Commodity Futures Trading Commission—2019 in Review

CFTC 2019 Enforcement and Regulatory Developments and a Look Forward

FEBRUARY 3, 2020

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I. Introduction

In 2019, the Commodity Futures Trading Commission (CFTC or Commission) experienced significant changes in leadership, including the appointment of Dr. Heath P. Tarbert as the Commission's 14th Chairman.[1]

The Division of Enforcement continued to be aggressive, breaking new ground programmatically and in the actions that it brought. Although the Division has faced headwinds when its allegations have been tested in court, we expect that the Division will not be deterred from its current course by these setbacks and will continue aggressively to administer its program.

The change in leadership also has resulted in renewed vigor in the Commission's administrative programs, with particular emphasis on the division's rulemaking activities. The Commission has emphasized consolidation and codifying of prior no-action relief and interpretative guidance, finalizing the few remaining issues to be addressed in order to fully implement the Dodd-Frank Act,[2] and revisiting particular, and limited, issues arising from its rules regulating the swaps markets.

II. Enforcement

The CFTC's Division of Enforcement had another active year in 2019. Overall, the Division of Enforcement filed 69 actions in 2019, slightly exceeding its average over the past five fiscal years (67.5), and obtained over $1.3 billion in penalties, disgorgement and other monetary relief, which represents a 39% increase from 2018, and the fourth-highest total since the CFTC's inception.[3]

In addition to the sheer volume of activity, there were several noteworthy trends and developments in CFTC enforcement over the past year. First, the Division continued to work closely with its counterparts at the Department of Justice (DOJ) on parallel criminal investigations. Second, the Division of Enforcement announced a program to address foreign corrupt practices involving a violation of the Commodity Exchange Act (CEA).[4] Third, for the first time in recent memory, the Commission brought an enforcement action against a registered entity for failing to adopt and enforce rules required by the CEA's Core Principles. Finally, the Commission won a significant ruling in the Ninth Circuit Court of Appeals regarding its authority under Rule 180.1.

Beyond these new developments, the remainder of the Commission's docket reflected its ongoing commitment to market integrity and customer protection. Consistent with the Division's recent focus, the Commission brought 16 cases involving manipulative conduct and spoofing, 25 cases involving commodity fraud, and six matters involving various customer protection issues. The Commission also continued to focus on reporting and recordkeeping issues, including seven cases related to issues with swap data reporting.

Actions Against Clearing Organizations

During 2019, the Commission brought actions against a registered derivatives clearing organization (DCO) and an exempt DCO. Both of these cases reveal a new willingness on the part of the Commission to address issues arising in the oversight of central counterparties (and registered entities) through the Division of Enforcement rather than through the rule enforcement reviews, regulatory audits and similar administrative oversight practices administered by the Commission's regulatory divisions.

On September 4, 2019, the Commission brought a settled action against the Options Clearing Corporation, a registered DCO, marking its first case against a registered entity in over 30 years. As set forth in the Commission's order, OCC allegedly violated the CEA's DCO Core Principles by failing to adopt policies and procedures reasonably designed to produce appropriate margin levels for every product cleared by OCC, effectively manage its credit exposure and liquidity risk, and ensure appropriate information security controls.[5] The Securities Exchange Commission (SEC) brought a parallel action for similar conduct. OCC did not admit or deny the SEC's and CFTC's findings, but agreed to pay a total of $20 million in penalties ($15 million under the SEC's order and $5 million under the CFTC's order). The OCC also replaced many of its most senior executives,

including its CEO, COO, and Head of Financial Risk Management, and dedicated additional resources to its risk management, legal, compliance and IT functions. OCC also agreed to review its internal policies and controls to comply with DCO Core Principles, including retaining an independent compliance auditor to assess its compliance with the applicable regulations.

In July 2019, the CFTC also charged the Korea Exchange, Inc. (KRX), an exempt DCO, with allegedly making a false statement regarding its compliance with the CFTC's exemptive order for observing international financial management standards.[6] While KRX had discovered its violation of those standards and had already begun remedial measures to address those failures, it continued to certify to the Commission that it had complied with the Commission's requirements in "all material respects." In settling this matter, KRX agreed to pay a $150,000 civil penalty and retain an independent third party to assess its compliance with the Commission's exemptive order and submit reports of those assessments to the CFTC for two-and-a-half years.

Interested parties should monitor these developments closely, as it could signal a dramatic shift in the relationship between the Commission and the major derivatives industry infrastructure providers.

Spoofing and Increased Parallel Enforcement Actions

The Commission continued to focus on spoofing in 2019, resulting in a number of high-priority settlements with individuals and entities. In many of these cases, the Commission was assisted by the DOJ, which brought parallel criminal actions against one or more of the same parties. In total, the Commission brought 16 manipulative conduct or spoofing cases in 2019. It also filed 16 actions in parallel with criminal authorities, a record for the agency.[7]

This cooperation led to several noteworthy developments, including the largest spoofing-related settlement in CFTC history.[8] In another material development, the DOJ charged three former traders from a large multinational bank under the Racketeer Influenced and Corrupt Organizations Act for engaging in an alleged spoofing conspiracy; the CFTC brought civil charges against the traders for the same conduct.

We expect this partnership to continue. The CFTC has particular expertise in analyzing market data to identify potential spoofing, while the DOJ has significantly more resources to conduct complicated investigations. Further, individuals may cooperate or plead guilty under the threat of criminal prosecution, increasing both the DOJ's and CFTC's leverage against other participants or their employers.

More generally, we expect spoofing to remain a priority for both the CFTC and DOJ. Regulators and law enforcement agencies have alleged that spoofing schemes have caused material losses to investors and market participants. Moreover, potential spoofing activity is relatively easy to identify,

and, under CEA Section 4c, can be proven without establishing the demanding elements of a traditional manipulation claim. While the government still bears the burden of establishing intent, it has shown that it is adept at directly establishing that element through cooperation agreements or guilty pleas, as well as by using trade data in cases where direct evidence is unavailable.

Foreign Corrupt Practices

In March 2019, the CFTC announced that it would pursue violations of the CEA that involved foreign corrupt practices, including the payment of bribes to secure business in connection with regulated activities or attempts to corruptly manipulate benchmarks or commodity prices that impact derivative contracts within the Commission's jurisdiction. Unlike the SEC, which has independent authority to charge foreign corrupt practices, the CFTC's authority is limited by conduct that violates the CEA's antifraud and antimanipulation provisions. Accordingly, while the CFTC could not directly charge market participants with paying or receiving bribes, it could potentially bring actions for bribes that are facilitated through wash trades or illegal off-exchange transactions, as well as bribes that are intended to affect the price of a commodity in interstate commerce. The CFTC potentially could also bring charges against market participants that pay bribes to fraudulently obtain business from state-owned investment funds.

Although this development does not increase the Commission's authority in any meaningful way, foreign corruption is clearly an area of focus, and market participants should prepare themselves for additional scrutiny of their involvement in foreign derivatives markets and their direct or indirect interactions with foreign state-owned enterprises and government officials.

Authority Under Rule 180.1

In July, the Commission won a significant victory in the Ninth Circuit regarding its authority under Section 6(c)(1) and Rule 180.1 thereunder. This ruling arises from the Commission's 2017 action against Monex Credit Company for defrauding retail customers out of hundreds of millions of dollars while executing thousands of illegal, off-exchange leveraged commodity transactions. In March 2018, the district court dismissed the CFTC's claims after, among other reasons, holding that the CEA did not prohibit fraud in connection with a contract of sale of a commodity in interstate commerce unless the defendant also attempted to manipulate the market. On July 25, 2019, the Ninth Circuit reversed the lower court's decision, holding that the Commission may bring fraud actions under Section 6(c)(1) and Rule 180.1(a), without alleging price manipulation.[9] The Ninth Circuit's decision adopts the CFTC's interpretation and paves the way for standalone fraud claims under those provisions.

Investigation Integrity

As part of its aggressive reading of its enforcement authorities, the CFTC has exhibited a focus on charging conduct that interferes or undermines its investigations.

As part of the 2010 amendments to the CEA implemented through the Dodd-Frank Consumer Protection and Wall Street Reform Act, Section 6 of the CEA was amended to prohibit anyone from making "any false or misleading statement of a material fact to the Commission … if the person knew, or reasonably should have known, the statement to be false or misleading." While Section 6 does not expressly apply to statements made in the conduct of an investigation, the Division of Enforcement has taken the position that liability under Section 6 can extend to false or misleading statements made to the Staff during the course of an investigation.

For example, the CFTC charged Tullet Prebon Americas Corp., an interdealer broker, with violating Section 6 after a supervisor allegedly instructed one of his brokers to "just to answer the questions and not to go on and on about it" before an interview with the staff.[10] According to the settled order, the broker then provided false or misleading statements in his interview. In another matter, the CFTC charged a trader with providing false information in testimony, after he falsely claimed to have always confirmed recommended trades with non-discretionary accounts before fulfilling orders.[11]

The CFTC has also sought significant fines from firms that did not maintain records relevant to ongoing investigations, even where those failures were entirely inadvertent. Most prominently, in November 2019, the CFTC brought a settled action against a large international bank holding company for failing to maintain certain audio recordings for a three-week period, which were required to be maintained under Rules 23.202 and 23.203. [12] This issue was introduced due to an inadvertent hardware issue following the installation of a security patch, and corrected the same day it was discovered. Despite the relatively short nature of the issue, the CFTC fined the bank $1 million, in part because the issue prevented the bank from producing "a significant number of requested recordings" in an unrelated matter, impeding the Commission's investigation.

These matters suggest that the Commission will aggressively charge any activity that it believes impedes its investigative authority or prerogatives. While the subjects of investigations must always take care to provide accurate responses to the responsible regulator, individuals and entities involved in Commission inquiries must be aware of the heightened risk of even inadvertent misstatements. Further, corporate subjects must also be sure that its employees are conducting themselves appropriately, as the Commission appears willing to charge entities for misstatements made by their employees.

Digital Assets

In 2019 the Division and its dedicated Virtual Currencies Task Force continued aggressively to prosecute misconduct involving digital assets. Most significantly, the Commission succeeded in several litigated matters, which confirmed the Commission's authority to prosecute fraud and manipulation involving digital assets that satisfy the broad statutory definition of "commodity."[13] The CEA broadly defines a commodity to include physical commodities, currencies, interest rates, and "all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in."[14]

In 2015, the CFTC first claimed jurisdiction over virtual currencies, which was most recently upheld in federal district court in October 2018.[15] Under this theory, the Commission also brought a number of cases involving frauds related to Bitcoin and other cryptocurrencies.[16] For example, in March 2019, 1pool Ltd. entered into a Consent Order with the CFTC after it had offered unregistered commodity transactions that were required to be registered by the CFTC because they were margined in Bitcoin.[17] The order included $175,000 in civil penalties and $246,000 in disgorgement.

These cases suggest that the Commission will continue its efforts to ensure the integrity of cryptocurrency markets within its jurisdiction through enforcement actions in the absence of, or in advance of, a regulatory framework.

Setbacks

Despite its notable successes, the CFTC also has suffered at least two serious setbacks over the last fiscal year, both of which extend and highlight the continuing difficulty in establishing manipulation claims under the CEA.

First, in *CFTC v. DRW Investments*,[18] CFTC lost a market manipulation case after the Southern District of New York held that the CFTC did not establish that the defendants had manipulated or attempted to manipulate certain interest rate derivatives. Particularly, the CFTC alleged that the defendants rigged a market for certain illiquid interest-rate swaps over seven months, which made a profit of about $20 million. While the defendant acknowledged that its activity was intended to have an effect on the settlement price of the relevant instruments, it maintained that its activity was grounded in a legitimate economic rationale. In ruling against the CFTC, the court held that the CFTC must prove that a defendant intended to create an artificial price by trading uneconomically or otherwise attempting to displace the natural forces of supply and demand and not merely that the defendant intended to affect prices.

Second, in August, the CFTC, Kraft Foods Group Inc. and Mondelēz Global LLC agreed to the U.S. District Court for the Northern District of Illinois' consent order to resolve the parties' market

manipulation litigation in connection with the CFTC's 2015 complaint. Kraft and Mondelēz agreed to pay a civil penalty of $16 million and the entry of an injunction prohibiting them from violating anti-manipulation provisions of the CEA and regulations thereunder. The settlement came with a gag order on both sides, which Kraft subsequently accused the CFTC and several of its commissioners of violating. In response, the district court vacated the settlement, reopened the case and ordered that certain Commissioners appear in person for contempt hearings.[19] Following a petition to stay the district court's order, the 7th Circuit found that the CFTC's Chairman, Commissioners and staff could not be held personally in contempt and that the court could not compel their testimony to "look behind the commission's public statements and administrative record." However, civil contempt proceedings continue against the Commission and the case is headed back to trial. No date has been set.[20]

Although these setbacks differ dramatically, they both highlight the difficulty in establishing manipulation claims under the CEA, and in using the new authority under Dodd-Frank to do so. Nevertheless, we do not expect the Commission to shy away from cases involving alleged manipulations, nor do we expect the Division of Enforcement to depart from its resolve to test legal theories that can be established without meeting the traditional four-part manipulation test.

Enforcement Division Developments

In addition to the Division's substantive work, there were several noteworthy developments regarding the Commission's enforcement program.

First, the Division of Enforcement formed several specialized task forces to focus on foreign exchange, spoofing, virtual currencies, insider trading and Bank Secrecy Act issues.[21] Each task force includes members from each of the CFTC's offices, in Chicago, Kansas City, New York and Washington, D.C. These tasks forces are intended to more effectively allocate the Division's limited resources by leveraging and further developing institutional expertise in each of these complex areas. While it is too early to tell how these task forces will affect the Commission's docket, the SEC has had success with this approach in its own enforcement efforts.

Second, the Division of Enforcement for the first time made its enforcement manual publicly available. This development was a welcome change and provides market participants, industry professionals and the enforcement bar with insights into the Division's detection, investigations and pursuit of alleged violations of the CEA and the regulations thereunder.[22]

Third, the CFTC's whistleblower program grew significantly in 2019.[23] Last year, the whistleblower program issued five awards, with a total payout of about $15.3 million. To put these figures in context, prior to 2019, the whistleblower program had issued a total of nine whistleblower awards. The Division estimates that approximately 30% to 40% of its open investigations involve a

whistleblower, suggesting that the importance of this program will only increase in 2020 and beyond.

III. REGULATORY

Following the mid-year change in leadership, Chairman Tarbert announced an ambitious regulatory agenda, which included addressing post-trade name give-ups for SEFs, speculative position limits, swap dealer capital requirements, cross-border rules for swap dealers, and swap data reporting.[24] Although this agenda was not a major departure from the Commission's existing priorities, it refocused the Commission's efforts and energy on finalizing pending matters, consolidation and codification of existing no-action relief or guidance and addressing the remaining open issues in implementing the Dodd-Frank Act.

Internal Process

In 2019, the Chairman announced a renewed emphasis on process and transparency, resulting in a dramatic increase in open Commission meetings from previous years. Indeed, the seven open Commission meetings held in 2019 exceeded the total number of open meetings held over the prior four years.[25] Chairman Tarbert also expressed reservations regarding staff relief and the use of no-action, interpretive and exemptive relief. Moving forward, CFTC policy will be to limit staff no-action, interpretive and exemptive letters to those situations that are "truly appropriate," including "situations with unique circumstances not suitable for general rulemaking or where only temporary relief is contemplated pending either the rule making process or one or more market events (e.g., Brexit, SOFR transition, etc.)."

The CFTC also formed a number of new advisory subcommittees in 2019. In July, the CFTC announced the formation of a new advisory subcommittee designed to identify and examine climate change-related financial and market risks.[26] On October 28, 2019, the CFTC voted to establish a new subcommittee on non-cleared swaps under the Global Markets Advisory Committee (GMAC).[27] The Subcommittee will examine the implementation of margin requirements for non-cleared swaps, identify challenges associated with upcoming implementation phases and recommend actions to the CFTC to mitigate the challenges identified.

Finally, on December 2, 2019, the CFTC announced the creation of the Central Counterparty Risk and Governance (CCRG) Subcommittee and Market Structures Subcommittee from the current membership of the Market Risk Advisory Committee (MRAC).[28] The CCRG Subcommittee will provide reports and recommendations directly to MRAC regarding current issues impacting clearinghouse risk management and governance, such as pre- and post-trade transparency and reporting regimes, emerging operational risks and the impact of competition on liquidity and market concentration.

Market Structure

In 2019, the Commission proposed or adopted a number of rules to fine tune the treatment of exchange-traded and OTC swaps and address the relationship of the U.S. regulatory framework within the global structure. The Commission, under Chairman Giancarlo's leadership, proposed far-reaching restructuring of the exchange-trading rules and registration requirements for clearing organizations. In contrast, Chairman Tarbert's agenda for swaps trading and clearing has been more incremental in nature.

Proposed Restructuring of Swaps Trading. During the first part of 2019, the Commission issued several major proposals aimed at significantly modifying the market structure for exchange-traded swaps, including a far-reaching proposal to reshape the trading mechanics on swap execution facilities (SEFs) and the associated role of introducing brokers.[29] The proposed rules, among other things, would have required interdealer brokers currently registered as introducing brokers to register as SEFs, expanded the trade execution requirement to cover all swaps listed by a SEF, and permitted greater flexibility in execution methods. This proposal proved to be quite controversial and finalizing it is not included on Chairman Tarbert's agenda. Neither is a proposed sweeping framework to exempt from DCO registration certain non-U.S. central counterparties that clear swaps. [30]

Post-Trade Name Give-Up. The proposal in 2019 with perhaps the greatest potential impact on market structure would prohibit the practice of "post-trade name give-up" for swaps traded anonymously on a SEF and intended to be cleared.[31] This prohibition, proposed by a unanimous Commission, would also apply to third-party trade processing services used to route transaction information from a SEF to a derivatives clearing organization.[32] In the Commission's view, prohibiting this practice will lead to greater participation by a more diverse group of market participants and promote increased liquidity. Market participants have argued that post-trade name give-up is a source of uncontrolled information leakage that could expose a market participant's trading positions, strategies and objectives. Market participants have also argued that post-trade name give-up allows dealers to observe whether investors and other buy-side firms have started to transact in anonymous order books, discouraging buy-side participation. However, post-trade name give-up is a common feature of many SEF trading platforms. For this reason, its prohibition, if adopted, may well constitute the most significant change in market structure since the adoption of the SEF trading rules in 2013, and a range of comments are expected.

Swaps Reporting. The Commission on May 13, 2019, proposed to require swap data repositories (SDRs) and reporting counterparties to verify the accuracy and completeness of swap data, even for terminated swaps. If adopted, the proposal would impose a significant, new reporting burden on SDRs and on swaps reporting parties generally, including significant technological and back-office challenges. [33] This is the first of three expected rulemakings intended to implement the CFTC's previously released "Roadmap to Achieve High-Quality Swaps Data."[34]

Segregation of Assets Held as Collateral in Uncleared Swap Transactions. On March 28, 2019, the CFTC adopted amendments simplifying requirements related to notifying counterparties of their right to segregate their initial margin for uncleared swaps pursuant to an individual segregation arrangement with an independent third-party custodian.[35] The Commission proposed these revisions to lessen the burden on market participants by removing the prescriptive conditions for providing notice to counterparties of their right to segregate initial margin for uncleared swaps and providing additional flexibility for parties to a swap to engage in written segregation arrangements.[36] These amendments, among other provisions, modified the notification provisions of Rule 23.701, replacing specific requirements in Rule 23.702 regarding the withdrawal or turnover of control of initial margin, and eliminating the restriction on investment of segregated margin to investments permitted under Rule 1.25.

Brexit. The Commission took a number of steps preparatory to the market changes that are likely to be occasioned by Brexit. On March 15, 2019, the Prudential Regulators adopted interim final rules (Bank Final Rules) allowing the transfer of qualifying uncleared swaps and security-based swaps out of the United Kingdom (UK) to the European Union (EU) or the United States without triggering Prudential Regulator uncleared swap and security-based swap margin requirements if the UK withdrew from the EU without a negotiated agreement between it and the EU (No-Deal Brexit).[37]

Intermediaries

The Commission took a number of actions relating to intermediaries during 2019. Some, such as codification of the cross-border guidance and no-action letters relating to family offices, provided greater certainty to the market by codifying existing guidance. In addition, other actions addressed new issues, such as how non-recourse clauses of different pools controlled by a single CPO should be addressed under the Commission's rules. However, perhaps the most significant action relating to intermediaries this year is the announcement of a new Division of Swap Dealer and Intermediary Oversight (DSIO) examination program.

Volcker. In another major regulatory development, the Commission joined with the banking regulators in proposing amendments to the rules implementing Section 13 of the Bank Holding Company Act (Volcker Rule.)[38] Section 13 limits banks' and board-supervised nonbank financial companies' ability to engage in proprietary trading and have certain interests in, or relationships with, a hedge fund or private equity fund.[39] Among other things, the amendments create a tiered compliance program based on a banking entity's trading activity, simplify reporting and make a number of changes to the proprietary trading restrictions including reversing the presumption that financial instruments held for less than 60 days are within the short-term intent prong of a trading account.[40]

Margin and Capital. The CFTC took a number of actions in 2019 relating to the CFTC's margin requirements for uncleared swaps.[41] Perhaps the most significant was the October 16, 2019, proposal to delay by one year the date by which swap dealers must comply with the CFTC's initial margin requirements in connection with uncleared swaps with financial end users with $50 billion or less (but more than $8 billion) average daily aggregate notional amount of such transactions.[42]

Family Offices. In December 2019, the Commission adopted final rules that formalize and codify several no-action positions and exemptive letters regarding CPO and CTA registration and compliance regarding family offices and exempt CPOs.[43] Specifically, the amendments provide an exemption from registration for CPOs and CTAs of family offices; adopt exemptive relief consistent with the Jumpstart Our Business Startups Act of 2012 by permitting general solicitation under applicable Commission regulations; and clarify that non-U.S. persons, regardless of financial eligibility requirements applicable to U.S. persons, are permitted participants in exempt pools.

In a second rulemaking the CFTC clarified that the exclusion from the CPO definition currently provided for registered investment companies should be claimed by the entity most commonly understood to solicit for or "operate" the investment company, i.e., its investment advisor, and added an exclusion for the investment advisors of business development companies.[44] The CFTC also adopted amendments to the "Reporting Person" definition that would eliminate the filing requirements for Forms CPO–PQR and CTA–PR for certain classes of CPOs and CTAs.

Examination Priorities. DSIO announced that it will be introducing a program of direct examinations in 2020.[45] Director Sterling stated that, as part of this initiative, DSIO will work closely with the National Futures Association (NFA) to conduct "targeted thematic reviews of select large swap dealers and CPOs."[46] Nevertheless, it will be a challenge to avoid unnecessary duplication with NFA.

Clearing

DCR's major rule initiative was a revision of Part 39 of the Commission's rules, which govern the registration and operation of DCOs. These rules, which were approved by the Commission in a unanimous vote, primarily clarify or codify existing interpretation, guidance or no-action letters. In contrast to the proposed exemptive framework, which would have been far-reaching in its impact, the new rule amendments which were adopted are largely administrative in nature.

The key revisions of Part 39 address the following:

- Governance Fitness Standards, Conflicts of Interest and Composition of Governing Boards: DCOs will be required to include market participants and individuals who are not executives, officers or employees or affiliates of the DCO on the DCO's governing board or board-level committee.

- Enterprise Risk Management: The rule requires that DCOs have an enterprise risk management program and identify their enterprise risk officers. The enterprise risk officer, who may also be the chief risk officer, may report to the board of directors, a committee of the board or the senior officer responsible for the DCO, but should have access to the board of directors.
- Risk Management: When conducting back tests of initial margin requirements, DCOs are required to compare portfolio losses only with those components of initial margin that capture changes in market risk factors.

Although these changes are largely administrative and technical in nature, the changes to the governance requirements may have a longer-term effect, providing for enhanced openness and inclusivity in the governance of DCOs. [47]

IV. Looking Forward

Although the Commission has addressed most of Chairman Tarbert's stated priorities, a few have yet to be addressed and are likely to be tackled during 2020. The Chairman's near-term agenda includes speculative position limits, international issues, revising Form PF and revisions to the bankruptcy rules.

In addition to the chairman's agenda, the Commission will likely face a number of significant issues generated by outside stakeholders, including Commission reauthorization and cross-border matters. More distant, the conversion to the Secured Overnight Financing Rate (SOFR) from LIBOR will likely consume an increasing amount of the Commission's attention.

Speculative position limits. The Commission at an open meeting on January 30, 2020, proposed new speculative position limit rules for futures, options on futures and swaps on certain physical commodities. In proposing these rules, the Commission is addressing the last major part of the Dodd-Frank Act not yet implemented. Past efforts to adopt speculative position limits have been highly contentious, resulting in a rare court challenge to a Commission rulemaking.

As proposed, speculative position limits would apply only in the spot month at a level of 25% of deliverable supply. Designated contract markets would be permitted to set their own position limits or position accountability rules for non-spot months. The list of enumerated hedge exemptions is proposed to be expanded, with a determination of requests for exemption of non-enumerated hedges to be determined by designated contract markets with veto authority by the Commission.

This proposal is likely to find greater acceptance by stakeholders than past attempts to adopt speculative position limits for several reasons. First, the extended period of sustained low energy prices in the U.S. has created a favorable environment for consideration of these proposed rules. Second, as Chairman Tarbert has recognized, a practical approach to implementing an effective

hedge exemption process is critical to the acceptance of any proposal.[48] Finally, many in the market may be resigned to the adoption of new speculative position limits and recognize that the current proposal mitigates many of the features most opposed in earlier proposals. We anticipate that final rules likely will be adopted in 2020 and that market participants in the latter part of the year will be implementing new policies and procedures related to speculative position limits.

International issues. Cross-border issues are likely to remain front and center as the Commission addresses Brexit-related issues and the Commission's relationship with the EU. Although the CFTC and the European Commission (EC) had a fruitful discussion on cross-border issues on September 5, 2019, the underlying concerns regarding reciprocity and aggressive cross-border regulation remain unresolved, particularly with the implementation of EMIR 2.2.[49]

A recent vote to approve the registration of three European foreign boards of trade (FBOTs) highlights the continuing tension. In voting to approve the registrations, Chairman Tarbert expressed hope that the approvals were a sign of the CFTC's "good faith and continuing commitment to negotiate with the European Commission and ESMA about significant issues." [50] However, while Commissioner Berkovitz voted to approve the registrations, he noted that the Commission could revisit its decision based on "any material changes in the applicable regulatory regimes, including developments relating to international comity," and indicated that a foreign jurisdiction's "lack of reciprocity could call into question whether a foreign regulatory regime is in fact comparable to the Commission's framework for markets and market participants in the United States," a necessary condition for FBOT registration.[51] More pointedly, Commissioner Quintenz dissented from registering EU-based markets until greater progress is made on the outstanding issues with the EU, stating:

> Today's vote, however, is not on a proposal, but on multiple final formal registrations. While I believe the Chairman and all my fellow Commissioners are just as committed to a satisfactory resolution to this cross-border discussion with the E.U. as I am, I question whether we should act on this today and under what conditions the decision will be made to reconsider this status should this discussion not resolve productively.
>
> FBOT registration depends on the CFTC's trust in our E.U. counterparts. Such trust continues to be misplaced until the E.U. can provide assurance that the CFTC-EC CCP Agreement will be upheld. [52]

Due to the global nature of the swaps market, the CFTC and its foreign counterparts will need to come to agreement regarding international comity and reciprocity. We anticipate that these issues will continue to be at the forefront of the CFTC's agenda, particularly as Brexit moves forward this year.

Reauthorization. The process to reauthorize the CFTC made significant progress in late 2019, but it is unclear whether Congress will continue to make headway in 2020, given the election year and competing demands for Congress' attention. On October 29, Committee Chairman Collin Peterson (D-MN) formally introduced the CFTC Reauthorization Act of 2019 (H.R. 4895).[53] The Agriculture Committee held a markup and passed the bill by voice vote,[54] with amendments, thereafter. However, the bill has not yet gone to the House floor for a final vote. Although Chairman Peterson expects the bill to be considered under suspension of the House of Representatives rules, a procedure typically reserved for expedited consideration of non-controversial legislation, the Congressional Progressive Caucus and other groups have expressed concerns about the bill, for, among other things, changing the way costs and benefits for CFTC regulations are evaluated, potentially reducing the burden for a petitioner in a rule challenge proceeding.[55] Despite the early progress, it is uncertain whether the process will be completed this year in light of the impeachment trial in the Senate and election year politics. Nevertheless, the reauthorization process will undoubtedly occupy a significant portion of the Commission's attention.

Security-based Swaps

In 2019 the SEC finalized the remaining rulemakings required to stand up the security-based swap regulatory regime. The final rules will be effective March 1, 2020, or 60 days following publication of the rules in the Federal Register (the Effective Date).[56] The compliance date for registration of security-based swap dealers (SBSDs) will be 18 months thereafter (i.e., likely September 1, 2021) (the Registration Compliance Date).

Many of the relevant rules, including (i) segregation, capital and margin; (ii) SBSD recordkeeping; (iii) business conduct standards; and (iv) trade acknowledgment and verification requirements will become effective on the Registration Compliance Date.[57] However, certain reporting rules will sunset four years after the compliance date for Regulation SBSR (Reporting and Dissemination of Security-Based Swap Information) for an asset class.[58]

We anticipate that during the coming year much of the industry's attention will be focused on compliance with the security-based swap regulatory framework.

LIBOR. Finally, LIBOR is slated to cease in 2021. The Commission is likely to play a key role in facilitating the transition. The pace of transition activities by the private sector and by regulatory authorities, including the Commission, is likely to quicken toward the end of 2020 and throughout 2021, as the challenges of transitioning to SOFR become more pressing.

V. Conclusion

2019 has been an active year for both enforcement and administrative matters. We expect that the Commission will continue in the early part of 2020 to vigorously pursue its stated agenda, though

activity may slow as the 2020 election nears, providing market participants an opportunity to assess the steps that they must take to keep current with the changes.

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[1] On July 15, 2019, Dr. Heath P. Tarbert succeeded former Chairman J. Christopher Giancarlo. Over the course of the year, the Commission also appointed new Directors of the Divisions of Market Oversight, Clearing and Risk, and Swap Dealer and Intermediary Oversight, as well as new heads of the Office of International Affairs, Office of Legislative and Intergovernmental Affairs, and the Office of Public Affairs. Of division directors, only the Director of Enforcement remained unchanged.

[2] Dodd-Frank Consumer Protection and Wall Street Reform Act, Public Law 111–203, 124 Stat. 1376 (2010) ("Dodd-Frank Act").

[3] CFTC, CFTC Division of Enforcement Issues Annual Report for FY 2019 (Nov. 25, 2019), https://www.cftc.gov/PressRoom/PressReleases/8085-19.

[4] 7 U.S.C. §1 et seq.

[5] Order, *In re The Options Clearing Corp.*, CFTC Docket No. 19-19 (Sept. 4, 2019); Press Release, CFTC, SEC and CFTC Charge Options Clearing Corp. with Failing to Establish and Maintain Adequate Risk Management Policies, PR800-19 (Sept. 4, 2019), https://www.cftc.gov/PressRoom/PressReleases/8000-19.

[6] Order, *In re Korea Exch., Inc.*, CFTC Docket No. 19-10 (Jul. 12, 2019); Press Release, CFTC, CFTC Issues Order Finding that Korea Exchange, Inc. Made False and Misleading Certification to the CFTC, PR797119 (Jul. 12, 2019), https://www.cftc.gov/PressRoom/PressReleases/7971-19 (the order found that Korea Exchange, Inc. (KRX) falsely represented in its annual certification that it was in compliance with the CFTC's exemptive order requiring it to follow certain international financial management standards).

[7] CFTC, CFTC Division of Enforcement Issues Annual Report for FY 2019 (Nov. 25, 2019), https://www.cftc.gov/PressRoom/PressReleases/8085-19.

[8] Order, *In re Tower Research Capital LLC*, CFTC Docket No. 20-06 (Nov. 6, 2019); *see also* Deferred Prosecution Agreement (DPA), *Tower Research Capital LLC*, No.: 19-cr-819 (S.D. Tex. Oct. 24, 2019).

[9] *CFTC v. Monex Credit Company*, 931 F.3d 966 (9th Cir. 2019); Press Release, CFTC, Ninth Circuit Rules in Favor of CFTC in Fraud Case Against Monex Deposit Company and Its Principals, PR7984-19 (Jul. 26, 2019), https://www.cftc.gov/PressRoom/PressReleases/7984-19.

[10] Order, *In re Tullet Prebon Americas Corp*., CFTC Docket No. 19-24 (Sept. 13, 2019); Press Release, CFTC, CFTC Orders Interdealer Broker to Pay $13 Million for Supervisory Failures and False Statements, PR8012-19 (Sept. 13, 2019), https://www.cftc.gov/PressRoom/PressReleases/8012-19.

[11] Order, *In re Rafael Novales*, CFTC Docket No. 19-35 (Sept. 30, 2019); Press Release, CFTC, CFTC Charges Former Registrant with Making False and Misleading Statements During a CFTC Investigation, PR8026-19 (Sept. 30, 2019), https://www.cftc.gov/PressRoom/PressReleases/8026-19.

[12] Order, *In re Goldman, Sachs Group, Inc. and Goldman, Sachs & Co.*, CFTC Docket No. 20-10 (Nov. 26, 2019); Press Release, CFTC, CFTC Orders Goldman Sachs to Pay $1 Million for Recordkeeping Violations, PR8086-19 (Nov. 26, 2019), https://www.cftc.gov/PressRoom/PressReleases/8086-19.

[13] Memorandum of Decision, *CFTC v. My Big Coin Pay, Inc.*, No. 18-cv-10077, ECF No. 106 (D. Mass. filed Sept. 26, 2018); Press Release, CFTC, Federal Court Finds that Virtual Currencies Are Commodities, PR7820-18 (Oct. 3, 2018), https://www.cftc.gov/PressRoom/PressReleases/7820-18; Final Judgment and Order, *CFTC v. Patrick K. McDonnell and CabbageTech, Corp. d/b/a Coin Drop Markets*, No. 18-cv-00361, ECF No. 173, (E.D.N.Y. filed Aug. 23, 2018); Press Release, CFTC, CFTC Wins Trial against Virtual Currency Fraudster, PR7774-18 (Aug. 24, 2018), https://www.cftc.gov/PressRoom/PressReleases/7774-18.

[14] Commodity Exchange Act § 1a(9), 7 U.S.C. § 1a(9).

[15] Press Release, CFTC, Federal Court Finds that Virtual Currencies Are Commodities, PR7820-18 (Oct. 3, 2018), https://www.cftc.gov/PressRoom/PressReleases/7820-18.

[16] Complaint, *CFTC v. Jon Barry Thompson*, No. 19-cv-09052 (S.D.N.Y. Sept. 30, 2019); Press Release, CFTC, CFTC Charges Individual with Multi-Million Dollar Bitcoin Fraud, PR8023-19 (Sept. 30, 2019), https://www.cftc.gov/PressRoom/PressReleases/8023-19; Complaint, *CFTC v. Control-Finance Ltd., and Benjamin Reynolds*, No. 19-cv-05631 (S.D.N.Y. Jun. 17, 2019); Press Release, CFTC, CFTC Charges Company and its Principal in $147 Million Fraudulent Bitcoin Trading Scheme, PR7938-19 (June 18, 2019), https://www.cftc.gov/PressRoom/PressReleases/7938-19.

[17] Consent Order, *CFTC v. 1Pool Ltd.*, No. 18-CV-2243, ECF No. 14 (D.D.C. Mar. 4, 2019), https://www.cftc.gov/sites/default/files/2019-03/enfconsentorder1poolltdandbrunnertrustcompanycomplex.pdf.

[18] *See U.S. Commodity Futures Trading Comm'n v. Wilson and DRW Invs., LLC*, No. 13-cv-07884, 2018 WL 6322024, at *1 (S.D.N.Y. Nov. 30, 2018).

[19] Mike Scarcella, *US Appeals Court Stops Judge's Contempt 'Inquest' of CFTC Leaders*, LAW.COM, Oct. 22, 2019, https://www.law.com/nationallawjournal/2019/10/22/us-appeals-court-stops-judges-contempt-inquest-of-cftc-leaders/.

[20] Dave Michaels, *Market Regulator Heads Back to Court Against Kraft and Mondelez*, WALL ST. J., Jan. 3, 2020, https://www.wsj.com/articles/market-regulator-heads-back-to-court-against-kraft-and-mondelez-11578056400.

[21] CFTC, Annual Report on the Division of Enforcement (Nov. 2018), https://www.cftc.gov/sites/default/files/2018-11/ENFAnnualReport111418_0.pdf.

[22] CFTC, Division of Enforcement, ENFORCEMENT MANUAL (May 8, 2019) (According to CFTC Director of Enforcement James McDonald, this move is intended to "promote fairness, increase predictability, and enhance respect for the rule of law."), https://www.cftc.gov/LawRegulation/Enforcement/EnforcementManual.pdf; *see also* WilmerHale's client alert, "CFTC Releases Enforcement Manual in Hopes of Increasing Transparency" (May 29, 2019), https://www.wilmerhale.com/en/insights/client-alerts/20190528-cftc-releases-enforcement-manual-in-hopes-of-increasing-transparency.

[23] The CFTC's whistleblower program was established in 2011 under the Dodd Frank Act. *See* Dodd-Frank Wall Street Reform & Consumer Protection Act, Pub L. No. 111-203, tit. VII, § 748, 124 Stat. 1376, 1739 (July 21, 2010) (codified at 7 U.S.C. § 26); Whistleblower Awards Process, 82 Fed. Reg. 24,487 (May 30, 2017); Whistleblower Incentives & Protection, 76 Fed. Reg. 53,171 (Aug. 25, 2011).

[24] Heath P. Tarbert, Chairman, CFTC, Remarks at the 35th Annual FIA (Futures Industry Association) Expo (Oct. 30, 2019), https://www.cftc.gov/PressRoom/SpeechesTestimony/opatarbert2. The Chairman's agenda also included amendments to the CPO/CTA rules; revisions to Form PF; principled guidance on digital assets; enforcement penalty guidance; revisions to the bankruptcy rules, and guidance on principles-based rulemaking.

[25] See CFTC, Upcoming Events, https://www.cftc.gov/PressRoom/Events/CommissionMeetings/index.htm (last visited Jan. 27, 2020).

[26] Request for Nominations for the Climate-Related Market Risk Subcommittee Under the Market Risk Advisory Committee, 84 Fed. Reg. 32,888 (Jul. 10, 2019).

[27] Press Release, CFTC, CFTC Commissioner Stump Announces New GMAC Subcommittee on Margin Requirements for Non-Cleared Swaps, PR8064-19 (Oct. 28, 2019), https://www.cftc.gov/PressRoom/PressReleases/8064-19.

[28] Press Release, CFTC, CFTC Commissioner Behnam Announces Two New Subcommittees of the Market Risk Advisory Committee, PR8087-19 (Dec. 2, 2019), https://www.cftc.gov/PressRoom/PressReleases/8087-19.

[29] Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61,946 (Nov. 30, 2018).

[30] 83 Fed. Reg. at 61946. The Commission also proposed a sweeping exemptive framework from registration as a Derivatives Clearing Organization (DCO). "Exemption From Derivatives Clearing Organization Registration," 84 Fed. Reg. 35456 (July 23, 2019). The exemption was proposed pursuant to the Commission's authority under section 5b(h) of the Act to exempt those clearing organizations subject to "comparable, comprehensive supervision and regulation" by a home country regulator. To facilitate this, the Commission also proposed to allow persons located outside of the United States to accept funds from U.S. persons to margin swaps cleared at an exempt DCO without registering as FCMs. Finalizing this proposal also is not on Chairman Tarbert's agenda.

[31] The practice refers to the disclosure of each swap counterparty's identity to the other after a trade intended to be cleared has been matched anonymously on a SEF. Post-trade name give-up originated in OTC markets for uncleared swaps as a means to verify the creditworthiness of the counterparties. The CFTC had previously proposed the rule on November 30, 2018, citing central clearing as favoring anonymity of matched trades. All comment letters submitted in response to the Name Give-Up Release are available through the Commission's website at https://comments.cftc.gov/PublicComments/CommentList.aspx?id=2935.

[32] The rule would not apply to name-disclosed methods of execution on a SEF, such as requests for quotes, or to uncleared transactions or OTC transactions.

[33] *See* Certain Swap Data Repository and Data Reporting Requirements, 84 Fed. Reg. 21044 (May 13, 2019) (Proposed Rule).

[34] CFTC, *Roadmap to Achieve High-Quality Swaps Data*, July 10, 2017, https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/dmo_swapdataplan071017.pdf.

[35] Segregation of Assets Held as Collateral in Uncleared Swap Transactions, 84 Fed. Reg. 12894 (Apr. 3, 2019).

[36] *Id.* at 12896.

[37] Margin and Capital Requirements for Covered Swap Entities, 80 Fed. Reg. 74840 (Nov. 30, 2015), available at https://www.govinfo.gov/content/pkg/FR-2015-11-30/pdf/2015-28671.pdf.

[38] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With Hedge Funds and Private Equity Funds, 84 Fed Reg 2778 (Feb. 8, 2019).

[39] Final rules were adopted by the banking regulators, the SEC and the CFTC in July. The changes primarily relate to the rule's proprietary trading and compliance program requirements.

[40] Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds, 84 Fed. Reg. 35008 (Jul. 22, 2019).

[41] In 2016, the CFTC promulgated rules for covered swap entities, establishing requirements to collect and post initial margin and variation margin for uncleared swaps. Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016). Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016). Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016).

[42] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 84 Fed. Reg 56950 (Oct. 24, 2019).

[43] Registration and Compliance Requirements for Commodity Pool Operators (CPOs) and Commodity Trading Advisors: Family Offices and Exempt CPOs, 84 Fed. Reg. 67355 (Dec. 10, 2019).

[44] Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors: Registered Investment Companies, Business Development Companies, and Definition of Reporting Person, 84 Fed. Reg. 67343 (Dec. 10, 2019).

[46] Joshua B. Sterling, Remarks by DSIO Director Joshua B. Sterling Before the Alternative Investment Management Association (Oct. 30, 2019), https://www.cftc.gov/PressRoom/SpeechesTestimony/opasterling4.

[47] The amendments also include revisions to default committee procedures and reporting requirements.

[48] *See* Transcript of Nomination Hearing of Heath P. Tarbert, of Maryland, to be Chairman and a Commissioner of the CFTC (Mar. 13, 2019), https://www.agriculture.senate.gov/imo/media/doc/03.13.19%20Nomiation%20Hearing%20of%20Heath%20P.%20Tarbert.pdf.

[49] Press Release, Joint Statement of the CFTC and the European Commission Following Meeting on Cross-Border Derivatives Regulatory Issues, PR8009-19 (Sept. 13, 2019), https://www.cftc.gov/PressRoom/PressReleases/8009-19?utm_source=govdelivery.

[50] Heath P. Tarbert, Commissioner, CFTC, Statement Before the Nov. 5, 2019 Open Meeting (Nov. 5, 2019), https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement110519.

[51] https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement110519.

[52] Brian Quintenz, Commissioner, CFTC, Dissenting Statement Before the Open Commission Meeting of November 5, 2019 (Nov. 5, 2019), https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement110519.

[53] CFTC Reauthorization Act of 2019, H.R. 4895 (Oct. 29, 2019), https://www.congress.gov/bill/116th-congress/house-bill/4895/actions?KWICView=false.

[54] House Committee on Agriculture, *Full Committee Business Meeting – Reauthorization of the Commodity Futures Trading Commission* (Oct. 30, 2019), https://agriculture.house.gov/calendar/eventsingle.aspx?EventID=1338.

[55] Rebecca Burns, *House Democrats Poised to Rubber-Stamp the "Achilles' Heel of Dodd-Frank,"* THE INTERCEPT, Dec. 3, 2019, https://theintercept.com/2019/12/03/wall-street-house-democrats-financial-regulations-cftc/.

[56] Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements, Exchange Act Release No. 34-87780, at 276 (Dec. 18, 2019), https://www.sec.gov/rules/final/2019/34-87780.pdf.

[57] *Id.* at 278.

[58] *Id*.