



WILMER CUTLER PICKERING HALE AND DORR LLP

WEBINAR

CFTC 2018 Year-in-Review and a Look Forward

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Speakers: Paul Architzel, Anjan Sahni, Dan Schubert and
Petal Walker

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WEBINAR

Speakers



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Agenda

Enforcement Developments

- Cooperation and Self-Reporting
- Declination Letter
- Enhanced Coordination
- Notable Enforcement Cases

Regulatory Developments

- Cross-Border Tensions
- Rulemaking
- Virtual Currencies and Blockchain
- Chairman's White Papers

Looking forward



Enforcement Developments



Enforcement Developments: Chairman's Agenda

“As I have made clear many times, there will be no pause, no let up, and no relaxation in the CFTC’s efforts to enforce the law and punish wrongdoing. We must keep the markets safe and fair for consumers.”

“[A] vigorous enforcement program is essential to fulfilling that mission and why a strong—and disciplined—enforcement program is compatible with strong economic growth and American prosperity. Indeed, those who have studied the issue have concluded that strong enforcement is necessary for strong markets.”

- J. Christopher Giancarlo, Chairman, Commodity Futures Trading Commission, Remarks at Economic Club of Minnesota (Oct. 2, 2018).



Enforcement Developments: Chairman's Agenda

In that same speech, the Chairman stressed that in the recently closed Fiscal Year the numbers:

- More enforcement actions. The 83 enforcement actions was a 25% increase from each of the last three years of the prior administration.
- More penalties. The amount imposed was approximately \$900 million, and almost \$800 million was collected (the second highest).
- More large-scale matters. In 2018, there were monetary judgments of more than \$10 million in 10 cases. More than three times the average over the prior seven years.
- More coordination with law enforcement. We will discuss this in greater detail below.
- More accountability.
- More whistleblower awards.



Enforcement Developments: Director's Agenda

Enforcement Director McDonald gave a summary speech in November stressing the Fiscal Year 2018 priorities, many parallel the Chairman's priorities:

- Preserving market integrity
- Protecting customers
- Promoting individual accountability
- Enhancing coordination with other regulators and criminal authorities
- Data analytics
- Specialized task forces
 - Spoofing and Manipulative Trading
 - Virtual Currency
 - Insider Trading and Protection of Confidential Information
 - Bank Secrecy Act



Enforcement Developments: Cooperation and Self-Reporting

- Director McDonald stated that the “early returns look good.”
- He identified three significant orders that involved self-reporting, each with a civil monetary penalty that was significantly reduced:
 - *In re The Bank of Nova Scotia*, CFTC Docket No. 18-50 (Sept. 28, 2018) (imposing a civil monetary penalty of \$800,000).
 - *In re UBS AG*, CFTC Docket No. 18-07 (Jan. 29, 2018) (imposing a civil monetary penalty of \$15 million).
 - *In re The Bank of Tokyo-Mitsubishi UFJ, Ltd.*, CFTC Docket No. 17-21 (Aug. 7, 2017).
- In the past year, there were two significant developments:
 - Bifurcated settlements, in which liability is set in the order but the amount of the penalty, if any, is determined after cooperation had been completed. This happened last year and again in another order issued earlier this week.
 - The first declination letter.



Enforcement Developments: Declination Letter

- On November 8, 2018, the Division issued its first public declination letter, indicating it was closing its investigation of Deutsche Bank AG, citing the bank's voluntary self-disclosure in the investigation of an individual managing director, its full cooperation in the matter and its proactive efforts to strengthen its swaps valuation process.
- The CFTC settled charges brought against an individual related to the investigation for fraudulently mismarking swap valuations.
- The Division stated in its letter that the misconduct was identified through Deutsche Bank AG's internal compliance, after which the bank commenced its own investigation and promptly reported its findings to the Division.



Enforcement Developments: Enhanced Coordination

- As noted above, the Chairman has stated that there is more partnering with federal and state law enforcement, other market and prudential regulators and self-regulatory organizations and the Director identified several new internal task forces.
- The CFTC brought several civil enforcement actions in parallel with criminal actions brought law enforcement and enforcement actions brought by other regulators (domestic and foreign).
- One particular area of coordination, both externally and internally, is spoofing.



Enforcement Developments: Spoofing

- CEA Section 4c(a)(5) makes it unlawful for any person to engage in “spoofing”—broadly defined as “bidding or offering with the intent to cancel the bid or offer before execution.”
- The CFTC announced a new Spoofing Task Force in January to make a coordinated effort across the Division to bring actions using new, sophisticated data analysis. That same month, the CFTC filed eight anti-spoofing enforcement actions against three banks and six individuals. CFTC Release No. 7681-18 (Jan. 29, 2018).



Enforcement Developments: Spoofing

- On the criminal side, “Spoofing” cases have created an interesting divergence in outcomes.
- Compare two litigated criminal proceedings:
 - The first spoofing conviction – *United States v. Coscia*
 - A cooperator explained that he was hired to write code for a spoofing strategy.
 - The program was to act “[l]ike a decoy” and would “pump the market.”
 - A successful defense – *United States v. Flotron*
 - While there were cooperators that explained the plan to create a program to fool the algorithms, the prosecution was unsuccessful.
 - Due to issues regarding jurisdiction of certain claims, the only count in the case was conspiracy.
 - There was insufficient evidence to prove an agreement between conspirators.
 - Flotron subsequently settled a parallel civil enforcement action.
- In other recent cases, defendants have elected to settle. One such case was noted earlier regarding its bifurcated settlement where there is an admission and the civil monetary penalty is pending further cooperation. That matter also involved a criminal guilty plea.



Enforcement Developments: Manipulation

- A court again rejected a market manipulation charge when the trading was motivated by good faith economic analysis and reflected bona fide interest in transacting on the terms submitted to the market, or where the trading did not create an “artificial” price.
- The court noted that “[i]t is not illegal to be smarter than your counterparties in a swap transaction, nor is it improper to understand a financial product better than the people who invented the product.”
- The court held that the CFTC failed to prove that the trading created an artificial price or intended to manipulate the market.
- Rather, while the trader had the ability to influence, sought to influence and did influence the price of the particular contract, there was no evidence that the resulting price was artificial or did “not reflect the basic forces of supply and demand.”
- The court found that the particular contract had been undervalued and that other market participants had come to agree with the trader’s valuation theory.



Enforcement Developments: Other Notable Cases

- Continued Focus—Benchmark Manipulation (ISDAFIX)
- New Focus—Cryptocurrency
 - *CFTC v. Gelfman Blueprint, Inc. and Nicolas Gelfman*, No. 17-7181 (S.D.N.Y. Sept. 21, 2017).
 - *CFTC v. Dillon Michael Dean and The Entrepreneurs Headquarters Limited*, No. 18-cv-00345 (E.D.N.Y. Jan. 18, 2018).
 - *CFTC v. My Big Coin Pay, Inc., Randall Crater, and Mark Gillespie*, No. 18-10077-RWZ (D. Mass. Jan. 24, 2018).



Regulatory Developments



Regulatory Developments: Chairman's Agenda

In 2018, the Chairman generally identified his areas of focus as:

- Swaps regulation reform; and
- Cross-border harmonization.

The Chairman's term expires in April and his replacement has already been announced.



Regulatory Developments: Cross-Border Tensions

- Chairman Giancarlo and other Commissioners have been and remain vocal in opposition to European attempts to increase oversight of third-country CCPs.
- If the EU proceeds to finalize its proposals, Chairman Giancarlo has noted that the CFTC is prepared to implement a response plan to protect U.S. market participants.
- Chairman Giancarlo noted:
 - Make no mistake: the CFTC cannot and will not allow its regulated markets and market participants to become subject to conflicting or overly burdensome regulation from abroad. No sovereign regulator would agree to it, let alone a regulator overseeing the world's largest derivatives markets. The CFTC will not allow US market participants to be put in the completely untenable position of having to choose between violating domestic laws and regulations or violating foreign laws and regulations. It is completely irresponsible for European regulators to seek to put US market participants in this position.
- In December, it appeared as if the European Commission was prepared to compromise, particularly to account for Brexit.



Regulatory Developments: Cross-Border Tensions

- In December, the CFTC issued relief to Eurex in three separate letters to permit it to begin clearing swap transactions on behalf of customers of FCMs.
- The relief was unusual in that the CFTC conditioned the relief on the absence of any material increase in EU legal or supervisory obligations imposed on US derivatives clearing organizations and further required agency staff to determine regularly whether any such increase has occurred.



Regulatory Developments: Cross-Border Tensions

- More recently, on February 25, 2019, the CFTC and the Bank of England, including the Prudential Regulation Authority (BoE) and the Financial Conduct Authority (FCA) issued a joint statement regarding derivatives trading and clearing activities post-Brexit
- The statement sought to address and reaffirm a commitment to:
 - the continuity of supervisory cooperation;
 - the extension of existing CFTC relief and comparability for the UK; and
 - UK equivalence for the US.
- The statement included a list with links to a selection of the guidance that is being continued (e.g., cooperation agreements, no-action letters, substituted compliance and exemption orders, etc.)



Regulatory Developments: SEF Proposed Rulemaking

- Amendments were proposed for the SEFs and trade execution requirement:
 - Would eliminate the “Made Available to Trade” process and requiring that all transactions for cleared swaps that are listed on a SEF or a DCM be traded on a SEF or a DCM, absent an explicit exemption
 - Would require all broking activities be performed by a registered SEF
 - Would remove restrictions on SEF execution rules
 - Would prohibit pre-trade communications and certain forms of off-facility transactions
 - Would permit SEFs to establish eligibility requirements
- The proposal was adopted in a 4-1 vote.
- There has been significant industry opposition.
- The proposal could potentially have devastating effect on foreign introducing brokers.



Regulatory Developments: Rulemaking

- De Minimis Threshold (Proposed and Final): A minimum threshold of activity that would be necessary for the definition of “swap dealer.”
- “Volcker Rule” (Proposed): Certain prohibitions and restrictions on proprietary trading by the Dodd-Frank Act identical to those proposals by the prudential banking regulators and the SEC; a re-visit of the initially adopted rule.
- Margin Requirements (Final): A re-visit to margin requirements for uncleared swaps for swap dealers and major swap participants.
- Unfinished Rulemaking:
 - Capital rules for swap dealers; and
 - Position limits.



Regulatory Developments: Virtual Currencies and Blockchain

- Bitcoin futures contracts.
- Customer Advisories covering:
 - Highlighting the potential for pump-and-schemes;
 - Warning potential investors to conduct research; and
 - Cautioning against sales pitches that tout “IRS Approved” virtual currency IRAs.
- Sought to maintain clarity along the jurisdictional lines.
- LabCFTC has been active within the Commission as a clearinghouse for information, but it remains to be seen whether LabCFTC will operate similar to the regulatory sandboxes in other jurisdictions.



Regulatory Developments: Chairman's White Papers

- Swaps Regulation Reform 2.0
 - SEF recommendations were included in the proposed SEF rule
 - Other recommendations related to:
 - Increased liquidity of funded resources more and more transparent recovery plans for CCPs;
 - Reporting for SDRs;
 - Reform of the standardized models used for swap dealer capital;
 - End-user exception to the clearing requirement; and
 - Execution.
- Cross-Broder Swaps Regulation Version 2.0
 - Territorial approach; and
 - Defer authority to comparable jurisdictions.



Looking Forward



Looking Forward: Big Picture

- Commission Composition
- Enforcement
- Regulatory
- Budget Increase



Looking Forward: Pending Cases

Spoofing continues to be an area of focus. For example:

US v. Vorley, et al., No. 18-cr-35 (N.D. Ill.).

- The government instead of charging the conduct as against the prohibition on spoofing has taken a position that the conduct constituted wire fraud.
- SIFMA, The Chamber of Commerce of the United States, and the Bank Policy Institute submitted a brief in February in support of the defendants' motion to dismiss.



Looking Forward: Regulatory Examination Priorities

On February 12, 2019, the CFTC published the Divisions' examination priorities for the first time. Items of note include:

- DMO
 - Cryptocurrency surveillance
 - Surveillance for disruptive trading and trade and market surveillance practices
 - Practices around market maker and trading incentive programs
- DSIO
 - Withdrawal of residual interest
 - Non-cash margin
 - Compliance with segregation requirements
- DCR, a general risk-based approach and individually tailored



Questions

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