJ upon request

## Development and Testing

- Backtesting, stress tests, testing of algorithmic trading code

## Monitoring

- Continuous, real-time monitoring; automated alerts; ability to disengage



# Proposed Regulation AT

## Compliance

- Policies and procedures reasonably designed to ensure compliance

## Training

- Procedures for designating and training all staff involved in the design, testing, and monitoring of algorithmic trading

## Annual Reports

- Requires CEO or COO certification

## Proposed Reg AT: DCM Requirements

DCMs must disclose specifications of matching platforms

DCM must disclose to public purpose and other information of Market and Trading Incentive Programs and to Commission agreements, benchmarks and payments.

Self-trading prevention rules by DCMs, and apply, provide or require self-trade prevention tools





## Proposed Regulation AT: Concerns

- Provisions raising most concerns by commenters
  - Source Code Repository Requirement for AT Persons
  - Duplication of requirements
    - Breadth of definition of Automated Trading—execution algorithms
  - Definition of AT Person is too broad (e.g., includes floor traders)
- Chairman Massad announced intention to offer additional proposal.



# Composition Changes at CFTC



# CFTC Composition

- Challenges of Operating with 3 Commissioners
  - Sunshine Act requirements--with only three Commissioners, any two constitute a meeting quorum.
  - Apparent difficulty Reaching Unanimity on Final Rulemakings
    - Two recent votes have been split decisions—but not the same Commissioner dissenting
- Current Nominees
  - Christopher Brummer (D)
    - Founder, Managing Principal, and Chief Investment Officer of Saeculum Capital Management LLC
    - Served in the office of U.S. Representative Deborah Pryce from 2001 to 2007
  - Brian D. Quintenz (R)
    - Professor at Georgetown Law and faculty director of the Institute of International Economic Law.
  - Several post-election scenarios possible



# CFTC Enforcement Developments



# Enforcement Developments

- CFTC aggressively investigating and prosecuting manipulation under its Dodd-Frank authority
- Criminal referrals for manipulation becoming increasingly common
- CFTC's enforcement of reporting rules
- The Whistleblower Program



# Dodd-Frank Anti-Manipulation Tools

- Insider trading
- Anti-manipulation
- Spoofing



## Insider Trading

CFTC Regulation 180.1 is patterned after SEC Rule 10b-5.

- (a) It shall be unlawful for any person, directly or indirectly, in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity, to intentionally or recklessly:
  - (1) Use or employ, or attempt to use or employ, any manipulative device, scheme, or artifice to defraud . . .
- The CFTC “will be guided, but not controlled, by the substantial body of judicial precedent applying the comparable language of [Exchange Act] Rule 10b–5.”

## First Insider Trading Case: Motazed

*In re Arya Motazed*, CFTC Docket No. 16 -02, at 3  
(Dec. 2, 2015)

- Employee used information about employer's trading in violation of employment terms to trade against employer and personally profit
- Two Parts of the Scheme
  - Matched Orders: Motazed placed fictitious trades between the company's account and his personal account at prices that disadvantaged the company.
  - Frontrunning: Motazed placed personal orders ahead of orders he placed for the company.





# Anti-Manipulation

## **180.1 Prohibition on the employment, or attempted employment, of manipulative and deceptive devices.**

- (a) It shall be unlawful for any person, directly or indirectly, in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity, to intentionally or recklessly:
  - (1) Use or employ, or attempt to use or employ, any manipulative device, scheme, or artifice to defraud . . .
  
- Implementing CEA Section 6(c)(1)
- The CFTC “will be guided, but not controlled, by the substantial body of judicial precedent applying the comparable language of [Exchange Act] Rule 10b–5.”



## Anti-Manipulation

CFTC wants to lower bar for proving manipulation. It has argued that 180.1 (1) prohibits non-fraud manipulations and (2) that it does not require specific intent, nor proof of an artificial price.

*CFTC v. Kraft Foods Group, Inc. and Mondelēz Global, LLC*, No. 15-cv-2881 (N.D. Ill. Apr. 1, 2015)

- Alleged manipulation of the wheat market
- Ruling on motion to dismiss was the first judicial interpretation of CEA Section 6(c)(1) and Rule 180.1
  - District court held that (1) 180.1 only prohibits fraud, not non-fraud manipulations; and (2) CFTC must show conduct was either reckless or intentional under 180.1.
  - Relies on securities laws precedent



# Anti-Manipulation

## 180.2 Prohibition on price manipulation.

It shall be unlawful for any person, directly or indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity.

- Implementing CEA Section 6(c)(3)
- CFTC “will be guided by the traditional four-part test for manipulation that has developed in case law arising under 6(c) and 9(a)(2).”
  - Four-Part Manipulation Test:
    - 1) the ability to influence market prices;
    - 2) specific intent to influence market prices;
    - 3) that artificial prices existed; and
    - 4) caused the artificial prices.
  - Test For Attempted Manipulation
    - 1) **An intent to [affect the market price]/[create an artificial price]; and**
    - 2) some overt act in furtherance of that intent.



## Anti-Manipulation

CFTC arguing for lower standard for attempted manipulation.

*CFTC v. Wilson & DRW Investments*, No. 13-cv-7884 (S.D.N.Y. Nov. 6, 2013)

- Alleged manipulation and attempted manipulation of the settlement price of an interest rate future.
- Judge denied motion to dismiss complaint.
- DRW moved for summary judgement.
- Debate about the necessary elements to prove attempted manipulation.



# Anti-Manipulation

*CFTC v. Wilson & DRW Investments*, No. 13-cv-7884 (S.D.N.Y. Nov. 6, 2013)

- Debate about the first element in attempted manipulation:
  - Test For Attempted Manipulation
    - An intent to [affect the market price]/[create an artificial price]; and
    - some overt act in furtherance of that intent.
  - “[T]he CFTC asks this Court to adopt a new legal standard for intent in attempted manipulation cases that departs in a significant respect from decades of settled law. **The CFTC argues it need only prove ‘an intent to affect price’ and not that the price was intended to be artificial.**”
    - CME, CMC, FIA, ICE and MFA Amici Curiae
  - “Under any standard, **trading with the specific intent to unilaterally affect and define prices . . . is manipulative intent.**”
    - CFTC Response in Opposition to Brief of Amici Curiae



## Spooing

Section 4c of the CEA: It is unlawful for “any person to engage in any trading, practice or conduct on or subject to the rules of a registered entity that . . . is, of the character of, or is commonly known to the trade as, ‘spoofing’ (bidding or offering with the intent to cancel the bid or offer before execution).”

CFTC 2013 Guidance: “[A] spoofing violation will not occur when the person’s intent when cancelling a bid or offer before execution was to cancel such bid or offer as part of a legitimate, good-faith attempt to consummate a trade.”



## CFTC Spoofing Cases in 2015

- *CFTC v. Panther Energy Trading and Michael J. Coscia*, CFTC Docket No. 13-26 (July 22, 2013)
  - DOJ and CFTC actions
  - Algorithmic trading in commodity futures
  - Court rejected Coscia's argument that anti-spoofing provision and the commodity fraud provisions were unconstitutional vague
  
- *CFTC v. Nav Sarao Futures Ltd. PLC*, No. 15-cv-03398 (N.D. Ill. Apr. 17, 2015)
  - DOJ and CFTC actions
  - Algorithmic trading in the E-Mini S&P futures contract



## CFTC Spoofing Cases in 2015

- *CFTC v. Heet Khara and Nasim Salim*, No. 15-civ-03497 (S.D.N.Y.) (complaint filed May 5, 2015)
  - Spoofing in gold and silver futures
- *CFTC v. Oystacher*, No. 1:15-cv-09196 (N.D. Ill. Oct. 19, 2015)
  - Manual trading in the E-Mini S&P 500, Copper, Crude Oil, Natural Gas, and VIX futures contracts
  - Also subject to several exchange enforcement actions
  - Oystacher challenged anti-spoofing provision as unconstitutionally vague



## Criminalization of Manipulation Cases

“We want to put the word out that if you violate the Commodity Exchange Act, you have a real chance of facing time in prison.”

- Aitan Goelman, CFTC Director of the Division of Enforcement



## Increased Coordination Between CFTC and DOJ

April 2014, the DOJ establishment of a Securities and Commodities Fraud Section in the US Attorney's Office for the Northern District of Illinois.

### CFTC Criminal Referrals

- FY 2014: 95% major fraud/manipulation cases involved parallel criminal proceeding
- FY 2015: 90% of major fraud/manipulation cases involved parallel criminal proceeding

## DOJ Parallel 'Spoofing' Prosecutions

- *United States v. Coscia*, 100 F. Supp. 3d 653 (N.D. Ill. 2015)
  - District judge rejected claim that CEA Section 4c(a)(5)(C) was unconstitutionally vague
  - Found guilty; sentenced to 3 years in jail
  - First person convicted of spoofing
- *United States v. Sarao*, No. 15 CR 75 (N.D. Ill. Feb. 11, 2015)
  - Ongoing. The Government is currently seeking to extradite Sarao from England. On March 23, 2016, an English judge ruled that Sarao should be extradited to the United States. Sarao is appealing
- *United States v. Milrud*, Crim. No. 15-455 (D.N.J.) (complaint filed Jan. 12, 2015)
  - Securities case.
  - Plead guilty to spoofing through placing and cancelling bogus trading orders.



## Reporting Violations

### **CFTC Focused on Improving the Quality of its Data**

- “For those industry participants who do not make timely, complete and accurate reporting, we will not hesitate to carry out enforcement actions . . . . We will continue to promote compliance in recordkeeping and reporting--and hold those who are not in compliance accountable.”
  - CFTC Chairman Tim Massad



## Reporting Violations – 2016 Cases

- *CFTC v. Deutsche Bank AG*, No.1:16-cv-6544 (S.D.N.Y. August 17, 2016) (Complaint)
  - Failure to report any swap data for multiple asset classes for five days.
  - Failure to comply with a previous order.
- *In the Matter of: Agrocorp International Pte Ltd.*, CFTC Docket No. 16-22 (Jul 11, 2016)
  - Failure to call cotton purchases.
  - CMP: \$150,000
- *In the Matter of: Golden Agri International Pte Ltd.*, CFTC Docket No. 16-21 (Jul 11, 2016) (150k; cash)
  - Failure to report cash positions.
  - CMP: \$150,000



## Reporting Violations – 2016 Cases

- *In the Matter of Barclays Bank PLC*, CFTC Docket No. 16-20 (Jul 6, 2016).
  - Failure to submit accurate large trader reports (LTRs) for physical commodity swap positions.
  - CMP: \$560,000
- *In the Matter of JP Morgan Ventures Energy Corp. and JP Morgan Chase Bank N.A.*, CFTC Docket No: 16-11 (Mar 23, 2016)
  - Failure to submit accurate large trader reports (LTRs) for physical commodity swap positions.
  - CMP: \$225,000
- *In the Matter of: CHS, Inc. and CHS Hedging, LLC, CHS*, CFTC Docket No. 16-07 (Mar 9, 2016)
  - Failure to accurately report fixed price cash corn and soybean purchases and sales in Form 204
  - CMP: \$1 million



# CFTC Whistleblower Program

## Number of Tips and Awards Growing, but lags well behind SEC program

- In 2015, the CFTC received 232 whistleblower tips, a large increase from the 58 whistleblower tips in 2012.

<b>FY 2015</b>	<b>CFTC Tips</b>	<b>SEC Tips</b>
Number of Tips	>232	>4,000

<b>2013-Present</b>	<b>CFTC Awards</b>	<b>SEC Awards</b>
Totals Sum	>\$10.5 million	>\$100 million
Largest Award	\$10 million	\$30 million
Total Awards	4	33



# CFTC Whistleblower Program

## Proposed Changes

- Larger Role for the Division of Enforcement (“DOE”)
  - Creates claims review staff that will be appointed by the DOE Director.
  - Gives DOE overall responsibility for administering the whistleblower program.
  - Gives the DOE authority to decide what whistleblower identifying information to disclose.





# CFTC Whistleblower Program

## Proposed Changes

- More Protections for Tipsters
  - Establish that retaliation is in fact a separate violation of the CEA.
    - Replaces 2011 interpretation stating that the CFTC lacked the statutory authority to make such a determination.
    - Harmonizes the CFTC's interpretation with the SEC's, ending "the incongruous situation where whistleblowers enjoy protection from retaliation through SEC enforcement action under the securities laws, but no such protection through commission enforcement action under the [CEA]."



# Questions?



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