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## CFTC Heightened Enforcement Activity

2012-10-18

**Background.** On October 5, 2012, the Commodity Futures Trading Commission (Commission or CFTC) announced fiscal year 2012 enforcement statistics and case highlights, and identified for practitioners and market participants the Division of Enforcement's (Division) likely 2013 priorities.<sup>1</sup> In addition to fraud-based actions, the announcement brought attention to cases involving allegations of manipulation, false reporting, wash trades, exceeding position limits, and deficient customer fund safeguards and supervision obligations.<sup>2</sup> In fiscal year 2012, the Division opened a record 350 new investigations, initiated 102 enforcement actions, and obtained orders imposing \$1.17 billion in sanctions, restitution and disgorgement. The Division has had a very busy year, demonstrating an aggressive approach to investigating and charging what it believes is unlawful conduct.

**Reporting to Price-Index Publishers.** The announcement highlighted the Division's activity relating to LIBOR and Euribor reporting by focusing on possible disconnects between actual transactions and the information submitted to rate-setting bodies. The Division's focus may have wider implications for commodities market participants when submitting transaction data to cash market price-index publishers. These market participants may wish to reexamine their policies and controls relating to providing quotes to price-aggregators, particularly in light of new CFTC Rule 180.1, which prohibits false reporting using fraud-based standards patterned after Rule 10b-5. Market participants actively reporting pricing data to index publishers should consider implementing measures—such as information barriers and trade submission, auditing and monitoring procedures—to ensure that submissions remain transaction-focused.

**Position Limits Enforcement.** The Division, by bringing a total of six actions in 2012, was very active in enforcing position limits. This increased enforcement presence is likely to continue and perhaps intensify in light of the importance the Commission has recently attached to position limits. A critical part of the Commission's current position limits framework and recently vacated<sup>3</sup> Position Limit Rules<sup>4</sup> involves interpreting position and account aggregation standards. With respect to aggregation, the Division's approach in at least one matter may be a harbinger of the possible intent to aggregate positions held by separate and independent subsidiaries with that of a parent when enforcing speculative limits.

**Customer Funds Safeguards.** The Division also actively enforced the Commission's segregated fund requirements and assessed a \$20 million civil monetary penalty which, according to the Commission, is the largest sanction for a segregated fund violation. Financial firms and futures commission merchants (FCMs) holding segregated FCM customer funds are prohibited from using such funds as though they belong to any person other than the customer. In light of the financial collapses of Peregrine Financial Group, Inc. and MF Global, it is likely that the Division will continue and intensify enforcing the segregation requirements by not only investigating the improper use of customer funds, but also enforcing compliance with customer account opening, titling and maintenance rules, including rules requiring written acknowledgements from depository institutions demonstrating their awareness that funds in an account are FCM customer funds.

**Supervisory Obligations.** The Division's activity covered actions relating to supervising the handling of accounts through which clients may be violating the Commodity Exchange Act (CEA) and CFTC rules. These cases indicate that the Division expects FCMs to diligently investigate questionable client activity and not rely solely on customer representations when responding to potential red flags. As the Commission's resources are stretched even thinner across regulated futures and swaps markets, it may increasingly seek to shift investigative efforts and costs to registrants. One way to do so is through bringing failure to supervise actions for not diligently investigating red flags caused by customer activity, thereby reinforcing the expectation that registrants self-investigate and remedy any improper activity.

**Cooperative Enforcement.** The fiscal year-end announcement highlighted the Division's cooperative enforcement initiatives, emphasizing that the Division worked actively with federal and state criminal and civil law enforcement authorities in more than 200 investigations and prosecutions. On the international front, the Division received responses from 70 different regulators under the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information or other information-sharing arrangements.

**Conclusion.** The Division of Enforcement has had its busiest year, as the number of investigations and enforcement actions, as well as the amount of fines, increase. Together with the Commission's increased presence, new CFTC Rule 180.1 (which is patterned after Rule 10b-5) and newly granted authority in CEA Section 4c(a)(5) to prohibit disruptive trading practices, including disorderly trading during a contract's closing period, we can expect to see this trend continue in fiscal year 2013. Market participants can expect the Division to focus on actions involving manipulative and disruptive trading, false reporting to price-index publishers, strict position limit aggregation standards, customer fund safeguards and the failure to diligently supervise customer account activity raising red flags.

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<sup>1</sup> CFTC Releases Enforcement Division's Annual Results, No. 6378-12 available at [cftc.gov/PressRoom/PressReleases/pr6378-12](http://cftc.gov/PressRoom/PressReleases/pr6378-12).

<sup>2</sup> The cases discussed in this article are available at

[cftc.gov/LawRegulation/Enforcement/EnforcementActions/index.htm](https://cftc.gov/LawRegulation/Enforcement/EnforcementActions/index.htm).

<sup>3</sup> ISDA, et al. v. CFTC, Civil Action No. 11-CV-2146 (RLW) (September 28, 2012).

<sup>4</sup> Position Limits for Futures and Swaps; Final Rule and Interim Final Rule, 76 Fed. Reg. 71626 (November 18, 2011).

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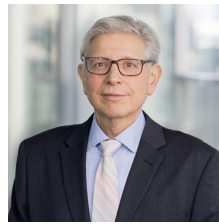


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