

The CFTC's Global Enforcement Agenda: The Shape of Things to Come Under Dodd-Frank

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Helen Marshall, *London*

Michael Lloyd Spafford, *Washington*

Joshua B. Sterling, *Washington*

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Today's Discussion

- Introductory Remarks
- CFTC Enforcement Powers and Recent Lessons
- International Cooperation in Investigations
- Connecting Reporting, Market Surveillance, and Enforcement
- Update on Position Limits Proposal and Review of High Frequency Trading
- Concluding Thoughts

Where We Are Today

- Wrapping up a period of intensive rule-writing under Dodd-Frank
- Period marked by significant expansion of authority:
 - New CFTC registrants
 - Newly regulated products and markets
 - Substantial increase in regulatory reporting
- Focus will shift to enforcement of rules that have been added
- Enforcement efforts likely based on information available to regulators

Key Considerations for Asset Managers

- Requirements for registered CPOs / CTAs:
 - Forms CPO-PQR and CTA-PR
 - NFA self-exam and annual questionnaire
 - CPO annual reports
 - NFA audit program
- Other key reporting and surveillance points:
 - Swap data reporting
 - Large trader reporting
 - Exchange / SEF surveillance
 - Broker exception reports

The CFTC's anti-fraud authority is expressly patterned after Section 10(b) and Rule 10b-5.

Rule 180.1 Prohibition on the employment, or attempted employment, of manipulative and deceptive devices.

(a) It shall be unlawful for any person, directly or indirectly, in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity, to intentionally or recklessly:

- (1) Use or employ, or attempt to use or employ, any manipulative device, scheme, or artifice to defraud;
- (2) Make, or attempt to make, any untrue or misleading statement of a material fact or to omit to state a material fact necessary in order to make the statements made not untrue or misleading;
- (3) Engage, or attempt to engage, in any act, practice, or course of business, which operates or would operate as a fraud or deceit upon any person; or,

Rule 180.1 Prohibition on the employment, or attempted employment, of manipulative and deceptive devices. – continued

(4) Deliver or cause to be delivered, or attempt to deliver or cause to be delivered, for transmission through the mails or interstate commerce, by any means of communication whatsoever, a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in reckless disregard of the fact that such report is false, misleading or inaccurate. Notwithstanding the foregoing, no violation of this subsection shall exist where the person mistakenly transmits, in good faith, false or misleading or inaccurate information to a price reporting service.

(b) Nothing in this section shall be construed to require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect.

(c) Nothing in this section shall affect, or be construed to affect, the applicability of Commodity Exchange Act section 9(a)(2).

CFTC Anti disruptive practices, 7 USC § 6c (5)

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).

Recent CFTC Enforcement Actions

- *In the Matter of JP Morgan Chase Bank* – the “London Whale”
First enforcement action pursuant to Regulation 180.1.
 - “Staggering, record setting, volume”
 - CFTC did not join other settlements
 - Admission of facts
- *In the Matter of Panther Energy Trading LLC and Michael J. Coscia*
First disruptive behavior enforcement
 - Spoofing
 - High speed trader
- Libor Benchmarks matters - Barclays, UBS, RBS, ICAP, Rabobank
 - Collusion
 - Importance of benchmarks
 - Email, instant messages, text, phone calls

GLOBAL DERIVATIVES REGULATORS

Canadian Securities Administrators

Commodities Futures Trading Commission (CFTC)
Securities and Exchange Commission (SEC)

Financial Conduct Authority (FCA)

European Securities and Markets Authority (ESMA)
European Commission – Competition
Agency for the Cooperation of Energy Regulators (ACER)
National Competition Authorities

Financial Services Agency of Japan (JFSA)

Hong Kong Monetary Authority (HKMA)
Hong Kong Securities and Futures Commission (SFC)

Monetary Authority of Singapore (MAS)

Australian Securities and Investment Commission (ASIC)
Australian Prudential Regulation Authority (APRA)

International Organization of Securities Commissions (IOSCO)

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International cooperation in enforcement actions

UK – Financial Conduct Authority (“FCA”) powers:

s169 of the Financial Services and Markets Act 2000 (“FSMA”)

“At the request of an overseas regulator, [a regulator] may –

- (a) exercise the power conferred by section 165; or
- (b) appoint one or more competent persons to investigate any matter.”

Memoranda of Understanding (“MoUs”)

The FCA and PRA have signed memoranda of understanding with various overseas regulators, including the CFTC and the SEC. Where a MoU has been signed by the FSA it continues in effect with the relevant successor UK authority (or authorities).

- **23 September 1986** – the DTI signed a MoU jointly with the SEC and CFTC on exchange of information in matters relating to securities and futures.
- **25 September 1991** – the DTI signed a MoU jointly with the SEC and the CFTC for mutual assistance and the exchange of information (this continues to take effect as between the SEC, CFTC, PRA and the Bank of England).

International cooperation in enforcement actions

Memoranda of Understanding (“MoUs”)

- **28 October 1997** – the FSA signed a MoU jointly with the SEC and CFTC.
- **17 May 2000** – the FSA signed a MoU with the CFTC on the arrangement of warehouse information to facilitate exchanges of information for surveillance and enforcement purposes regarding deliverable commodities.
- **May 2002** (updated in **May 2012**) – the FSA and the CFTC signed a MoU concerning consultation and cooperation and the exchange of information with the International Organization of Securities Commissions (“**IOSCO**”). The MOU sets an international benchmark for cross-border cooperation. Established in 2002, it has provided securities regulators with the tools for combating the cross-border fraud and misconduct that can weaken global markets and undermine investor confidence.
- **14 March 2006** – the FSA signed a MoU with the SEC on the exchange of information regarding the oversight of financial services firms.
- **17 November 2006** – the FSA signed a MoU with the CFTC concerning consultation, cooperation and the exchange of information related to market oversight.
- **14 September 2009** – the FSA signed a MoU with the CFTC concerning cooperation and the exchange of information related to the supervision of cross-border clearing organisations.
- **22 July 2013** – the FCA signed a MoU with the SEC on the supervision of the asset management industry; MoUs were concluded with 25 EU and 3 EEA member state regulators; they provide a framework for cooperation and exchange of information between regulators at an international level.

Enforcement action

22 July 2013 – Panther Energy Trading LLC (“Panther”) and Michael Coscia

- The FCA fined a US-based trader, Michael Coscia, \$903,176 for deliberate manipulation of commodities markets using an abusive trading strategy known as ‘layering’. The FCA worked with the CFTC and the Chicago Mercantile Exchange in order to take enforcement action against Mr Coscia; the CFTC went on to impose fines totalling \$2.8m on Mr Coscia and Panther for the use of similar trading strategies on the US markets.

18 September 2013 – “The London Whale”

- The FCA issued a fine of £137,610,000 to JP Morgan Chase Bank N.A. (“**JPM**”) for serious failings relating to its Chief Investment Office’s “London Whale” trades. The cross-border nature of the investigation meant that the FCA worked closely with (amongst others) the SEC and the CFTC. JPM also agreed to settle actions brought by the SEC (who imposed a financial penalty of \$200m and required JPM to admit wrongdoing) the Office of the Comptroller of the Currency and the Federal Reserve (which imposed fines of \$300m and \$200m respectively). A subsequent agreement with the CFTC also resolved the CFTC’s investigation with a penalty of \$100m, and JPM admitting that its traders acted “recklessly” in violation of Dodd-Frank.

Enforcement action

The international nature of the investigations relating to the London Interbank Offered Rate (“Libor”) manipulation scandal necessitated a cross-border approach; the FCA worked with a number of overseas regulators in order to address misconduct relating to Libor.

February 6, 2013 – The Royal Bank of Scotland plc (“RBS”)

- The FSA issued RBS with a fine of £87.5m for misconduct relating to Libor; the FSA found that *“RBS sought to manipulate Libor in connection with its own submission of rates that formed part of the calculation of the Japanese Yen (JPY) and Swiss Franc Libor and also sought to influence other banks’ JPY Libor submissions.”* The FSA worked with the CFTC, the US Department of Justice and the FBI, the Monetary Authority of Singapore and the Japanese Financial Services Authority in order to bring enforcement action against RBS. The CFTC imposed a fine of \$325m.

September 25, 2013 – ICAP Europe Limited (“IEL”)

- The FCA fined IEL £14m for Libor-related misconduct; the FCA said that IEL employees *“sought to manipulate JPY Libor submissions made by banks that contributed to the calculation of published Libor rates”* and *“IEL, through its brokers, colluded with traders at UBS AG as part of a coordinated attempt to manipulate JPY Libor submissions.”* The FCA worked closely with the CFTC on this investigation; IEL also agreed to a \$65m settlement in relation to a related action brought by the CFTC.

Enforcement action

29 October 2013 – Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. (“Rabobank”)

- Rabobank was given a £105m fine by the FCA for “*serious, prolonged and widespread misconduct relating to Libor*”. As part of its investigation, the FCA worked closely with the De Nederlandsche Bank, the Openbaar Ministerie, the Japanese Financial Services Authority, the CFTC and the US Department of Justice. The CFTC imposed a fine of \$475m.

International criminal proceedings...

The UK Serious Fraud Office (the “**SFO**”) is set to bring charges against Tom Hayes, a former trader at both UBS and Citigroup, for alleged Libor-related misconduct; it has been reported that the US Department of Justice is also bringing criminal charges against Mr Hayes.

On 15 July 2013 the SFO published a press release stating that it is bringing charges against Terry Farr and James Gilmour, former brokers at RP Martin Holdings Limited for alleged Libor manipulation.

In addition, former employees of IEL, Rabobank, RBS, Deutsche Bank and UBS were among the 22 individuals that the SFO included as alleged co-conspirators of Mr Hayes on a draft indictment against Mr Hayes. The indictment has since been withdrawn, but the SFO sent a letter to the 22 individuals on 30 September 2013 informing them that they were being investigated in connection with Libor.

Increased international cooperation

Requests to the FCA from overseas regulators are increasing

The FCA has revealed that it received 885 information requests from foreign regulators in 2012, with 250 of these requests coming from the US regulatory authorities. These figures were disclosed as a result of a freedom of information request made to the FCA.

Foreign Exchange Market investigations

The FCA has confirmed that it is “*gathering information from a wide range of sources including market participants*” as part of a formal investigation into alleged manipulation of foreign exchange rates (“**Forex**”) alongside several other international regulators.

The Swiss Financial Market Supervisory Authority and the Hong Kong Monetary Authority have confirmed that they are investigating conduct in currency markets and the US Justice Department has launched a criminal probe.

On 7 October 2013 European antitrust regulators said that they are also reviewing the Forex market.

Other UK and EU regulators

UK

- The FCA and PRA.
- The Financial Ombudsman Service.
- The Office of Fair Trading (*the UK's consumer and competition authority*).
- The Serious Fraud Office.
- Other criminal authorities (e.g. the Criminal Prosecution Service).

Europe

- The European Commission (*the EU's antitrust authority*).
- The European Securities and Markets Authority (**ESMA**) (*independent EU authority which aims to foster supervisory convergence both amongst securities regulators, and across financial sectors by working closely with the other European Supervisory Authorities competent in the field of banking (the EBA), and insurance and occupational pensions (EIOPA)*).
- EIOPA (*independent EU authority which works to support the stability of the financial system, transparency of markets and financial products as well as the protection of insurance policyholders, pension scheme members and beneficiaries*).
- The European Banking Authority ("**EBA**") (*independent EU Authority which works to ensure effective and consistent prudential regulation and supervision across the European banking sector*).

Reporting / Market Surveillance / Enforcement

- Information available to CFTC under new rules will be a tool for assessing compliance with those rules
- Information will be available at several levels for review and investigation
 - Exchanges and SEFs
 - NFA (CFTC registrants)
 - CFTC (all market participants)
- Brokers will continue to be sources for the regulators
 - E.g., exception reporting

Reporting / Market Surveillance / Enforcement

- Regulatory reports will inform exam and enforcement priorities
 - E.g., Forms CPO-PQR and CTA-PR
- CFTC can use existing authorities to identify trading / account relationships and enforce existing rules
 - E.g., position limits
- CFTC cans also use “special call” powers to request information on market developments
 - E.g., recent requests on “exchange of futures for swaps”

Position Limits Proposal / High Frequency Trading Review

- Position Limits
 - Proposal seeks to replace rules vacated by federal court in 2012
 - Would cover 28 core referenced futures contracts
 - Permits exchanges / SEFs to adopt position limits or position accountability rules, including as to “excluded” commodities
 - Limits would apply on futures equivalent basis to other contracts, including swaps
 - Rules for aggregating accounts under position limits proposed separately
 - Comment period closes in early 2014

Position Limits Proposal / High Frequency Trading Review

- High Frequency Trading
 - Concept release puts forth 120+ questions on current regulation and possible reforms
 - Areas of focus include:
 - Pre-trade risk controls
 - Post-trade risk controls
 - System safeguards
 - Other protections
 - Comment period closes on December 11, 2013
 - Next steps are unclear, but this is an area of ongoing concern for the CFTC

Thank you



Helen Marshall

helen.marshall@bingham.com

T +44.20.7661.5378

London



Michael Lloyd Spafford

michael.spafford@bingham.com

T +1.202.373.6190

Washington



Joshua B. Sterling

joshua.sterling@bingham.com

T +1.202.373.6556

Washington

BINGHAM

Beijing
Boston
Frankfurt
Hartford
Hong Kong
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