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WEBINAR

CFTC 2020 Year-in-Review and a Look Forward

March 23, 2021

Speakers: Paul M. Architzel, Elizabeth L. Mitchell, Petal P. Walker, Matthew Beville and Aaron Friedman

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WEBINAR

Speakers



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Agenda

- Enforcement Developments
- Regulatory Developments
- Questions

A photograph of a modern building facade with a grid of windows and illuminated panels. A large, semi-transparent red rectangle is overlaid in the center, containing the text 'Enforcement Developments' in a white, italicized serif font. The building's facade features a series of horizontal bands of small, glowing yellow lights, and the windows reflect the sky and surrounding environment. The overall scene is brightly lit, suggesting daytime.

Enforcement Developments



Enforcement Overview of 2020

Annual Report touted FY 2020 as “record-breaking year”

- Most enforcement actions in Commission’s history (113)
 - Compared to previous high of 102 and 30-year average of 58
- 4th highest total monetary relief (more than \$1.3B)
 - Second year of more than \$1B and third year-over-year increase
- Largest spoofing and manipulation case (\$920M)
- Most retail fraud actions (56)
- Continued coordination with law enforcement counterparts (16 parallel criminal actions)
- Joint enforcement matter with 30 state regulators
- 140 pending litigation matters



Enforcement Priorities

- **Substantive areas of focus**
 - Spoofing and manipulative trading
 - Digital assets
 - Foreign corruption
 - Bank Secrecy Act compliance
- **Operational transparency and priorities**
 - May 2020 Penalty Guidance
 - September 2020 Compliance Guidance
 - Coordination with criminal and other regulators
 - Whistleblower program
 - Surveillance program/data analytics



Enforcement Priorities: Spoofing and Manipulative Trading

- Spoofing and antimanipulation are cornerstones of Commission's Enforcement program
 - Historically tension between Commission's aggressive posture and burden of proof to establish claims
 - More recent regulatory changes give Commission new authority and more leverage in complex cases
- Actions often initiated or supported by Commission's market surveillance efforts
- Actions often involve parallel criminal proceedings



Enforcement Priorities: Manipulative Trading

Traditional elements under CEA Section 6(c) and 9(a)(2):

- Defendant possessed an ability to influence market price
- An artificial price existed
- Defendant caused the artificial price
- Defendant specifically intended to cause the artificial price; mere intent to affect price is not sufficient



Enforcement Priorities: Manipulative Trading

New Authority under Regulation 180.1

- Mirrors Exchange Act Rule 10b-5 and prohibits use of “manipulative or deceptive” devices
- Adopts recklessness standard; significantly lowers burden for manipulation claims
- Also prohibits insider trading based on misappropriation of confidential information
- Commission appears more confident in relying on Regulation 180.1 following recent decisions affirming expansive interpretation of authority



Enforcement Priorities: Spoofing

Establishing spoofing is significantly easier under CEA Section 4c(a)(5)

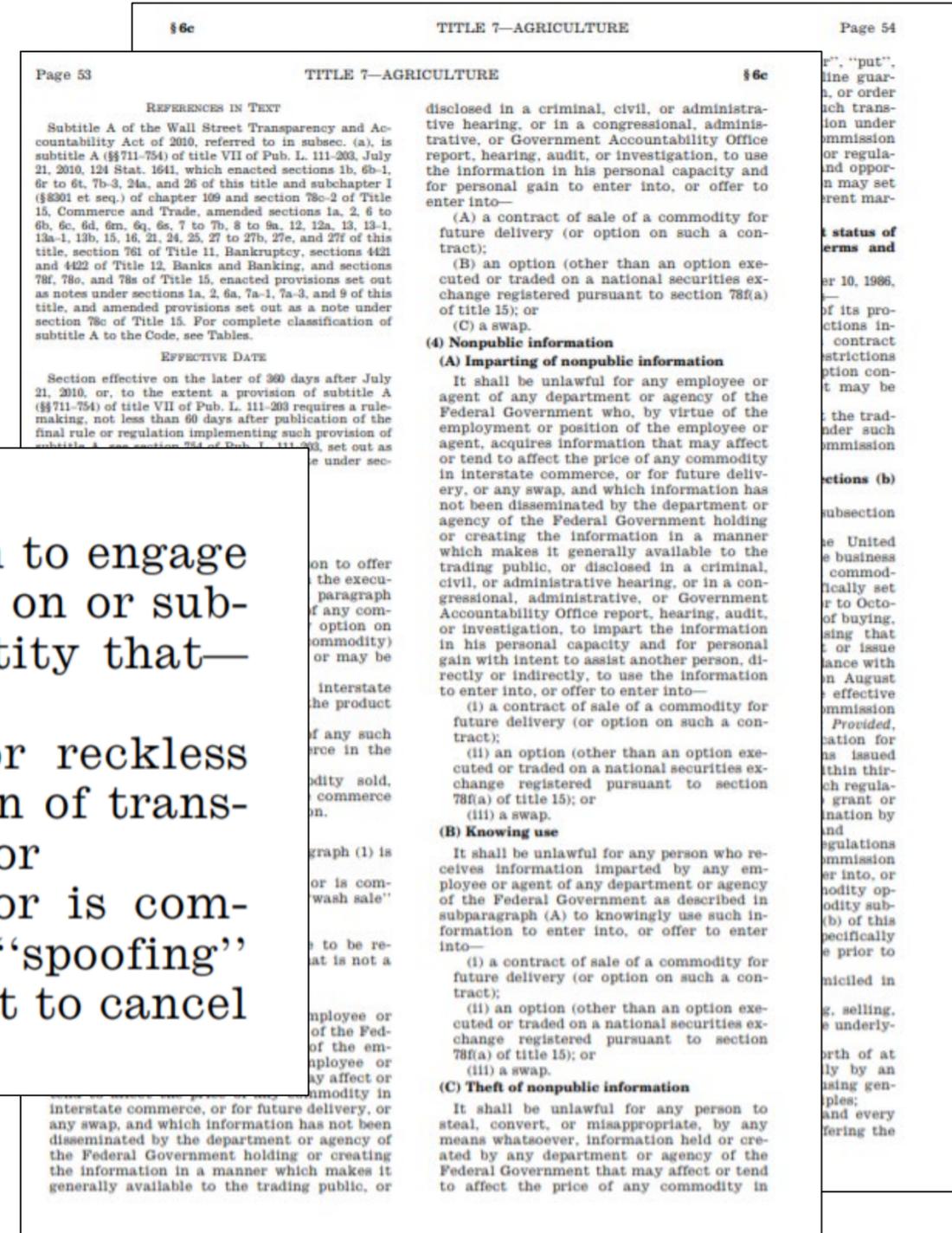
(5) Disruptive practices

It shall be unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that—

(A) violates bids or offers;

(B) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or

(C) is, 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).





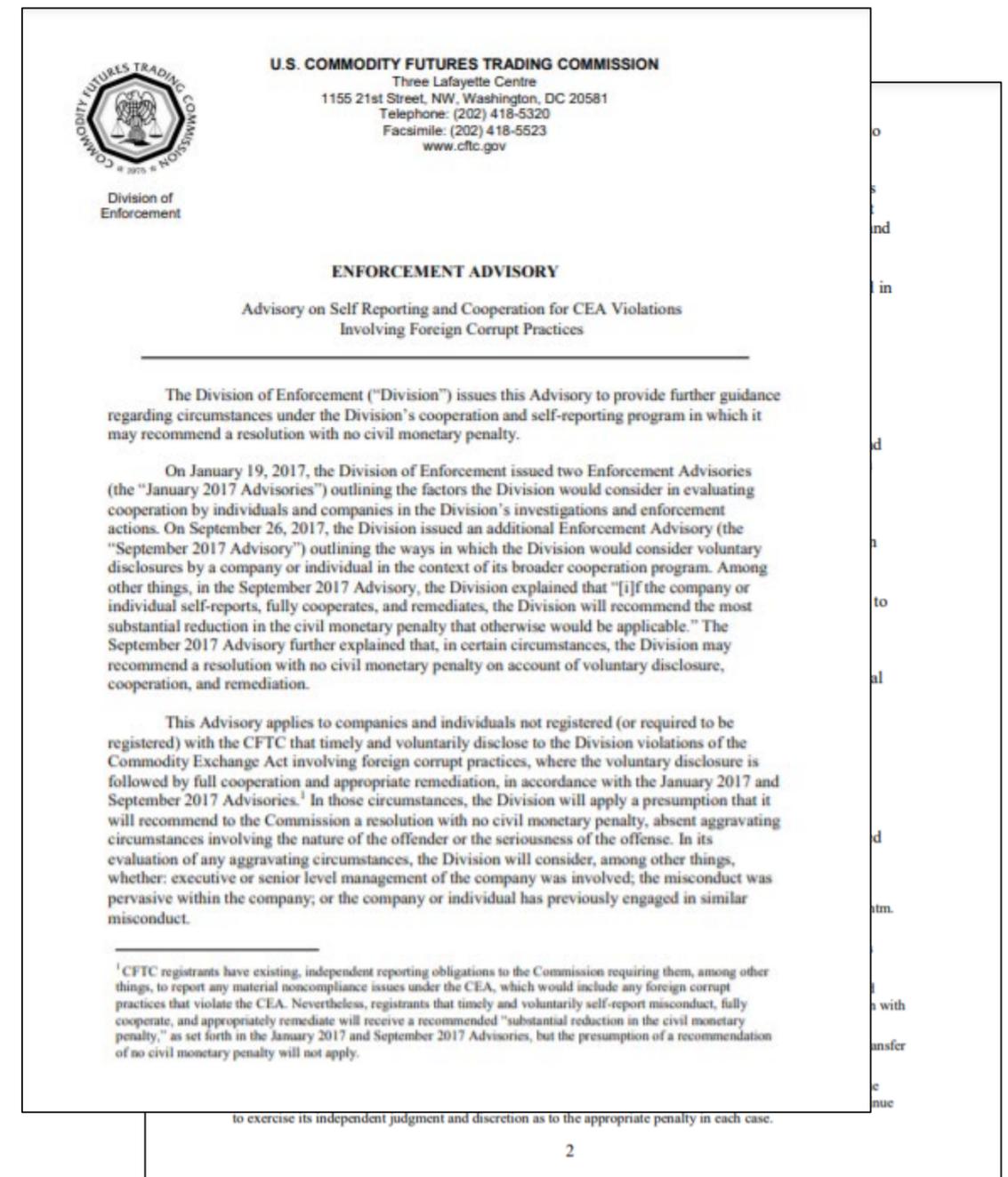
Enforcement Priorities: Digital Assets

- Commission actively policing digital asset markets within its jurisdiction
 - Measured approach intended to avoid stifling innovation, while ensuring market participants comply with CEA and applicable regulations
 - Willing to challenge large players if seen as noncompliant
- Notable enforcement activities include:
 - In March 2021, filed first action related to alleged manipulation of cryptocurrency markets
 - In October 2020, filed contested action against major cryptocurrency exchange for operating as an unregistered DCM and SEF
 - Several retail actions against individuals and entities in connection with allegedly fraudulent cryptocurrency investments



Enforcement Priorities: Foreign Corruption

- March 2019: Division Director announced intent to combat foreign corruption in commodities and derivatives markets
 - Focused on protecting domestic markets from unfair advantage
 - Pledged to work closely with DOJ and SEC to avoid duplication/piling on
- December 2020: First CFTC enforcement action involving foreign corruption
 - Global oil and gas trading firm paid bribes/kickbacks to agents and employees of foreign state-owned entities
 - In exchange, received preferential treatment, access to trades, and material nonpublic information regarding pricing, supply and demand
 - Conduct violated Section 6(c)(1) and Regulation 180.1





Enforcement Priorities: BSA Compliance

- Key priority due to crucial role in market integrity and customer protection
 - Suspicious activity reporting
 - KYC/CIP procedures
- Three actions in 2020, including first for CFTC Regulation 42.2 violation
 - Settled action involving missed red flags on at least five accounts
 - Settled action involving single failure to file SAR
 - Contested action against unregistered exchange that did not have an AML program



Enforcement Developments: Operational Transparency

May 2020 Civil Monetary Penalty Guidance

- Provides qualitative, not quantitative guidance
- Reduced fines for:
 - Self-reporting
 - Remediation
 - Cooperation
- Commission considers “existence and effectiveness of the company’s pre-existing compliance program” when determining sanctions



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Division of
Enforcement

MEMORANDUM

TO: Division of Enforcement Staff
FROM: James M. McDonald
Director, Division of Enforcement
DATE: May 20, 2020
SUBJECT: Civil Monetary Penalty Guidance

This memorandum summarizes various factors that Commodity Futures Trading Commission (“CFTC” or “Commission”) Division of Enforcement (“Division”) staff will consider in recommending an appropriate civil monetary penalty to the Commission in an enforcement action, whether administrative or injunctive. This guidance will be set forth in the Enforcement Manual,¹ and will be binding on all Division staff.

Recently, the Commission for the first time articulated a set of core agency values, namely: Commitment, Forward-thinking, Teamwork, and Clarity.² In particular, this Division guidance advances the core value of clarity, providing market participants with greater transparency as to Division staff’s decision-making criteria regarding civil monetary penalties. This guidance will facilitate the Division’s efforts to be tough on those who break the rules while striving for fair and consistent outcomes in doing so. As Chairman Tarbert has stated, “[W]e must be transparent in how we enforce the law. One goal of our enforcement program is to change behavior in a positive way by deterring misconduct before it happens. Deterrence requires clarity about how our laws work.”³

The factors below generally reflect the existing practice within the Division, which has been refined over time as a result of changes to relevant legal authorities and precedents, as well as lessons learned from the Commission’s enforcement actions.

The Commission, through the Division, acts to protect the public and preserve market integrity by detecting, investigating, and prosecuting violations of the Commodity Exchange Act (“Act”) and Commission Regulations (“Regulations”). In furtherance of that mandate, the Commission may require civil monetary penalties against individuals and companies in

¹ See <https://www.cftc.gov/LawRegulation/Enforcement/EnforcementManual.pdf>.

² CFTC, Mission, Vision, and Values, <https://www.cftc.gov/About/Mission/index.htm>.

³ Chairman Heath P. Tarbert, CFTC, Statement: “Tripling Down on Transparency” (Dec. 10, 2019), <https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement121019>.



Enforcement Developments: Operational Transparency

September 2020 Guidance on Evaluating Compliance Programs

- Framework for evaluating effectiveness of a company's compliance program
- Builds on May 2020 CMP Guidance
- Emphasizes scope and speed of remediation
- Focus on individual accountability



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Division of Enforcement

MEMORANDUM

TO: Division of Enforcement Staff

FROM: James M. McDonald
Director, Division of Enforcement

DATE: September 10, 2020

SUBJECT: Guidance on Evaluating Compliance Programs in Connection with Enforcement Matters

As part of any enforcement matter, Commodity Futures Trading Commission ("CFTC" or "Commission") Division of Enforcement ("Division") staff may undertake a review and assessment of compliance programs of Commission registrants or other participants in our markets. To ensure consistency and transparency, this guidance provides a framework for Division staff conducting such a review ("Compliance Guidance"). This Compliance Guidance will be set forth in the Enforcement Manual,¹ and will be binding on Division staff.²

In May 2020, the Division provided guidance to staff concerning factors that should be considered in recommending an appropriate civil monetary penalty to the Commission in an enforcement action ("Penalty Guidance").³ Among other factors, the Penalty Guidance directs staff to consider any relevant mitigating or aggravating circumstances, including "the [e]xistence and effectiveness of the company's pre-existing compliance program" and post-violation "efforts to improve a compliance program."⁴ Staff may also evaluate a company's compliance program in connection with non-monetary terms of a resolution, such as remediation or other undertakings.

In evaluating a corporate compliance program, the Division will consider, among other things, whether the compliance program was reasonably designed and implemented to achieve three goals: (1)

¹ See Commodity Futures Trading Commission, Enforcement Manual (2020) <https://www.cftc.gov/LawRegulation/Enforcement/EnforcementManual.pdf>.

² This Compliance Guidance is not binding on the Commission or any other Division or office of the Commission. It is not intended to be, and may not be, relied upon to create any rights, substantive or procedural, enforceable at law by any party, nor does it create any specific obligations or safe harbors for Commission registrants or other market participants. This Compliance Guidance represents the current views of the Division and does not mandate a particular outcome in any specific case.

³ Memorandum from James M. McDonald, Director CFTC, Civil Monetary Penalty Guidance (May 20, 2020), <https://www.cftc.gov/media/3896/EnfPenaltyGuidance052020/download>; see also Enforcement Manual § 6.8.1.

⁴ *Id.* at Section II, A and D.

to exercise its independent judgment and discretion as to the appropriate penalty in each case.



Enforcement Priorities: Coordinated Regulatory Actions

- Over 30 parallel enforcement actions in FY 2020
 - CFTC lends subject matter expertise regarding its markets
 - Enhanced deterrence and protection via broadened range of remedies
- Half involved parallel criminal actions brought by DOJ
 - Primarily but not exclusively involving spoofing
- Increased coordination with other regulators, including SEC and state securities regulators



Enforcement Priorities: Whistleblower Program

- **Significant source of investigative leads and expected to grow**
 - 16 awards of approximately \$20M in aggregate
 - 30 to 40% of ongoing investigations involve whistleblower component
- **Whistleblower alerts aligned with enforcement priorities/specialized task forces**
 - Spoofing
 - Bank Secrecy Act
 - Insider Trading
 - Foreign corrupt practices
 - Digital assets/virtual currency



CFTC Whistleblower Alert: Blow the Whistle on Spoofing in the Commodities and Derivatives Markets

Under the Whistleblower Program of the Commodity Futures Trading Commission (CFTC), individuals can become eligible for both financial awards and certain protections by identifying Commodity Exchange Act (CEA) violations connected to spoofing.

What is spoofing?

A trader "spoofs" when he or she places an order in a futures market with the intention to cancel the order prior to execution. Traders typically spoof to misrepresent supply or demand in order to induce other traders to act in a way beneficial to the spoofer. Spoofing is a federal crime punishable by up to 10 years' imprisonment per violation.

What types of misconduct should you be on the lookout for?

The CFTC has used its civil authority to charge individuals and companies with spoofing, as in [In re Tower Research Capital LLC](#), [In re Merrill Lynch Commodities, Inc.](#), [In re Mohan](#), [In re Gandhi](#), [CFTC v. Zhao](#), [In re Liew](#), [CFTC v. Sarao](#), or [In re Panther Energy Trading LLC and Coscia](#). The Commission is concerned with conduct such as:

- Manual and automated trading schemes that place and quickly cancel bids and offers in futures contracts in order to benefit other orders and/or positions
- Orders being quickly placed and canceled at or near the best bid or offer, especially if opposite-side orders are filled
- Multiple orders of the same size repeatedly and simultaneously being placed and canceled
- Any scheme designed to cause prices to artificially move

What can you do if you suspect misconduct?

You do not need to be a company "insider" (like trader or trading firm employee) to be a whistleblower. In fact, victims of fraud and other market participants who observe misconduct committed by others may be best situated to identify spoofing and qualify as whistleblowers. If you see something suspicious, you can

- Complete a [Form TCR \(Tip, Complaint, Referral\)](#) correctly and as completely as possible
- Provide details that are specific, credible, and timely
- Include as much information about the misconduct as possible, including the markets and contracts involved, precise timestamps, and Tag 50 identifiers
- Attach supporting documents or files to your Form TCR, as long as they are not protected by the attorney-client privilege – e.g., screen shots or video of the market activity
- Perform independent analysis of trading activity
- Supplement your Form TCR filing with any additional information via mail, fax, or email

About the CFTC

The mission of the CFTC is to promote the integrity, resilience, and vibrancy of the U.S. derivatives markets through sound regulation.

About the Whistleblower Program

The CFTC will pay 10%-30% monetary awards to persons who voluntarily provide us with original information on a Form TCR about violations of the CEA or its rules, if that information leads to a successful CFTC enforcement action resulting in more than \$1 million in monetary sanctions. The program also affords confidentiality and anti-retaliation protections.

For more information go to: www.whistleblower.gov

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January 2020



Enforcement Priorities: Surveillance program/data analytics

- **Commission focus on market surveillance**
 - Key focus since financial crisis and Flash Crash
 - Ongoing project to strengthen data analytics
- **Use of data analytics is long-term priority of Enforcement Division**
 - Identification of trading patterns or positions that warrant inquiry
 - Continued coordination with exchanges
 - Expanding to other enforcement priority areas

A photograph of a modern building facade with large glass windows and illuminated panels. A central red overlay contains the text 'Regulatory Developments' in a white, italicized serif font. The building's facade features a grid of windows and horizontal bands of glowing orange light. The sky is visible in the upper right corner.

Regulatory Developments



COVID-19 Related Relief

- Total of nine no-action letters to facilitate functioning of the derivatives markets during the pandemic
- Complimentary noticed by the NFA
- Key relief:
 - Rules relating to floor brokering and location-specific compliance systems
 - Supervision requirements
 - Delay of reporting obligations
- No-action relief extended to **April 15, 2021**



Speculative Position Limits

- On October 15, 2020, the Commission adopted final rules imposing speculative position limits in derivative contracts referencing 25 agricultural, metals and energy commodities
- A decade of rule making
 - 2010: The first notice of proposed rulemaking was issued in 2010 and was subsequently withdrawn.
 - 2011-2012: The second notice was issued, and the rules adopted, in 2011, but ultimately the rules were vacated by the US District Court for the District of Columbia because the court found that there were at least two plausible readings of the Act and, therefore, the court did not uphold the CFTC's interpretation of the statutory requirements regarding the imposition of position limits.
 - 2013: The Commission issued a third notice, relating to aggregation of positions, and a fourth notice, relating to repropoed position limits. The Commission then issued a revised reproposal pertaining to aggregation of positions and federal position limits and adopted final rules on aggregation of positions.
 - 2016: The Commission issued a supplemental rulemaking and another revised reproposal of its position limits regime.



Speculative Position Limits (continued)

- The final rules expand the application of federal speculative position limits to 25 core referenced futures contracts, which are 25 physically settled agricultural, metals, and energy futures and options on futures contracts
- For all covered contracts, these limits apply separately to positions in physically and cash-settled products and to cash-settled futures and options contracts that are either “directly or indirectly” linked to the price of a “core referenced futures contract” or the same commodity
- Limits apply to “economically equivalent swaps”
- Amend the regulations governing exchange-set position limit levels
- Expand the definition of “bona fide hedging transaction or position”
- Compliance dates:
 - **January 1, 2022:** futures and options contracts not currently subject to federal limits
 - **January 1, 2023:** economically equivalent swaps



Market Regulation

- Swap Execution Facilities
 - Name give-up
 - Audit trail, financial resource and CCO requirements
 - Exemptions for package trades and error trades
 - Exemption from required trade execution
 - Withdrawal of prior proposed rules
- Digital Assets
- Electronic Trading



Clearing and Derivatives Clearing Organization Operations

- In January, the CFTC approved final rules that clarify or codify existing interpretation, guidance or no-action letters with respect to the operation of DCOs. The rule amendments are largely administrative in nature.
- In July, the CFTC codified conditions to the inter-affiliate clearing exception relating to transactions with a non-US affiliate.
- In November, the CFTC codified exemptions from the clearing mandate under Section 2(h) of the Act for central banks, sovereign entities, IFIs, bank holding companies, savings and loan holding companies, and community development financial institutions.



Intermediaries: Margin

- In April, the Commission amended the 2016 rules governing the phase-in of initial margin requirements for uncleared swaps.
- These revisions reduce the margin requirement threshold and lengthen the phased compliance schedule by bifurcating the final phase.
- On May 28, 2020, the Commission approved an interim final rule that deferred the compliance date of September 1, 2020, for Phase 5 by a year, until September 1, 2021, in response to the dislocations resulting from the COVID-19 outbreak.
- In a further action related to margin, on November 24, 2020, the CFTC and the SEC approved a final rule to harmonize the minimum margin level for security futures held in a futures account with the minimum margin level for security futures held in a securities portfolio margin account.



Intermediaries: Capital

- In July 2020, the Commission adopted final rules establishing capital requirements for swap dealers and major swap participants
- The final capital rules applicable to swap dealers
 - 1) outline the minimum capital requirements
 - 2) define how swap dealers must calculate their actual capital amount and
 - 3) establish other requirements (e.g., use of internal models, notice requirements, etc.)
- Minimum Capital Approaches
- Availability of substituted compliance



Intermediaries: CPO/CTA Disqualifications

- On June 4, 2020, the CFTC approved a new rule that will affect CPOs with a statutory disqualification under the CEA that claim an exemption from registration under CFTC Rule 4.13
- The new rule requires a person claiming an exemption from registration as a CPO under Regulation 4.13 to represent that, subject to certain exceptions, neither the claimant nor any of its principals has a CEA Section 8a(2) disqualification that would require disclosure if the claimant sought registration with the CFTC
- Exemptive relief
- Family offices



Intermediaries: Amendments to Form CPO-PQR

- During 2020, the Commission revisited Form CPO-PQR, easing certain of the burdens or simplifying the requirements associated with that report
- Quarterly filing by all reportable CPOs, regardless of the amount of AUM
- Filing with NFA Form PQR instead of revised CFTC Form CPO-PQR
- Elimination of substituted compliance with Form CPO-PQR filing requirements via the CFTC's and the SEC's Joint Form PF



Reporting

- In September the CFTC amended its reporting requirements relating to swap data repositories, real-time reporting, and reporting of creation and continuation data
- Key aspects of the rule include:
 - Replacing the rule's previous set of data elements with data elements that are harmonized internationally
 - Providing the means to ensure that the data reported to the SDR is accurate
 - Establishing appropriate time delays for large, market-moving swaps



Cross-Border

- In September, CFTC adopted a new rule regarding the cross-border application of the swaps regulatory framework
- Key aspects of the final rule include:
 - Definition of “U.S. Person”
 - Definition of “Significant Risk Subsidiary”
 - Counting swaps toward the de minimis threshold
 - Arranged, negotiated and executed trades
 - Transaction-level requirements



Security-Based Swap Rules

- Although security-based swaps are under the jurisdiction of the SEC and not the CFTC, futures and derivatives practitioners should be aware of the major development during 2020 relating to these instruments.
- The SEC's security-based swap dealer (SBSD) rules have finally been issued, and a large amount of work will be required in order to comply. The rules represent the culmination of many years of work by the SEC implementing its Dodd-Frank mandate, and they begin the clock for participants that meet the definition of an SBSD or a major security-based swap participant to register with the SEC.
- The SEC's SBSD and major security-based swap participant registration compliance date is October 6, 2021.



Looking Ahead

- New leadership
- Enforcement Priorities
- Potential areas of focus for policymaking



Questions

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