

CFTC 2017 Year-in-Review and a Look Forward

February 27, 2018

Paul Architzel, Partner

Anjan Sahni, Partner

Petal Walker, Special Counsel





Speakers



Paul Architzel, Partner



Anjan Sahni, Partner



Petal Walker, Special Counsel



Webinar Guidelines

- Participants are in listen-only mode
- Submit questions via the Q&A box on the bottom right panel
- Questions will be answered as time permits
- Offering 1.0 CLE credit in California and New York*
- WebEx customer support: +1 888 447 1119, press 2

**WilmerHale has been accredited by the New York State and California State Continuing Legal Education Boards as a provider of continuing legal education. This program is being planned with the intention to offer CLE credit in California and non-transitional CLE credit in New York. This program, therefore, is being planned with the intention to offer CLE credit for experienced New York attorneys only. Attendees of this program may be able to claim England & Wales CPD for this program. WilmerHale is not an accredited provider of Virginia CLE, but we will apply for Virginia CLE credit if requested. The type and amount of credit awarded will be determined solely by the Virginia CLE Board. Attendees requesting CLE credit must attend the entire program.*



Agenda

- **CFTC Enforcement Developments**
 - Chairman Giancarlo's Enforcement Agenda
 - Current Cooperation Regime at CFTC
 - Non-Prosecution Agreements
 - Notable Enforcement Cases
- **CFTC Regulatory Developments**
 - Chairman Giancarlo's Regulatory Agenda
 - Virtual Currencies
 - Project KISS
 - Final Rules
 - Pending Rules



CFTC ENFORCEMENT DEVELOPMENTS



Chairman Giancarlo's Enforcement Agenda

“Let me take this moment to warn those who may seek to cheat or manipulate our markets: you will face aggressive and assertive enforcement action by the CFTC under the Trump Administration. **There will be no pause, let up or reduction in our duty to enforce the law and punish wrongdoing in our derivatives markets.**”

- J. Christopher Giancarlo, Chairman, CFTC, Remarks before the 42nd Annual International Futures Industry Conference in Boca Raton, FL, “CFTC: A New Direction Forward” (March 15, 2017)



Chairman Giancarlo's Enforcement Agenda

- In March 2017, Chairman Giancarlo appointed **James McDonald**, a former prosecutor in the Southern District of New York, as Director of the Agency's Enforcement Division.
- Also in March, Chairman Giancarlo relocated the **Surveillance Branch**, previously housed in the Division of Market Oversight, to the **Enforcement Division**. This change means that the surveillance and enforcement functions at the Commission will be much more closely coordinated in their approach to detecting and prosecuting fraud and manipulation.

Current Cooperation Regime at CFTC

- January 2017: Enforcement Advisories on Cooperation
- September 2017: Updated Advisory on Self-Reporting and Full Cooperation
- Illustrative Cases

Current Cooperation Regime at CFTC

January 2017: Enforcement Advisories on Cooperation

- In January 2017, the Division issued revised cooperation credit guidelines for companies, as well as its first cooperation credit guidelines for individuals.
- The Advisories list four factors that the CFTC will consider in evaluating cooperation in investigations and enforcement actions:
 - the value of the cooperation to the Division's investigation(s) and enforcement action(s);
 - the value of the cooperation to the Commission's broader law enforcement interests;
 - the culpability of the company or individual and other relevant factors; and
 - uncooperative conduct that offsets or limits credit that the company or individual would otherwise receive.

Current Cooperation Regime at CFTC

September 2017: Updated Advisory on Self-Reporting and Full Cooperation

- The Updated Advisory outlines three requirements for full self-reporting and cooperation credit:
 - voluntary disclosure of misconduct to the Division,
 - full cooperation during an investigation, and
 - timely and appropriate remediation of flaws in compliance and control programs.
- If the company or individual self-reports, fully cooperates, and remediates, the Division “will recommend the most substantial reduction in the civil monetary penalty that otherwise would be applicable.” In extraordinary circumstances, the Division may recommend a declination of prosecution.

Current Cooperation Regime at CFTC

Illustrative Cases

- *In the Matter of David Liew*, CFTC Docket No. 17-14 (June 2, 2017)
 - “[T]he Commission recognizes Liew’s cooperation . . . including his entry into a formal Cooperation Agreement . . . with the Division, his provision of substantial assistance to the investigation and his undertaking to continue to cooperate.”
- *In the Matter of Tokyo-Mitsubishi Ltd.*, CFTC Docket No. 17-21 (August 7, 2017)
 - The Firm “promptly self-reported the misconduct and proactively implemented large-scale remedial measures and process improvements to deter and detect similar misconduct.”



Non-Prosecution Agreements

- In June 2017, the Commission entered into its first non-prosecution agreements with three traders who admitted to spoofing in US Treasury futures while trading for a large FCM and provisionally registered SD.
- Director McDonald commented:
 - “I am pleased to announce the first non-prosecution agreements entered into by the Commission, **which I expect will be an important part of the Division’s cooperation program going forward.** Non-prosecution agreements like these give the Division a **powerful tool** to reward extraordinary cooperation in the right cases, while providing individuals and organizations **strong incentives** to promptly accept responsibility for their wrongdoing and cooperate with the Division’s investigation.”



Notable Enforcement Cases

Spoofing

- *US v. Coscia*, Case No. 16-3017 (7th Cir., August 7, 2017)
 - The Seventh Circuit rejected the appeal of Michael Coscia, who was sentenced in July 2016 to three years in prison and two years of supervised release for spoofing and commodities fraud.
 - In 2013, Coscia and his trading firm had entered into a settlement order with CFTC, providing for a \$1.4 million civil penalty and the disgorgement of \$1.4 million in profits for spoofing violations.
 - Coscia appealed, arguing, in part, that the anti-spoofing statute is void for vagueness.
 - The Seventh Circuit affirmed the judgment of the District Court: “The anti-spoofing provision provides clear notice and does not allow for arbitrary enforcement. Consequently, it is not unconstitutionally vague.”



Notable Enforcement Cases

Trade Practice Violations—Wash Trades

- *In the Matter of Copersucar Trading A.V.V.*, CFTC Docket No. 17-22 (August 15, 2017)
- *In the Matter of Rosenthal Collins Capital Markets LLC*, CFTC Docket No. 17-17 (June 29, 2017)

Recordkeeping

- *In the Matter of Ikon Global Markets, Inc.*, CFTC Docket No. 17-23 (August 31, 2017)



Notable Enforcement Cases

New Focus—Cryptocurrency

- *CFTC v. Gelfman Blueprint, Inc. and Nicolas Gelfman*, No. 17-7181 (S.D.N.Y. September 21, 2017)
- *CFTC v. Dillon Michael Dean and The Entrepreneurs Headquarters Limited*, No. 18-cv-00345 (E.D.N.Y. January 18, 2018)
- *CFTC v. My Big Coin Pay, Inc., Randall Crater, and Mark Gillespie*, No. 18-10077-RWZ (D. Mass. January 24, 2018)



CFTC REGULATORY DEVELOPMENTS



CFTC Regulatory Developments

- Chairman Giancarlo's Regulatory Agenda
 - Cross-Border Harmonization
- Virtual Currencies
- Project KISS
- Final Rules
- Pending Rules

Chairman Giancarlo's Regulatory Agenda

In a January 2017 keynote address before the SEFCON VII conference, Acting Chairman Giancarlo outlined the five key elements of his “Making Market Reform Work for America” agenda:

- Providing Customer Choice in Trade Execution
- Fixing Swaps Data Reporting
- Achieving Cross-Border Harmonization
- Encouraging FinTech Innovation
- Cultivating a Regulatory Culture of Forward Thinking



Chairman Giancarlo's Regulatory Agenda

Providing Customer Choice in Trade Execution

- Chairman Giancarlo criticized the CFTC's "flawed swaps trading regime" and announced that he intends to move forward with the alternative swaps trading regulatory framework outlined in his 2015 white paper. He argued that his proposal "will better align regulatory oversight with inherent swaps market dynamics."
- To date, the CFTC has not yet proposed amendments to SEF rules.

Fixing Swaps Data Reporting

- Chairman 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.
- In July, DMO announced plans to review swap data reporting rules. DMO is reviewing Parts 43 (Real-Time Public Reporting), 45 (Swap Data Recordkeeping and Reporting Requirements) and 49 (SDRs).



Chairman Giancarlo's Regulatory Agenda

Achieving Cross-Border Harmonization

- In his remarks at SEFCON VII (January 2017), Chairman Giancarlo:
 - Faulted the CFTC's cross-border approach as "over-expansive, unduly complex and operationally impractical."
 - Argued that we "cannot expect to achieve cross-border harmonization if we continue to follow an identical, rule-by-rule substituted compliance analysis."
 - Said 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."



Cross-Border Harmonization – MiFID Equivalence

October 2017 – CFTC and EC agreed to Common Approach

December 2017 – CFTC issued an Order of Exemption

- Exempted 10 MTFs and 6 OTFs from SEF registration
- US persons can execute mandatory / non-mandatory swaps on these
- Other requirements still apply:
 - E.g., reporting and ECP status
 - **Mandatory** swaps → DCO or Exempt DCO
 - Non-Mandatory **Proprietary** swaps → DCO or Exempt DCO
 - All **Customer** swaps → through FCM & by a DCO
- Can “modify, condition, suspend, terminate,” with notice, at will

December 2017 – EC implemented a Decision

- Recognized as equivalent 14 DCMs and 23 SEFs
- EU persons that have a trading obligation can trade on these
- EC should “monitor[] on a regular basis” US regime
- “Possibility” of “re-assess[ing]” equivalence and “repeal[ing]” it



Cross-Border Harmonization – CCP Recognition

Feb 2016 – CFTC and EC agreed to Common Approach

March 2016 – CFTC issued a Comparability Determination

- Main EMIR provisions are comparable to and comprehensive as CFTC requirements
- Issued no-action providing limited relief from the application of CFTC regulations to discrete aspects of CCPs' non-US clearing activities
- Streamlined the registration process for non-US CCPs

March 2016 – EC implemented a Decision

- Regulation of SIDCOs and Subpart C DCOs are equivalent to EMIR
- But CCPs' internal rules must additionally reflect:
 - 2-day liquidation period for IM for proprietary positions
 - Procyclicality provisions
 - CCP can withstand default of 2 largest clearing members
 - Exception for US agricultural products
- EU persons can clear on these / CCPs attain QCCP status
- ESMA then had to recognize CCPs; ESMA has recognized 5 US CCPs



CCP Cross-Border: Growing Tension

Written Testimony of Chairman J. Christopher Giancarlo before the Senate Agriculture Committee (February 15, 2018)

- **Current agreement is appropriate**
 - “The 2016 equivalence agreement is built upon the principle of regulatory and supervisory deference.”
- **Concerned about Brexit discussions’ implication for US CCPs**
 - “[T]here are some indications that the European Commission views the UK’s decision to exit the EU as a basis to vitiate the agreement. It appears that some EU policymakers want to go back to the negotiating table.”
 - “There appears to be an expectation that the CFTC should be prepared to renegotiate many of the same issues covered by the existing agreement, but with new people and new authorities.”



CCP Cross-Border: Growing Tension

- **Clear statement that US does not plan to renegotiate**
 - “The United States will not be put into this position. We honor our commitments and expect others to do the same.”
 - “The CFTC negotiated the 2016 equivalence agreement in good faith. **A deal is a deal.**”
 - “While we appreciate the EU’s need to address the ramifications of Brexit, the US and its markets must not be its **collateral damage.**”
 - “When it comes to US CCPs, we insist that the parties stay true to the terms of the 2016 equivalence agreement, give **proper assurances that US CCPs will not be treated differently than they are now**, and pledge support for deference as the governing principle for how we regulate and supervise each other’s CCPs today and in the future.”



Chairman Giancarlo's Regulatory Agenda

Encouraging FinTech Innovation

- Chairman 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.”
- On May 17, 2017, the CFTC launched LabCFTC to promote the CFTC's understanding of new technologies.
- In his February 15, 2018 testimony before the Senate Ag Committee, Chairman Giancarlo was very supportive of innovation.

Cultivating a Regulatory Culture of Forward Thinking

- Chairman Giancarlo argued that market regulation by the CFTC has not kept pace with the “enormous changes 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.



Virtual Currencies – Guidance

LabCFTC Primer on Virtual Currencies (October 2017)

- CFTC has jurisdiction when a virtual currency is used in a derivatives contract, or when there is fraud or manipulation involving a virtual currency traded in interstate commerce.
- Aside from instances of fraud or manipulation, the CFTC is generally not involved with cash market exchanges and transactions concerning virtual currencies that do not utilize margin, leverage, or financing.
- **Examples of Prohibited Activities:**
 - Price manipulation of virtual currencies traded in interstate commerce.
 - Pre-arranged or wash trading in an exchange-traded virtual currency swap or futures contract.
 - A virtual currency futures or option contract or swap traded on a domestic platform or facility that has not registered with the CFTC as a SEF or DCM.
 - Certain schemes involving virtual currency marketed to retail customers, such as off-exchange financed commodity transactions with persons who fail to register with the CFTC.



Virtual Currencies – Guidance

Customer Advisory: Understand the Risks of Virtual Currency Trading (December 2017)

- Issued to “inform the public about the risks associated with investing or speculating in virtual currencies or recently launched Bitcoin futures and options.”
- Risks associated with virtual currency:
 - Most cash markets are not regulated or supervised by a government agency;
 - Platforms in cash markets may lack system safeguards;
 - Volatile cash market;
 - Cash market manipulation;
 - Cyber risks; and
 - Platforms selling from their own accounts and putting customers at an unfair disadvantage.

Virtual Currencies – Bitcoin Contracts

- In December 2017, the Chicago Mercantile Exchange, Inc. (CME) and the CBOE Futures Exchange (CFE) self-certified new contracts for Bitcoin futures products and the Cantor Exchange self-certified a new contract for Bitcoin binary options.
- The CFTC has engaged in a “heightened review” with the Designated Contract Markets (DCMs) and have collaborated through several drafts of the terms and conditions of Bitcoin futures products.
- Recent meetings of the Market Risk Advisory Committee (MRAC) and the Technology Advisory Committee (TAC) have been devoted to Bitcoin contracts.



Project KISS

- In March 2017, Chairman Giancarlo announced Project KISS (“Keep It Simple, Stupid”)—an agency-wide review of rules, regulations, and practices to make them “**simpler, less burdensome, and less costly.**”
 - Project KISS is a response in part to Executive Order 13777, which directed federal agencies to designate a Regulatory Reform Officer, establish a Regulatory Reform Task Force, and take other measures to reduce regulatory burden.
- In November 2017, Regulatory Reform Officer Michael Gill announced that the Commission had received more than 40 comments and that it was “actively reviewing the submissions.”
- First output of Project KISS:
 - **Definitions, Interim Final Rule, 83 Fed. Reg. 7979 (February 23, 2018)**



Final Rules

1. Recordkeeping
2. Anti-Retaliation Protections for Whistleblowers & Enhancements to the Award Claims Review Process



Final Rules – Recordkeeping

- In May 2017, the CFTC adopted amendments to Rule 1.31 (Books and Records, Keeping and Inspection), which include the most significant changes to the Commission’s recordkeeping rules since 1999:
 - Defines the term “regulatory records”;
 - Eliminates the requirement that records entities store regulatory records in their “native file format” and in a non-rewritable, non-erasable format (*i.e.*, the “WORM” requirement);
 - Eliminates the requirement to retain a third-party technical consultant to file certain representations with the Commission;
 - Shortens the retention period for pre-trade communications for swaps and forwards to five years from the date the communication was created (rather than the duration of the swap +5 years); and
 - Eliminates the requirement to maintain the “chain of custody elements” of any electronic regulatory records.



Pending Rules

1. Capital Requirements for SDs and MSPs
2. De Minimis Level

Pending Rules – Capital Requirements

Three approaches to allow firms to meet capital requirements:

- An approach based on bank capital requirements that would be available to SDs that are subsidiaries of a bank holding company and thus subject to BHC capital requirements;
- An approach modeled after the SEC’s capital requirements; and
- A “tangible net worth” approach limited to commercial entities that are “predominantly engaged in nonfinancial activities” (15% test).

Chairman Giancarlo has expressed concerns regarding:

- The rule’s effect on smaller SDs and how much additional capital they may have to raise;
- The broad scope of the proposal; and
- The proposed capital model review and approval process.



Pending Rules – *De Minimis* Level

- In October 2017, the CFTC issued an Order establishing a new *de minimis* threshold phase-in termination date of December 31, 2019.
 - So, the threshold stays at \$8 billion until end of 2019.
 - (Which really means January 1, 2019, since calculating the notional requires a 12-month lookback.)
 - Without the extension, the threshold would have decreased to \$3 billion on December 31, 2018.
- Reasons given for the 1-year extension in the Order:
 - Insufficient data;
 - CFTC should have sufficient data “in the near future”;
 - Firms reducing dealing activity in 2018 to meet possible \$3 billion could lead to reduced liquidity, efficiency, etc.;
 - Time for Commissioners and DSIO director to get up to speed.

Chairman's Remarks on Market Sizing

Remarks of Chairman Giancarlo at Derivcon 2018 (February 1, 2018)

- “Notional value” is not an accurate measure of swap markets.
- Empty-Netted Notional Amounts for IRS
 - Nets longs and shorts between pairs of counterparties, within each currency.
 - Results in a sizing of the market that is about 8% of size as defined under notional value (\$15T vs. \$179T).
- He explained that ENNs should not affect *de minimis* discussion:
 - “Now, some may ask whether the ENN analysis is suitable for calculating regulatory thresholds such as for registered swap dealing activity. . . . [I]t was not my intention in directing Dr. Tuckman’s research to come up with a specific alternative to the CFTC’s current swap dealer *de minimis* calculation methodology.”



Questions?

Paul Architzel, Partner

paul.architzel@wilmerhale.com

Anjan Sahni, Partner

anjan.sahni@wilmerhale.com

Petal Walker, Special Counsel

petal.walker@wilmerhale.com

**WilmerHale has been accredited by the New York State and California State Continuing Legal Education Boards as a provider of continuing legal education. This program is being planned with the intention to offer CLE credit in California and non-transitional CLE credit in New York. This program, therefore, is being planned with the intention to offer CLE credit for experienced New York attorneys only. Attendees of this program may be able to claim England & Wales CPD for this program. WilmerHale is not an accredited provider of Virginia CLE, but we will apply for Virginia CLE credit if requested. The type and amount of credit awarded will be determined solely by the Virginia CLE Board. Attendees requesting CLE credit must attend the entire program.*

Wilmer Cutler Pickering Hale and Dorr LLP is a Delaware limited liability partnership. WilmerHale principal law offices: 60 State Street, Boston, Massachusetts 02109, +1 617 526 6000; 1875 Pennsylvania Avenue, NW, Washington, DC 20006, +1 202 663 6000. Our United Kingdom office is operated under a separate Delaware limited liability partnership of solicitors and registered foreign lawyers authorized and regulated by the Solicitors Regulation Authority (SRA No. 287488). Our professional rules can be found at www.sra.org.uk/solicitors/code-of-conduct.page. A list of partners and their professional qualifications is available for inspection at our UK office. In Beijing, we are registered to operate as a Foreign Law Firm Representative Office. This material is for general informational purposes only and does not represent our advice as to any particular set of facts; nor does it represent any undertaking to keep recipients advised of all legal developments. Prior results do not guarantee a similar outcome. © 2004-2018 Wilmer Cutler Pickering Hale and Dorr LLP