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2016 CFTC Year-in-Review and a Look Forward

By Paul M. Architzel, Dan M. Berkovitz, Anjan Sahni, Gail C. Bernstein, Matthew Beville and Daniel J. Martin

I. Introduction

In 2016, the Commodity Futures Trading Commission (CFTC or Commission) continued to pursue high-profile enforcement cases and to test its new enforcement authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). On the regulatory front, the Commission issued several major final rules (margin for uncleared swaps, cross-border requirements for the margin rules, aggregation of positions and cybersecurity) and several important proposals which remain pending (position limits, Regulation AT, cross-border application of the registration thresholds and external business conduct standards, and swap dealer and major swap participant capital requirements).

Looking forward to 2017, the Commission's composition and regulatory agenda are certain to change. The Trump Administration, together with a Republican-majority Congress, likely will cause a significant shift in the regulatory landscape, both through the administration's appointments and through new legislation. The new president will have an opportunity to appoint three new members to the Commission in early 2017, and Congress has already begun work on CFTC reauthorization. Typically, the agency's enforcement agenda has not varied as much as the regulatory agenda from one administration to the next, but even here significant shifts in emphasis or focus are possible. Nevertheless, it is too early to predict the course of the next administration and exactly how expansive the shifts in the regulatory and enforcement programs will be.

II. Enforcement

The CFTC filed 68 enforcement actions in Fiscal Year 2016 (ended in September), obtaining $1.29 billion in restitution, disgorgement and civil monetary penalties.[1] Although the number of actions is consistent with the CFTC's recent enforcement activity, the amount of monetary sanctions represents a decrease from the $3.14 billion obtained in 2015 and the record $3.27 billion obtained in 2014. The Commission filed an additional four enforcement actions from October 1 through December 31, 2016, and settled or obtained judgment in an additional nine actions during this period.

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[1] Press Release, Commodity Futures Trading Comm'n, CFTC Releases Annual Enforcement Results for Fiscal Year 2016, PR7488-16 (Nov. 21, 2016).

The following discussion highlights the noteworthy enforcement efforts in 2016.

A. Manipulation and Attempted Manipulation

In 2016, the Commission continued to apply its new anti-manipulation and anti-spoofing authorities.

Spoofing

In October 2016, the Commission agreed to settle its closely watched case against Igor B. Oystacher and 3 Red Trading LLC. The settlement, which was approved in December by the US District Court for the Northern District of Illinois, requires the defendants to pay a civil monetary penalty of $2.5 million.[2]

The Commission had charged Oystacher and 3 Red with repeatedly engaging in an alleged spoofing scheme in certain futures contracts across five derivatives markets, in violation of Sections 4c(a)(5)(C) and 6(c)(1) of the CEA and Regulation 180.1. The CFTC alleged that Oystacher and 3 Red "manually place[d] large . . . passive order(s) on one side of the market at or near the best bid or offer price, which were intended to be canceled before execution," and then "cancel[ed] or attempt[ed] to cancel all of the spoof order(s) before they were executed."[3] The CFTC further alleged that Oystacher and 3 Red then attempted to "virtually simultaneously 'flip' their position from buy to sell (or vice versa) by placing at least one aggressive order on the other side of the market at the same or better price to trade with market participants that had been induced to enter the market by the spoof orders they just canceled."[4]

The court's order requires that an independent monitor assess and monitor for three years all of Oystacher's and 3 Red's futures trading for the purpose of identifying any future violations of CFTC Regulations or CEA requirements. It also requires Oystacher and 3 Red to employ certain compliance tools with respect to all of Oystacher's trading on US futures exchanges for a period of 18 months, and permanently prohibits Oystacher and 3 Red from spoofing or using any manipulative or deceptive devices while trading futures contracts.

In November 2016, the CFTC entered into a consent order issued by the US District Court for the Northern District of Illinois to settle its spoofing and price manipulation case against Navinder Singh Sarao.[5] Sarao had been charged with price manipulation, spoofing and use of a manipulative device in connection with his trading of and submitting bids and offers regarding the E-mini S&P 500 contract on a large number of occasions between April 2010 and April 2015. Among other admissions, Sarao admitted to spoofing and the use of a "dynamic layering" program on May 6, 2010, the day of the Flash Crash. The order requires Sarao to pay a civil penalty of $25.74 million and a disgorgement of $12.87 million. The order imposes permanent trading and registration bans against Sarao and prohibits Sarao from further violations of the CEA and CFTC Regulations. Just prior to entering into the order, Sarao pleaded guilty to one count of spoofing and one count of wire fraud in the same court in a related criminal case brought by the US Department of Justice.

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2 Consent Order of Permanent Injunction, Civil Monetary Penalty, and Other Equitable Relief Against Igor B. Oystacher and 3 Red Trading LLC, *CFTC v. Oystacher*, No. 15-cv-09196 (N.D. Ill. Dec. 20, 2016).

3 Complaint at 2, *CFTC v. Oystacher*, No. 15-cv-09196 (N.D. Ill. Oct. 19, 2015).

4 *Id.*

5 Consent Order of Permanent Injunction, Civil Monetary Penalty, and Other Equitable Relief Against Navinder Singh Sarao, *CFTC v. Sarao*, No. 15-cv-3398 (N.D. Ill. Nov. 14, 2016).

Manipulation

On September 30, 2016, in the case of *CFTC v. Wilson & DRW Investments*, an action brought by the CFTC alleging that the defendant manipulated and attempted to manipulate the settlement price of certain interest rate futures contracts, the US District Court for the Southern District of New York held that in order to establish attempted manipulation, the CFTC must prove that "Defendants had the specific intent to affect market prices that 'did not reflect the legitimate forces of supply and demand.' This means, that there is 'no manipulation without intent to cause artificial prices.'"[6] The CFTC had contended that it could establish intent by showing only that the defendant had an intent to "affect market prices." The court expressly disagreed with this contention, stating that the CFTC "base[d] its position on shorthand language suggesting that the intent standard is merely the intent to affect prices. But it is well established that the intent to create an artificial price is the correct standard."[7] The court held a bench trial in the case in early December; both parties have filed post-trial memorandums and are awaiting the judge's decision.

In 2016, the Commission continued to investigate and impose significant penalties for benchmark manipulation. In May, the CFTC reached settlements with Citibank in two actions alleging attempted manipulation and false reporting relating to the London Interbank Offered Rate (LIBOR), the European Tokyo Interbank Offered Rate (Euroyen TIBOR), and the US Dollar International Swaps and Derivatives Association Fix (USD ISDAFIX) global benchmarks.[8] The CFTC orders alleged that Citibank and its Japanese affiliates engaged in multiple acts of attempted manipulation in violation of Sections 6(c), 6(d) and 9(a)(2) of the CEA and required Citibank and its affiliates to pay a total of $425 million in civil monetary penalties and to undertake remedial steps to improve internal controls and ensure the integrity and reliability of the benchmarks.

In December 2015, the Commission issued a $3.6 million penalty against and imposed a two-year trading limitation on a Houston-based natural gas trading and marketing firm and a trader for their attempts to manipulate the monthly index settlement prices of natural gas at four major trading locations during monthly settlement periods.[9]

Insider Trading

The CFTC brought another insider trading case under Regulation 180.1 for an employee's misappropriation of nonpublic, confidential and material trading information from his employer and using such information to trade for his personal benefit.

In September 2016, the Commission ordered Jon P. Ruggles to pay a $1.75 million penalty and to disgorge more than $3.5 million in ill-gotten profits, and banned him from trading and registration.[10] Ruggles was responsible for developing his employer's fuel-hedging strategies and for executing futures and options trades on NYMEX. In violation of his duties to his employer, Ruggles traded in the same NYMEX products in personal accounts in his wife's name, which he controlled.

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6 Memorandum and Order at 26, *CFTC v. Wilson & DRW Investments*, No. 13-cv-7884 (S.D.N.Y. Sept. 30, 2016) (quoting *In re Amaranth Nat. Gas Commodities Litig.*, 730 F.3d 170, 183 (2d Cir. 2013)).

7 *Id.* at n.14.

8 *In re Citibank, N.A.*, CFTC Docket No. 16-16 (May 25, 2016); *In re Citibank, N.A.; Citibank Japan Ltd.; and Citibank Global Markets Japan Inc.*, CFTC Docket No. 16-17 (May 25, 2016).

9 *In re Total Gas & Power North America, Inc.*, CFTC Docket No. 16-03 (Dec. 7, 2015).

10 *In re Jon P. Ruggles*, CFTC Docket No. 16-34 (Sept. 29, 2016).

The Ruggles order followed the CFTC's first insider trading case under Regulation 180.1 in December 2015. In that case, the Commission ordered Arya Motazedi to pay a civil monetary penalty of $100,000 and restitution of more than $216,000, and banned him from trading and CFTC registration.[11] Motazedi, who was employed as a gasoline futures trader, was charged with breaching his duties to his employer by misappropriating trading information gained from his employment and placing personal orders based on that information ahead of the orders he placed for the company's trading account.

These cases mark a significant development in CEA enforcement. Historically, "insider trading" was not prohibited by the commodities laws. With the adoption of CEA Section 6(c)(1) and CFTC Regulation 180.1, the Commission now has broad-based authority to bring "insider trading" actions based on deceptive conduct, similar to the Securities and Exchange Commission's (SEC's) authority under Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder. Nonetheless, the differences in trading between futures and securities make it unlikely that insider trading enforcement will become a centerpiece of the CFTC's enforcement program as it is for the SEC's.

B. Failures to Register, Illegal Off-Exchange Contracts

Trading or advising clients without proper registration remains a focus of the CFTC's enforcement program, particularly where fraud is involved. Last year, the CFTC targeted several unregistered firms and individuals involved in fraudulent trading schemes.[12]

In September, the Commission filed a civil enforcement action against Jamal Y. Vance and his firm, All City Investments, LLC, in the US District Court for the Southern District of New York. The Commission alleged that Vance and All City fraudulently solicited customers for the purported purpose of trading in off-exchange foreign currency accounts and operated as commodity trading advisors without being registered as such with the CFTC.[13] Vance and All City contest the Commission's allegations, and the matter is currently before Judge Alison J. Nathan.

Also in September, the CFTC filed a complaint in the Southern District of New York against Kevin Michael Symons; his company, FTS Financial, Inc.; and Jerry Austin Simmons, alleging that the defendants fraudulently solicited and sold access to an online futures trading forum.[14] FTS marketed its "Real Time Trade Room" as a way for clients to observe Simmons as he traded futures contracts in "real time"; in reality, Simmons never actually traded any futures contracts in the room. The Commission further alleged that Simmons solicited managed futures accounts but failed to register with the Commission as an associated person of a commodity trading advisor. This matter is still pending before Judge Ronnie Abrams in the Southern District.

In another matter, the CFTC settled charges with Advanced Trading Workshop, Inc. (ATW), for fraudulently soliciting clients to participate in a managed account program and failing to register as a commodity trading advisor as required.[15] ATW was also charged with fraudulently soliciting

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11 *In re Arya Motazedi*, CFTC Docket No. 16-02 (Dec. 2, 2015).

12 In addition, the Commission has issued a number of Fraud Advisories, warning individuals about commodity pool fraud, forex fraud and other trading scams. *See* *CFTC Fraud Advisories*.

13 Complaint for Injunctive and Other Equitable Relief and for Civil Monetary Penalties Pursuant to the Commodity Exchange Act, *CFTC v. All City Investments, LLC*, Case No. 1:16-cv-07372 (S.D.N.Y. Sept. 21, 2016).

14 Complaint for Injunctive and Other Equitable Relief and Civil Monetary Penalties Under the Commodity Exchange Act, *CFTC v. FTS Financial, Inc.*, No. 1:16-cv-07513 (S.D.N.Y. Sept. 26, 2016).

15 *In re Advanced Trading Workshop, Inc.*, CFTC Docket No. 16-31 (Sept. 27, 2016).

clients to purchase access to an online trading room. The CFTC ordered ATW to pay a civil monetary penalty of $470,000 and disgorgement of $470,000.

Finally, the Commission settled charges against Raja Michael Mawad and his firm, RNS Holdings LP, charging them with fraud in connection with operation of a commodity pool.[16] Mawad was charged with withdrawing more than $189,000 from the fund for unauthorized personal and other expenses over a six-year period, none of which were disclosed to pool participants, in violation of Section 4o(1)(B) of the CEA. In addition, RNS was charged with failing to distribute to participants or submit to the National Futures Association (NFA) required annual reports for 2013 and 2014, in violation of Regulation 4.22(c).

C. Trade Practice Violations—Wash Trades, Fictitious Trades, Position Limits, Trading Ahead

The Commission settled charges against Russia-based JSC VTB Bank (VTB) and its affiliate VTB Capital PLC for executing over 100 fictitious block trades in Russian ruble/US dollar futures contracts, with a total notional value of approximately $36 billion, in violation of Sections 4c(a)(1) and (2) of the CEA and Regulation 1.38(a). VTB was charged with not seeking price quotes from unrelated third parties and obtaining from its affiliate pricing that was more favorable than it could have obtained from the broader market. The CFTC found that the block trades were structured to negate market risk and avoid price competition. As a result, VTB and VTB Capital were ordered to pay a $5 million civil monetary penalty.

D. CFTC Whistleblower Program

The CFTC continued to grow its Whistleblower Program in 2016, including by making its largest award to date and by launching a public-facing website, whistleblower.gov, in January. The Whistleblower Program, which was authorized by Section 748 of the Dodd-Frank Act, provides for monetary awards to whistleblowers who voluntarily provide original information to the Commission that results in a successful enforcement action involving sanctions greater than $1 million. Under the program, whistleblowers may receive 10-30 percent of the monetary sanctions collected.

Ten final orders were issued under the Whistleblower Program in 2016. Of these, two granted awards and eight denied awards. In March 2016, the CFTC announced a whistleblower award of more than $10 million, the largest amount awarded by the Commission to date.[17] In July the Commission announced its fourth whistleblower award, in the amount of approximately $50,000.[18]

In September, the CFTC issued a proposed rule to "enhance the process for reviewing whistleblower claims" and clarify various other authorities.[19] The proposed rule also would

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16 *In re RNS Holdings LP*, CFTC Docket No. 16-28 (Sept. 20, 2016).

17 CFTC Whistleblower Award Determination No. 16-WB-06 (Mar. 28, 2016); Press Release, Commodity Futures Trading Comm'n, CFTC Announces Whistleblower Award of More Than $10 Million, PR7351-16 (Apr. 4, 2016).

18 CFTC Whistleblower Award Determination No. 16-WB-08 (July 19, 2016); Press Release, Commodity Futures Trading Comm'n, CFTC Announces Fourth Whistleblower Award, PR7411-16 (July 26, 2016).

19 Press Release, Commodity Futures Trading Comm'n, CFTC Seeks Public Comment on Proposed Whistleblower Rule Amendments, PR7435-16 (Sept. 1, 2016).

reinterpret the Commission's anti-retaliation authority to permit the Commission to bring enforcement actions against any person or entity that retaliates against a whistleblower.[20]

E. Other Enforcement Actions

Conflicts of Interest

In December 2015, JPMorgan Chase Bank, N.A., agreed to settle allegations that it had failed to disclose certain conflicts of interest to its wealth management business clients, in violation of Section 4o(1)(B) of the Act and Regulation 4.41(a)(2).[21] In particular, the Commission alleged that with respect to certain discretionary portfolios, JPMorgan Chase failed to disclose its preference for proprietary hedge funds and mutual funds and failed to disclose its preference for retrocession-paying third-party hedge fund managers.

Reporting and Recordkeeping Violations

Emphasizing that accurate reporting is critical to its surveillance and enforcement programs, the Commission initiated a number of actions against swap dealers, futures commission merchants (FCMs) and companies for various recordkeeping violations.

In the first action of its kind, the Commission in August 2016 brought a federal court action against a swap dealer for failing to comply with the reporting requirements of Parts 43 and 45 of the CFTC Regulations. The Commission filed the complaint in the US District Court for the Southern District of New York against Deutsche Bank AG, charging the firm with a number of swap reporting violations and related supervisory failures.[22] The Commission found that, following a systems outage, Deutsche Bank did not report any swap data for multiple asset classes over a five-day period, and the firm's attempts to rectify its errors created new reporting problems. The Commission further found that the firm failed to have in place an adequate business continuity and disaster recovery plan. In October, at the parties' request, Judge William Pauley appointed an independent monitor to test the adequacy of the firm's swaps reporting systems, assess the adequacy of previously reported data, and recommend improvements to its reporting and supervisory systems.

In December 2016, the CFTC ordered Société Générale SA to pay a $450,000 civil monetary penalty for failing to timely report certain swap transactions, in violation of Parts 43 and 45 of the CFTC Regulations.[23] Specifically, Société Générale was charged with failing to report non-deliverable forwards, FX swaps and FX forwards to a registered swap data repository in a timely manner. The order recognized that Société Générale self-reported the matter, undertook an internal investigation and remediated its reporting failures.

Risk Management and Failure to Supervise

In September 2016, the Commission brought its first action under Regulations 1.11 and 1.73, which impose risk management program and supervision obligations for FCMs and clearing member FCMs, respectively. The CFTC ordered Advantage Futures LLC, an FCM, to pay a $1.5 million civil monetary penalty for failure to diligently supervise the handling of certain

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[20] Whistleblower Awards Process, 81 Fed. Reg. 59551 (Aug. 30, 2016). The Commission stated that this new interpretation would conform the CFTC's anti-retaliation authority with that of the SEC.

[21] *In re JPMorgan Chase Bank, N.A.*, CFTC Docket No. 16-05 (Dec. 18, 2015).

[22] Complaint for Injunctive Relief, Civil Monetary Penalties, and Other Equitable Relief, *CFTC v. Deutsche Bank AG*, No. 1:16-cv-06544 (S.D.N.Y. Aug. 18, 2016).

[23] *In re Société Générale SA*, CFTC Docket No. 17-01 (Dec. 7, 2016).

commodity interest accounts, despite notifications from three exchanges that they had observed an Advantage customer engaging in unlawful trading. The Commission also found that Advantage had deficient risk management and credit risk practices and knowingly made inaccurate statements in its Annual Chief Compliance Officer Report filed with the Commission.[24] Additionally, the Commission charged Advantage's chief executive officer and chief risk officer with supervision failures.

False Statements to the NFA

The Commission continued to bring actions against firms and individuals for making false statements or knowingly providing inaccurate information to regulators. For example, the CFTC found that Edmund Hysni and his firm, Atlantas Group, Inc., willfully made false statements to the NFA in connection with its investigation into the firm's solicitation fraud, in violation of Section 9(a)(4) of the Act.[25]

Retail Commodity Fraud

Last year the Commission continued its long-standing efforts to crack down on fraudulent activity involving the sale of precious metals to retail customers. For example, in August 2016, the CFTC won a fraud trial in the US District Court for the Southern District of Florida against Miami-based Robert Escobio and his companies, Southern Trust Metals, Inc., and Loreley Overseas Corporation.[26] The defendants were found to have falsely told retail customers that they could purchase physical precious metals on a leveraged basis, when, in reality, there were no physical precious metals and no loans. The court ordered the defendants to pay approximately $2.5 million in restitution and penalties, and permanently banned the defendants from trading. The CFTC's complaint alleged violations of Sections 4(a); 4b(a)(2)(A), (B) and (C); 4d; and 6(c) of the CEA, and Regulation 180.1(a).

III. Regulatory Developments

Last year the Commission continued to implement the Dodd-Frank Act and adopted final rules relating to cybersecurity. Its other high-profile regulatory initiative, a modified proposed rule on automated trading, remains pending. Below is an overview of the Commission's key regulatory actions in 2016.

A. Dodd-Frank Act Implementation

Permanent SEF Registrations Granted

In January 2016, the Commission granted registration to 18 swap execution facilities (SEFs) that previously were operating under temporary registration status.[27] The CFTC subsequently

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[24] *In re Advantage Futures LLC*, CFTC Docket No. 16-29 (Sept. 21, 2016).

[25] *In re Atlantas Group, Inc.*, CFTC Docket No. 16-23 (July 14, 2016). In another matter underscoring the importance of full and prompt cooperation with the NFA, last year the NFA issued a complaint against 18-year-old trader Jacob Wohl and his firm, Nex Capital Management LLC, alleging a failure to cooperate promptly and fully with the NFA during an attempted examination, in violation of NFA Compliance Rule 2-5. *In re Nex Capital Management LLC*, NFA Case No. 16-BCC-011 (Aug. 19, 2016).

[26] Final Judgment, *CFTC v. Southern Trust Metals, Inc.*, No. 1:14-cv-22739 (S.D. Fla. Aug. 29, 2016).

[27] Press Release, Commodity Futures Trading Comm'n, CFTC Grants Registration to 18 Swap Execution Facilities, PR7313-16 (Jan. 22, 2016). The Commission approved for registration 360 Trading Networks Inc.; BGC Derivatives Markets, L.P.; Bloomberg SEF LLC; Chicago Mercantile Exchange Inc.; DW SEF LLC; GFI Swaps Exchange LLC; ICAP Global Derivatives Limited; ICAP SEF (US) LLC; ICE Swap Trade, LLC; Javelin SEF, LLC; LatAm SEF, LLC; MarketAxess SEF Corporation; SwapEx, LLC; Thomson Reuters (SEF) LLC; tpSEF Inc.; Tradition SEF, Inc.; trueEX LLC; and TW SEF LLC.

granted registration to a number of additional SEFs throughout the year. As of the date of this alert, there are 23 SEFs fully registered with the Commission.

Final Rule—Margin Requirements for Uncleared Swaps

In January 2016, the Federal Register published the CFTC's final rules regarding both initial and variation margin requirements for uncleared swaps for swap dealers and major swap participants.[28] The rules became effective April 1, 2016.

The final rules apply to covered swap entities (CSEs) (i.e., a swap dealer or major swap participant for which there is no prudential regulator[29]) and financial end users (including, among others, security-based swap dealers and major swap participants). In general, under the final rules, CSEs must collect and post initial margin for swaps with other swap entities, and for swaps with financial end users with "material swaps exposure" of $8 billion.[30] In addition, CSEs must collect and post variation margin each business day with all swap entities and financial end users until the uncleared swap is terminated or expires, in accordance with the means of calculation in CFTC Regulation 23.155.

Consistent with the corresponding compliance dates for the parallel margin requirements adopted by the prudential regulators, the Commission adopted a phased-in implementation schedule with respect to compliance with these margin requirements. As of September 1, 2016, initial margin must be collected where both the CSE with all its affiliates and its counterparty with all its affiliates have an average daily aggregate notional amount of covered swaps for March, April and May of 2016 that exceeds $3 trillion. This threshold decreases to $2.25 trillion on September 1, 2017, and gradually decreases until September 1, 2020, at which point initial margin must be collected with respect to covered swaps with any other covered counterparty. As of September 1, 2016, variation margin must be collected where both the CSE, combined with all its affiliates, and its counterparty, with all its affiliates, have an average daily aggregate notional amount of covered swaps for March, April and May of 2016 that exceeds $3 trillion. Unless the current compliance schedule is modified by the Commission, which appears likely, on March 1, 2017, variation margin must be collected with respect to covered swaps with any other counterparty that is a swap entity or financial end user.

In May 2016, the Commission adopted final rules regarding the cross-border application of the margin requirements for uncleared swaps.[31]

The CFTC's margin rule applies to all uncleared swaps of a US CSE and the swaps of a non-US CSE that are guaranteed by a US person. Substituted compliance is available with respect

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[28] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016).

[29] The term "Prudential Regulator" is defined in CEA Section 1a(39) to include the Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Farm Credit Administration; and the Federal Housing Finance Agency.

[30] "Material swaps exposure" means that an entity and its margin affiliates have an average daily aggregate notional amount of uncleared swaps, uncleared security-based swaps, foreign exchange forwards and foreign exchange swaps with all counterparties for June, July and August of the previous calendar year that exceeds $8 billion, where such amount is calculated only for business days. An entity shall count the average daily aggregate notional amount of an uncleared swap, an uncleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and a margin affiliate only one time. The calculation does not include exempt swaps or security-based swaps. *See* 17 C.F.R. §23.151.

[31] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements, 81 Fed. Reg. 34818 (May 31, 2016). *See also* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements, 80 Fed. Reg. 41376 (July 14, 2015).

to initial margin posted to (but not collected from) any non-US counterparty (including a non-US CSE) whose obligations under the uncleared swap are not guaranteed by a US person. The margin requirements do not apply to an uncleared swap entered into by a non-US CSE, where neither of the counterparties' obligations are guaranteed by a US person and neither counterparty is a US branch of a non-US CSE or a foreign consolidated subsidiary (FCS, i.e., a non-US CSE whose financial statements are included in those of a US ultimate parent entity).[32] The final rules set forth a process for requesting comparability determinations for substituted compliance. Generally, the CFTC's cross-border rules are similar to the cross-border margin requirements adopted by the prudential regulators in their rulemaking for margin for uncleared swaps.

The cross-border rules also define "US person" by regulation. This regulatory definition is largely based on the territorial approach to the definition of US person earlier set forth in the Commission's cross-border guidance.[33] One significant difference is that the definition in the rule does not include a collective investment vehicle that is more than 50 percent owned by US persons. In addition, to provide legal certainty, the definition in the rule does not include the catch-all prefatory phrase "includes, but is not limited to" that had been included in the guidance.

Proposed Rule—Arrange, Negotiate, Execute

In October 2016, the Commission proposed rules regarding the cross-border application of certain swap provisions.[34] As a preliminary matter, the proposal defines the terms "US person" and "foreign consolidated subsidiary" consistent with the definition adopted in the Cross-Border Margin Rule. The proposal sets forth the Commission's view that persons engaged in swap transactions that are arranged, negotiated or executed using personnel located in the United States (i.e., ANE transactions) would fall within the scope of the Dodd-Frank Act. The Commission interprets the terms "arrange" and "negotiate" to refer to "market-facing activity normally associated with sales and trading, as opposed to internal, back-office activities, such as ministerial or clerical tasks," and the term "executed" to refer to "the market-facing act of becoming legally and irrevocably bound to the terms of the transaction under applicable law."[35]

The proposed rule also addresses when a potential swap dealer should include its cross-border dealing activities in making its de minimis threshold determination under Regulation 1.3(ggg)(4). In sum, a US person or FCS "would include all of its swap dealing transactions," a non-US person "would include all swap dealing transactions with respect to which it is a US Guaranteed Entity," and a non-US person who is neither an FCS nor a US guaranteed entity (other non-US Person) "would include all of its swap dealing transactions with counterparties that are US persons, US guaranteed entities, or FCSs, unless the swap is executed anonymously on a registered SEF, DCM or FBOT and cleared."[36] Finally, the proposed rule addresses the cross-border application of external business conduct standards for swap dealers and major swap participants.[37]

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[32] This exclusion does not apply if the risk from the trade is transferred to a US CSE or a non-US CSE guaranteed by a US person through inter-affiliate trades and the market-facing trade is not subject to comparable margin collection requirements in its home jurisdiction.

[33] Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45292 (July 26, 2013).

[34] Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, 81 Fed. Reg. 71946 (Oct. 18, 2016).

[35] *Id.* at 71953.

[36] *Id.* at 71957.

[37] *See id.* at 71961.

Proposed Rule—Capital Requirements for Swap Dealers and MSPs

In December 2016, the CFTC proposed rules establishing minimum capital requirements for swap dealers and major swap participants not subject to the capital rules of a prudential regulator (i.e., CSEs).[38] Broadly speaking, depending on the characteristics of the registered entity, the proposal sets forth three approaches. First, the *bank-based capital approach* would permit swap dealers to elect a capital requirement based on capital rules adopted by the Federal Reserve Board for bank holding companies. Second, the *net liquid assets capital approach* would permit swap dealers to elect a capital requirement based on existing and proposed rules governing FCMs, broker-dealers and security-based swap dealers. Third, the *tangible net worth capital approach* would permit swap dealers that meet certain conditions evidencing that they are "predominantly engaged in nonfinancial activities" to calculate their capital requirement based on the firms' tangible net worth.[39]

Under the proposed rule, a covered swap entity may apply to the Commission or to the NFA for approval of internal credit risk and market risk models for purposes of calculating its regulatory capital.[40]

Extension of Swap Dealer Registration De Minimis Exception

In October 2016, the Commission extended the swap dealer registration de minimis threshold phase-in termination date to December 31, 2018.[41] The de minimis exception in Regulation 1.3(ggg)(4) provides that a person shall not be deemed a swap dealer until its swap dealing activity exceeds an aggregate gross notional amount of $3 billion over the course of the immediately preceding 12 months, subject to a phase-in level of $8 billion. Absent Commission action, the phase-in period would have expired on December 31, 2017. The Commission noted that a one-year delay would allow for more information to become available to consider this issue and would provide "clarity to market participants regarding when they would need to begin preparing for a change to the de minimis exception."[42]

Final Rule—Expansion of Interest Rate Swaps Subject to Mandatory Clearing

In September 2016, the Commission expanded and amended its existing clearing requirement for interest rate swaps under Regulation 50.4(a).[43] Under Regulation 50.4(a), interest rate swaps denominated in certain currencies and having certain termination dates must be submitted for clearing to a registered or an exempt derivatives clearing organization. Previously, the rule applied to interest rate swaps denominated in the US dollar, the euro, the British pound sterling and the Japanese yen. The amended rule expands the requirement to include interest rate swaps denominated in nine additional currencies: Australian dollar (AUD), Canadian dollar (CAD), Hong Kong dollar (HKD), Mexican peso (MXN), Norwegian krone (NOK), Polish zloty (PLN), Singapore dollar (SGD), Swedish krona (SEK) and Swiss franc (CHF).

Specifically, the CFTC's amendments to Regulation 50.4(a) include "(i) [a]dding fixed-to-floating interest rate swaps denominated in the nine additional currencies; (ii) adding AUD-denominated

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38 Capital Requirements of Swap Dealers and Major Swap Participants, 81 Fed. Reg. 91252 (Dec. 16, 2016).

39 *Id.* at 91254.

40 *Id.* at 91269.

41 Order Establishing De Minimis Threshold Phase-In Termination Date, 81 Fed. Reg. 71605 (Oct. 18, 2016).

42 *Id.* at 71606.

43 Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps, 81 Fed. Reg. 71202 (Oct. 14, 2016).

basis swaps; (iii) adding NOK-, PLN-, and SEK-denominated [forward rate agreements]; (iv) changing the maximum stated termination date for USD-, GBP-, and EUR-denominated OIS to three years from two years; and (v) adding AUD- and CAD-denominated OIS."[44] The adopting release sets forth projected compliance dates for each of the impacted products.[45]

Final Rule—Aggregation of Positions

In December 2016, in connection with its position limits vote, the CFTC adopted a final rule amending Part 150 of its Regulations regarding aggregation of positions for futures and option contracts on nine agricultural commodities.[46] The final rule will require aggregation of all positions in accounts or entities for which a person directly or indirectly controls trading or holds a 10 percent or greater ownership or equity interest. The rule also will require aggregation when a person holds or controls the trading of positions in more than one account or pool with substantially identical trading strategies. The final rule preserves the current exemptions from aggregation and creates several new exemptions, including where (1) the ownership is based on broker-dealer activities in the normal course of business as a dealer; (2) the sharing of information associated with such aggregation creates a reasonable risk of violating state, federal or foreign laws or regulations; and (3) the ownership interest is 10 percent or greater in an entity whose trading is independently controlled (owned-entity exemption).[47] The final rule will become effective on February 14, 2017.

Reproposed Rule—Position Limits

In December 2016, the Commission extended its long-standing position limits rulemaking by reproposing speculative position limits for 25 exempt and agricultural commodity futures and option contracts, as well as physical commodity swaps that are "economically equivalent" to such contracts.[48] In addition, the Commission reproposed the definition of a "bona fide hedging" exemption and reproposed exemptions for preexisting positions that are established in good faith prior to the effective date of the final rule.

The Commission's decision to repropose the rule will leave the rule's outcome to a Commission that is ultimately constituted during the Trump Administration. Noting that the Commission "is now in a time of transition," Former Chairman Timothy Massad explained that he did not want "to adopt a final rule today that the Commission would choose not to implement or defend next year."[49]

B. Regulation Automated Trading

On November 3, 2016, the CFTC, by a vote of 2 to 1, introduced revisions to proposed Regulation Automated Trading (Reg AT).[50] Reg AT, which was initially proposed in December

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44 *Id.* at 71226.

45 *Id.* at 71230.

46 Aggregation of Positions, 81 Fed. Reg. 91454 (Dec. 16, 2016).

47 Under the final rule, notice-filing is required for certain of the exemptions, including the owned-entity exemption, the exemption for accounts held by FCMs, the independent account controller exemption and the exemption for the information sharing restriction.

48 Position Limits for Derivatives; Reproposal (Dec. 15, 2016).

49 Statement of Chairman Timothy Massad Regarding Proposed Rule on Position Limits for Derivatives (Dec. 5, 2016).

50 Regulation Automated Trading, Supplemental Notice of Proposed Rulemaking, 81 Fed. Reg. 85334 (Nov. 25, 2016).

2015,[51] seeks to empower the Commission to engage in adequate surveillance of modern markets and to minimize the risk of disruption caused by automated trading. The modifications would impose greater process requirements on the Commission in obtaining access to algorithmic trading source code, reduce necessary risk controls from three levels to two, introduce a minimum volume threshold to the "AT Person" definition and substitute a certification for the previously proposed annual report.

As initially proposed, Reg AT required that algorithmic trading source code be preserved and made available to the Commission in accordance with the Commission's general recordkeeping requirements. Market participants expressed serious concerns regarding the confidentiality and security of such commercially sensitive data. Many commenters reasoned that proprietary source code is, and should remain, available to the Commission only through the subpoena process, expressing concern that source code obtained using more casual procedures and stored on government servers would be vulnerable to cyberattack.[52] In response, the Supplemental Proposal provides that CFTC access to algorithmic trading source code would require either (1) a subpoena or (2) a "special call" approved by the Commission itself. The Supplemental Proposal notes that the Commission is legally obligated to protect confidential information and has data security measures in place to protect sensitive information.

As the 2-1 vote of the Commission indicates, the provisions relating to Commission access to source code remain quite controversial. Commissioner J. Christopher Giancarlo, the now acting chairman, strongly opposed the revised provision, expressing concerns regarding due process and the ability of the Commission to maintain the confidentiality of the information.[53] It is highly likely that the proposed regulation will be further revised before final consideration by the Commission.

C. Cybersecurity/System Safeguards Testing Requirements

In September 2016, the CFTC adopted amendments to its system safeguards rules for designated contract markets, swap execution facilities, swap data repositories and derivatives clearing organizations.[54]

The final rules require designated contract markets, SEFs, swap data repositories and derivatives clearing organizations to conduct five specific types of cybersecurity testing: (1) vulnerability testing, (2) external and internal penetration testing, (3) controls testing, (4) security incident response plan testing and (5) enterprise technology risk assessments. Certain tests must be conducted by independent contractors.

Under the rules, system safeguards testing and assessment must be broad enough to include all testing of automated systems, networks and controls necessary to identify any vulnerability that could enable an intruder or unauthorized user or insider to interfere with the entity's operations or with fulfillment of the entity's statutory and regulatory responsibilities; impair or degrade the reliability, security or adequate scalable capacity of the entity's automated systems;

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51 Regulation Automated Trading, Proposed Rule, 80 Fed. Reg. 78824 (Dec. 17, 2015).

52 For a more detailed description of the proposal and discussion of the issues therein, please see WilmerHale's client alert "CFTC Revises Proposed Reg AT" (Nov. 9, 2016). For a summary of concerns regarding the source code provision, see Opening Statement of Commissioner J. Christopher Giancarlo before the CFTC Staff Roundtable on Regulation Automated Trading (June 10, 2016).

53 *See* Statement of Dissent by Commissioner J. Christopher Giancarlo Regarding Supplemental Notice of Proposed Rulemaking on Regulation Automated Trading (Nov. 4, 2016).

54 System Safeguards Testing Requirements, 81 Fed. Reg. 64272 (Sept. 19, 2016); System Safeguards Testing Requirements for Derivatives Clearing Organizations, 81 Fed. Reg. 64322 (Sept. 19, 2016).

add to, delete, modify, exfiltrate or compromise the integrity of any data related to the entity's regulated activities; or undertake any other unauthorized action affecting the entity's regulated activities or the hardware or software used in connection with those activities.

IV. Looking Forward: 2017

Currently, there are only three CFTC commissioners. Former Chairman Massad stepped down as chairman on January 20, 2017, and has indicated that he will remain as a commissioner for a short period of time. Accordingly, President Trump will have the opportunity to fill the chair's position and three vacancies on the Commission, subject to Senate confirmation.

Commissioner Giancarlo, who was chosen to serve as acting chairman upon the end of Chairman Massad's service, has been reported to be a leading choice for chairman. His priorities likely will include a general focus on ensuring American markets do not face a competitive disadvantage globally, and a specific focus on revising the SEF rules and on automated trading, financial technology and digital innovation in both the swaps and futures markets. On January 18, 2017, he delivered a speech announcing his "Making Market Reform Work for America" agenda, in which he outlined five key elements of that plan:[55]

(1) Providing Customer Choice in Trade Execution—Commissioner Giancarlo criticized the CFTC's "flawed swaps trading regime," and announced that he intends to move forward with the alternative swaps trading regulatory framework he proposed in his 2015 white paper.[56] He argued that his proposal "will better align regulatory oversight with inherent swaps market dynamics."

(2) Fixing Swaps Data Reporting—Commissioner Giancarlo said that "[o]f all the many mandates to emerge from the financial crisis . . . failure to accomplish [transparency into swaps counterparty exposure of major financial institutions] is certainly the most disappointing." He said he would redouble the Commission's efforts to achieve full visibility into swaps counterparty exposure, and that he will have "more to say about such initiatives" in the coming months.

(3) Achieving Cross-Border Harmonization—Commissioner Giancarlo faulted the CFTC's cross-border approach as "over-expansive, unduly complex and operationally impractical," and argued that we "cannot expect to achieve cross-border harmonization if we continue to follow an identical, rule-by-rule substituted compliance analysis." He plans to define the limits on cross-border application of US swaps rules "in a way that invites international comity, rather than demands international uniformity." Additionally, he noted that the March 1, 2017, variation margin deadline for unclear swaps is "unrealistic," and announced that he intends "to look at solutions to ease the March 1st transition in a responsible manner."

(4) Encouraging FinTech Innovation—Commissioner Giancarlo said that he will make fintech a priority at the CFTC and urged a "do no harm" approach to technology. He argued that US financial regulators are falling behind their foreign counterparts in promoting fintech, and warned against "impeding essential [digital ledger technology] innovation by protracted rule uncertainty or uncoordinated actions."

(5) Cultivating a Regulatory Culture of Forward Thinking—Finally, Commissioner Giancarlo argued that market regulation by the CFTC has not kept pace with the "enormous changes

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55 Address of CFTC Commissioner J. Christopher Giancarlo Before SEFCON VII, "Making Market Reform Work for America" (Jan. 18, 2017).

56 Commissioner J. Christopher Giancarlo, Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank, White Paper (Jan. 29, 2015).

taking place in global trading markets." He said he plans to move ahead with the "forward-looking, twenty-first century agenda" he laid out in his September 2016 speech to the American Enterprise Institute.[57] In particular, he announced that he plans to extend beyond January 24, 2017, the comment period for the supplemental notice of proposed rulemaking for Reg AT.

Acting Chairman Giancarlo's comments presage a significant shift in the priorities and goals of the Commission during the Trump Administration. In addition, Congress will play an important role in setting the agenda for the Commission.

On January 12, 2017, the House of Representatives passed the Commodity End-User Relief Act (H.R. 238), a bill reauthorizing the CFTC.[58] The bill would freeze the Commission's budget at its current level, $250 million, from FY2017 through FY2021, as opposed to the $330 million the CFTC had requested for FY2017. The bill contains four titles, one of which addresses mainly the Dodd-Frank-related sections of the CEA.

H.R. 238 is substantially similar to the CFTC reauthorization legislation passed by the House in the last congressional session (H.R. 2289). The Senate's prior CFTC reauthorization bill stalled in the 114th Congress, largely due to the likelihood of a veto by President Obama. In this Congress, reauthorization legislation is much more likely to be considered by the Senate. Although it is too early to predict which provisions will survive to be included in the final bill, a full reversal of the core provisions of the Dodd-Frank Act appears to be unlikely. Nevertheless, in light of the unified government, it is likely that reauthorization will occur during the 115th Congress and that the reauthorization statute will roll back a number of Dodd-Frank Act provisions.

V. Conclusion

There is significant uncertainty surrounding the work of the CFTC in 2017. Although we believe that the Commission will continue to aggressively pursue violations of core CEA requirements, at this time it is unclear how expansive the Commission's enforcement agenda will be with respect to certain of the newer Dodd-Frank requirements. For his part, Acting Chairman Giancarlo recently expressed his view that "[w]e must imbue our regulatory agencies with an institutional culture that is concerned for the overall durability, vibrancy and healthy functioning of American markets and not just with enforcing rules against market manipulation."[59] As we have noted, the reauthorization legislation, in addition to the regulatory agenda of Acting Chairman Giancarlo, suggests that we should expect significant changes in the tone and direction of the Commission as well as in the overall regulatory framework.

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57 Address of CFTC Commissioner J. Christopher Giancarlo to the American Enterprise Institute, "21st Century Markets Need 21st Century Regulation" (Sept. 21, 2016).

58 Commodity End-User Relief Act, H.R. 238, 115th Cong. (1st Sess. 2017).

59 Address of CFTC Commissioner J. Christopher Giancarlo to the American Enterprise Institute, "21st Century Markets Need 21st Century Regulation" (Sept. 21, 2016).

FOR MORE INFORMATION ON THIS OR OTHER FUTURES AND DERIVATIVES MATTERS, CONTACT:

Paul M. Architzel +1 202 663 6240 paul.architzel@wilmerhale.com

Dan M. Berkovitz +1 202 663 6352 dan.berkovitz@wilmerhale.com

Jeannette K. Boot +1 212 295 6507 jeannette.boot@wilmerhale.com

Douglas J. Davison +1 202 663 6690 douglas.davison@wilmerhale.com

Elizabeth Mitchell +1 202 663 6426 elizabeth.mitchell@wilmerhale.com

Anjan Sahni +1 212 937 7418 anjan.sahni@wilmerhale.com

Dino Wu +1 212 295 6436 dino.wu@wilmerhale.com

Gail C. Bernstein +1 202 663 6155 gail.bernstein@wilmerhale.com

Matthew Beville + 1 202 663 6255 matthew.beville@wilmerhale.com

Daniel J. Martin +1 202 663 6469 daniel.martin@wilmerhale.com

Aaron Friedman +1 202 663 6603 aaron.friedman@wilmerhale.com