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U.S. CFTC Enforcement Considerations for 2017

At a Glance:

Change is in the air and the political landscape may significantly affect the U.S. Commodity Futures Trading Commission's enforcement agenda. Last month, Commissioner J. Christopher Giancarlo rose to the position of Acting Chairman and announced a number of staffing changes at the Commission, including a new Acting Director of the Division of Enforcement. Meanwhile, the U.S. Congress is considering legislation that could pare back a number of Dodd-Frank Act reforms to the Commodity Exchange Act. In this client alert, we review recent enforcement trends in light of the new political agenda and highlight important developments at the CFTC, including its potential enforcement priorities for 2017.

Shortly after President Donald J. Trump was inaugurated on January 20, 2017, Commissioner J. Christopher Giancarlo ascended to the position of Acting Chairman of the U.S. Commodity Futures Trading Commission ("CFTC"). In less than a week, Giancarlo announced a number of staffing changes, including the appointment of Vincent McGonagle as Acting Director for the Division of Enforcement. Meanwhile, the Commodity End-User Relief Act, which would reauthorize the CFTC through 2021 with a budget of \$250 million a year and pare back some of the Dodd-Frank Act reforms to the Commodity Exchange Act ("CEA"), passed in the House of Representatives and similar legislation will now be considered in the Senate. Furthermore, President Trump's transition team continues to work on broad policy guidelines for the reform of U.S. financial markets.¹

In short, change is in the air and the political landscape may significantly affect the CFTC's enforcement agenda. Market participants should expect:

- 1) **Enforcement of Current Laws and Regulations.** The CFTC must and will continue enforcing the CEA and the regulations that are currently in effect;
- 2) **Greater Cooperation with the SROs.** The National Futures Association ("NFA") and commodities exchanges will continue enforcing the law that is in effect and, given budgetary constraints, the CFTC will push more on-the-ground enforcement responsibility and authority to these self-regulatory organizations ("SROs");
- 3) **Focus on Money.** Because the CFTC is assessed by its effectiveness as a regulator and by how much money it brings into the U.S. Treasury, the CFTC will continue prosecuting and imposing sanctions for violations of the CEA and its rules; and
- 4) **Use of Existing Law.** There has been a significant body of law developed in the past 7 years following the passage of the Dodd-Frank Act that the CFTC can readily deploy in its prosecution of questionable market behavior. Strengthened by the Securities and Exchange Commission ("SEC") precedents in similar actions such as insider trading, the CFTC's Division of Enforcement has effective tools to build new enforcement actions.

Given that it is unlikely that the CFTC will ease up on enforcement actions in 2017, market participants should be aware of the following new guidelines and developments.

I. The Division of Enforcement Updated its 2007 Enforcement Advisory

Like other regulatory agencies, the CFTC acknowledges companies' and individuals' cooperation with its investigations when determining appropriate penalties for misconduct. The day before Acting Chairman Giancarlo assumed his new role, the Division of Enforcement issued updated advisories on how companies should behave during CFTC investigations to receive maximum cooperation credit (the "Cooperation Advisories").² The Cooperation Advisories, which update a previous 2007 advisory,³ offer helpful guidance and best practices to companies under investigation.

The Cooperation Advisories specify that the CFTC considers the following factors in determining the appropriate monetary penalties and other sanctions: (1) the value of a company's cooperation to the CFTC's investigation(s) and enforcement actions; (2) the value of a company's cooperation to the CFTC's broader law enforcement interests; and (3) the balancing of the level of a company's culpability and history of prior misconduct with the acceptance of responsibility, mitigation and remediation.

The Cooperation Advisories also explicitly indicate which actions by a company or individual may offset the credit that could be achieved through other cooperative actions. These include conduct that “impedes the Division’s investigation or inappropriately consumes government resources.” The CFTC indicates that such activities include, but are not limited to: (1) failing to respond to Division requests in a timely manner; 2) misrepresenting or minimizing the extent of the company’s misconduct; (3) failing to preserve relevant information; and (4) inappropriately advising employees not to cooperate fully with the investigation.

Market participants should review the Cooperation Advisories and implement compliance programs that facilitate cooperation. In addition, market participants should advise their employees that if they become aware of an issue that may prompt an investigation, they should contact the company’s compliance department. Additionally, if employees are contacted by the CFTC in connection with an investigation, they are not obligated to discuss any matters with the staff of the CFTC, the NFA or the SRO without a lawyer present.

Market participants should also note that the CFTC’s whistleblower program is increasingly becoming more active. The CFTC announced its third and fourth whistleblower awards last year for \$10 million and \$50,000, respectively.

II. The CFTC Adjusted its Civil Monetary Penalties

On January 24, 2017, the CFTC issued new civil monetary penalties, adjusted for inflation, pursuant to the Federal Civil Penalties Inflation Adjustment Act of 1990.⁴ Notably, the rule adjusts the current maximum civil monetary penalty for market manipulation and attempted manipulation from the greater of \$1,098,190 or triple the monetary gain, to the greater of \$1,116,156 or triple the monetary gain. The rule also adjusts the maximum civil monetary penalty for non-manipulation violations from the greater of \$167,728 or triple the financial gain, to \$170,472 or triple the financial gain. Market participants should note that although the price of many commodities is not keeping pace with inflation, the CFTC’s civil monetary penalties are adjusted each year and the increase is not inconsequential. All future civil monetary penalty assessments will be based on these inflation-adjusted amounts.

III. A Significant Enforcement Action Offers a Cautionary Tale Regarding Effective Compliance Programs

On January 19, 2017, the CFTC fined a swap dealer \$25 million for spoofing (i.e., entering orders with the intent to cancel them) and failure to supervise.⁵ Following the enactment of Dodd-Frank and implementation of related regulations, the swap dealer circulated a compliance alert to its traders that included the amended statutory language prohibiting spoofing but provided no additional training or guidance on the subject. Moreover, the swap dealer did not put any systems or controls in place to detect spoofing by its traders or analyze their trading activity to detect spoofing. Five traders subsequently engaged in spoofing by entering

orders they intended to cancel before execution. One trader observed others place spoof orders and began to do so himself. He incurred a loss and had to answer to his supervisor, who told him not to do it again but never reported the incident to compliance.

In addition to issuing a \$25 million civil monetary penalty, the CFTC ordered the swap dealer to (1) provide annual training addressing the CEA's legal requirements with regard to spoofing to its employees who trade on designated contract markets; and (2) maintain systems and controls reasonably designed to detect spoofing activity by its traders.

This case is an example of why market participants must take compliance seriously and ensure that they adequately supervise and train their traders and employees. Simply informing them about regulatory or legal changes is usually not adequate given the complexities of the provisions. As a new year begins, market participants should verify that their compliance materials are up-to-date and that their personnel have adequate training.

IV. The CFTC is Likely to Continue to Pursue Recordkeeping and Reporting Violations

As mentioned in our previous Client Alert regarding CFTC enforcement in 2016, the CFTC continues to pursue a larger swath of recordkeeping and reporting cases each year and this trend is likely to continue. Recordkeeping and reporting violations are low-hanging fruit for enforcement and, given the CFTC's projected budget of \$250 million⁶, the Division of Enforcement is likely to bring more of these actions in 2017.

In January alone, the Division of Enforcement has already brought three such actions. On January 17, the CFTC fined an investment and trading company \$150,000 for failing to file Form 304 Cotton-On Call Reports on 53 occasions and filing late reports on 2 occasions.⁷ This action is consistent with the others Series '04 reporting violations cases brought by the CFTC over the past few years. These actions are likely to continue, especially if the CFTC's position limits rulemaking is finalized. Such rulemaking would expand the scope of the Form 204 and 304, and create new Forms 504, 604, and 704.

On January 26, the CFTC fined a dually -registered introducing broker ("IB") and futures commission merchant ("FCM") \$280,000 for failing to retain required records and failing to supervise.⁸ The IB/FCM did not preserve and maintain audit trail logs for its customers and failed to implement policies and procedures to ensure retention of those records for roughly five years. The CFTC ordered the IB/FCM to update its policies and procedures on recordkeeping and provide appropriate training to its officers and employees regarding the CFTC's recordkeeping requirements.

Finally, on January 11, the CFTC fined a dually -registered FCM and swap dealer ("SD") \$900,000 after its officers, employees, and agents overcharged customers

for trading and clearing exchange-traded products.⁹ Although the CFTC did not pursue a recordkeeping violation, the failure to supervise charge related to the FCM/SD's systems for receiving and reconciling invoices from exchanges. As a result of its failure to implement adequate systems, the FCM/SD overcharged customers in the aggregate amount of roughly \$7.8 million.

V. Recent CFTC Rule Enforcement Reviews May Prompt More Enforcement Actions

The CFTC's Division of Market Oversight recently performed a rule enforcement review ("RER") of ICE Futures U.S.¹⁰ The RER recommended, among other things, that the exchange expand the scope of all of its trade practices investigations "as appropriate" to scrutinize for patterns of abuse. It also recommended that ICE Futures U.S. conduct trade practice reviews for all trade dates and maintain documentation sufficient to demonstrate that it conducted the reviews. Similarly, in an RER of the New York Mercantile Exchange and the Commodities Exchange, the CFTC recommended that the exchanges implement a formal review process to verify that market participants' position limits exemptions are legitimate.¹¹ Given budgetary constraints and a concern with the enforcement of exchange rules, the CFTC is likely to continue to pressure exchanges to scrutinize trading practices and bring enforcement actions when appropriate. The NFA, which collected \$700,000 in fines, expelled 22 members, and suspended 11 members in 2016, may follow suit.

Conclusion

With all of the political appointments and personnel changes at the CFTC, the big question is whether the CFTC will continue to aggressively pursue market participants for violations of the CEA and related regulations. We believe it will.

In his former role as a Commissioner of the CFTC, Acting Chairman Giancarlo did reveal his vision for enforcement. However, enforcement generally tends to remain consistent from administration to administration. Although some of the CFTC's regulations may change under the Trump Administration, the Division of Enforcement is likely to keep busy. The new Acting Director of Enforcement Vincent McGonagle served in the Division of Enforcement in the past and the departure of former Director of Enforcement Aitan Goelman is unlikely to affect its operations.

Congress is considering versions of the Commodity End-User Relief Act and Financial CHOICE Act that would reform the CEA, but these bills would have little effect on the CFTC's enforcement agenda. The core provisions enforced by the CFTC, including reporting, recordkeeping, market manipulation, and disruptive trading practices would largely be unaffected by the reforms.

Accordingly, market participants should remain cognizant of the enforcement trends and compliance lessons as the new make-up of the CFTC continues to take shape.

- ¹ See H.R. 238, 115th Cong. (2017); S. 2917, 114th Cong. (2016); H.R. 5983, 114th Cong. (2016).
- ² The Cooperation Advisory for Corporations is [available here](#), and the Cooperation Advisory for Individual is [available here](#).
- ³ The 2007 Advisory on Cooperation Factors in Enforcement Division Sanction Recommendations is [available here](#).
- ⁴ Annual Adjustment of Civil Monetary Penalties for Inflation—2017, 82 Fed. Reg. 7,643 (Jan. 23, 2017).
- ⁵ See *In the Matter of Citigroup Global Markets Inc.*, CFTC Docket No. 17-06 (Jan. 19, 2017).
- ⁶ The \$250 million budget is the same as the 2016 enacted level, and \$80 million below the President's Budget for fiscal year 2017 (prepared for the Committee on Appropriations, February 2016).
- ⁷ See *In The Matter of CNCGC Hong Kong Ltd.*, CFTC Docket No: 17-05 (Jan. 17, 2017).
- ⁸ See *In The Matter of E*TRADE Securities LLC and E*TRADE Clearing LLC*, CFTC Docket No. 17-07 (Jan. 26, 2017).
- ⁹ See *In The Matter of J.P. Morgan Securities LLC*, CFTC Docket No. 17-04 (Jan. 11, 2017).
- ¹⁰ See ICE Futures U.S. Trade Practice Rule Enforcement Review
- ¹¹ See NYMEX and COMEX Market Surveillance Rule Enforcement Review

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