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Financial Markets and Funds

A New Captain at the Helm: The CFTC's 16-Month Regulatory and Enforcement Agenda Under Chairman Tarbert

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Key Topics

- Dr. Heath Tarbert, new CFTC chair, will need to set an agenda that addresses challenges such as unfinished business remaining from former-Chairman Giancarlo’s tenure and a rapidly changing derivatives market, making the most with the CFTC’s limited resources.
- Chairman Tarbert’s willingness to appoint multiple industry experts with a wide range of relevant experience to serve in high-level CFTC staff positions bodes well for future success.
- Katten has broken down regulatory and enforcement-related topics into four sections, which correspond with the relevant operating divisions of the CFTC (the Division of Market Oversight; the Division of Swap Dealer and Intermediary Oversight; the Division of Clearing and Risk; and the Division of Enforcement) and assigned a “Likelihood Score” to serve as a helpful guide on the likelihood that a particular initiative will be accomplished in the next 16 months.¹

On July 15, Dr. Heath Tarbert became the Commodity Futures Trading Commission’s (“CFTC” or “Commission”) 14th chair.² Chairman Tarbert has had a distinguished career in both public service and the private sector, including his most recent posts at the US Department of the Treasury as Assistant Secretary for International Markets and as Acting Under-Secretary for International Affairs.

Chairman Tarbert has joined the Commission at a time when the global derivatives markets are at the precipice of major changes with the proliferation of cryptocurrency trading, potential market disruption resulting from major geopolitical and financial market events such as Brexit and the replacement of the London Interbank Offered Rate (LIBOR) as a key reference rate in derivatives documentation, as well as calls from senior US policy-makers to finalize — once and for all — the agency’s position limits rulemaking without delay.³

¹ The information in this report is for informational purposes only and is derived from sources believed to be reliable as of September 24, 2019. No representation or warranty is made regarding the accuracy of any statement or information in this report. Also, the information in this article is not intended as a substitute for legal counsel, and is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. The impact of the law for any particular situation depends on a variety of factors; therefore, readers of this article should not act upon any information in the article without seeking professional legal counsel. Views of the authors may not necessarily reflect views of Katten or any of its partners, employees or clients. Katten may represent one or more entities mentioned in this paper.

² This number does not include the 10 acting chairs who led the agency since its formation in 1974.

³ See, e.g., Letter from US Senators Maria Cantwell, Sherrod Brown and Dianne Feinstein to CFTC Chairman Timothy Massad (Dec. 14, 2016), available at [here](#); Letter from US Senators Maria Cantwell, Sherrod Brown, Joe Donnelly and Dianne Feinstein to CFTC Chairman Timothy Massad (Mar. 18, 2016), available [here](#).

And while the Commission has promulgated most of its required swaps rulemakings pursuant to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act” or “Dodd-Frank”),⁴ there are some rulemaking topics that remain unfinished or require fine-tuning. Indeed, under Chairman Tarbert’s predecessor, J. Christopher Giancarlo, the Commission reconsidered various policy issues, including the agency’s trading rules for swaps, and it is possible that the Commission may continue its effort to refine its regulatory approach on these issues.

Not much is known at this point regarding Chairman Tarbert’s regulatory agenda. He has not provided much detail or publicly announced his areas of focus except for some general statements during his confirmation process and in a couple of press statements.⁵ For instance, in a recent op-ed, Chairman Tarbert shared his broad vision for the agency to return to a more pragmatic and principles-based approach to adopting regulations and guidance. Likewise, in a recent speech, Chairman Tarbert previewed a strategic plan that he intends to release in the coming weeks.⁶ As outlined, the strategic plan will address five main themes: (1) strengthening the resiliency and integrity of the derivatives markets while fostering their vibrancy; (2) regulating derivatives markets while protecting the interests of all Americans; (3) encouraging innovation and enhancing the regulatory experience for US and non-US market participants; (4) staying “tough on those who break the rules”; and (5) focusing on the unique mission of the CFTC and improving its operational effectiveness.⁷ He has not, however, offered up many specific details about which rulemakings or regulatory issues the agency will prioritize.

Although Chairman Tarbert’s term as a commissioner is set to end in April 2024, depending on the outcome of the next US presidential election, his tenure as CFTC chairman could be much shorter. Given this unknown, market participants and industry observers are very focused on which rulemaking topics and regulatory issues Chairman Tarbert and the agency can likely address and/or undertake within the next 16 months.

This report forecasts the CFTC’s regulatory agenda over the 16 months under Chairman Tarbert. Katten provides brief summaries of the various rulemaking topics and regulatory initiatives that the Commission could address within this time period and predicts the likelihood that the agency will finalize a rulemaking or take final action with respect to a particular issue.⁸

The information in this report is grouped into four sections, each of which focuses on initiatives that may be undertaken by one of the following divisions of the CFTC: (1) the Division of Market Oversight (DMO); (2) the Division of Swap Dealer and Intermediary Oversight (DSIO); (3) the Division of Clearing and Risk (DCR); and (4) the Division of Enforcement (DOE). The report is organized in this fashion in order to group the topics and issues in accordance with the staff that is charged with managing those topics and issues. In each of these sections, we also explain how Chairman Tarbert’s senior staff choices (e.g., his recent hires to lead DCR and DSIO, as well as his decision to keep a senior counsel in the chairman’s office who worked under former CFTC Chairman Giancarlo and who focused on

⁴ Pub. L. 111-203, 124 Stat. ̄376 (2010).

⁵ See US Senate Committee on Agriculture, Nutrition, & Forestry, Nomination Hearing of Heath P. Tarbert (Mar. 13, 2019), available [here](#); See Heath Tarbert, “Why the CFTC is the most important regulator you’ve never heard of,” Fox Business (July 29, 2019), available [here](#). See also CFTC Chairman Heath Tarbert Fireside Chat, Program on Corporate Compliance and Enforcement at New York Law School (Sept. 10, 2019), available [here](#).

⁶ See Closing Remarks of Chairman Heath P. Tarbert, CFTC Open Meeting (Sept. 16, 2019), available [here](#).

⁷ See *id.*

⁸ The views expressed in this Alert are solely those of the authors and reflect an analysis of publicly available information and sources. This Alert and the analysis provided herein are not based on non-publicly available information provided by the CFTC, its commissioners or staff. Katten may represent one or more entities mentioned in this paper.

cross-border swap issues) may affect his policy decisions and indirectly signal his intent to focus on specific rulemaking topics and regulatory issues.⁹

Finally, with respect to each topic, this report evaluates the likelihood that the Commission will take action by assigning a “Likelihood Score” to each action based on a score of five-to-one, with five signifying a very high probability that the Commission **will** act and one signifying a very high probability that the Commission **will not** take action on a particular rulemaking or regulatory issue. However, unknown intervening events between now and the termination of Chairman Tarbert’s term could have a material impact on the likelihood of any predicted Commission action or inaction. Sixteen months is a very short time to achieve more than just a few priorities in Washington, DC.

The Division of Market Oversight

DMO staff has been working on several significant rulemakings over the past two years under the previous CFTC chairman. That work was largely stewarded by the previous DMO Director Amir Zaidi, who recently left the Commission for the private sector. In his place, Chairman Tarbert announced that Dorothy DeWitt will serve as the new DMO Director. Ms. DeWitt will join the CFTC from Coinbase Inc., which is one of the world’s largest cryptocurrency exchanges, where she served as Vice President and General Counsel for Business Lines and Markets. Prior to Coinbase, Ms. DeWitt served in senior legal and compliance roles for Citadel Securities LLC.

Separately, Chairman Tarbert has hired Andrew Ridenour to his office’s professional staff, who was previously special counsel in DMO and who, prior to returning to the Commission, had developed meaningful cryptocurrency experience as general counsel for Coinbase. The hires of Ms. DeWitt and Mr. Ridenour could signal that Chairman Tarbert will take a friendlier position with respect to issues involving virtual currencies; at a minimum, his decisions regarding virtual currencies will be highly informed.

Aside from these personnel changes, we expect that DMO may likely put forward to the Commission for its consideration draft text on the following rulemaking topics: (a) re-proposed rules establishing new speculative position limits and exemptions from those limits; (b) new swaps trading regulations that could potentially supplant the existing swaps trading regulations promulgated under Dodd-Frank; (c) rules and guidance pertaining to the regulation of virtual currencies; and (d) regulations specifically applicable to automated trading. A discussion of each of these rulemaking topics follows, along with our assessment of, and rationale for, the respective Likelihood Score.

Speculative Position Limits

Several decades ago, pursuant to its authority under CEA Section 4a, the CFTC first promulgated regulations for the establishment of federal speculative position limits for futures and options contracts on certain enumerated agricultural commodities. The CFTC’s legacy position limits regime is broken into three components: (1) the level or threshold of speculative positions a person may hold in the spot month, any individual month, and all months combined; (2) exemptions for positions that constitute bona fide hedging transactions and certain other types of transactions; and (3) rules to determine which accounts and positions a person must aggregate for the purpose of determining compliance with the position limit levels.

⁹ See CFTC Press Release 7987-19, “Chairman Tarbert Announces Key Executive Leadership Appointments” (July 30, 2019), available [here](#). See also CFTC Press Release 7977-19, “Chairman Tarbert Announces Key Office Appointments,” (July 17, 2019), available [here](#).

Since the passage of Dodd-Frank, several past CFTC chairpersons have endeavored to finalize all three components of the CFTC's position limits regime in order to conform the requirements of the CFTC's existing regulations to specific changes introduced by Dodd-Frank. To date, the CFTC has not adopted various proposed changes to the first and second components,¹⁰ whereas the CFTC has successfully adopted final rules addressing the third component — rules for aggregating a person's accounts and positions for compliance with position limit levels for the legacy enumerated agricultural commodity contracts.¹¹ The CFTC also has finalized speculative position limits for security futures.¹² Finally, CFTC staff has issued and recently extended no-action relief delaying compliance with many of the obligations in that rule.¹³

Like his predecessors, Chairman Tarbert has promised to do the same. In his Senate confirmation hearing, in response to questions from Senate Agriculture Committee Chair Pat Roberts and Ranking Committee Member Debbie Stabenow, he stated that he would work to "get it done."¹⁴ It also has been widely noted that DMO staff has been hard at work for over a year on a new position limits proposal.¹⁵ Based on Chairman Tarbert's public statements and the current status of internal drafts of the new proposal, we believe that the Likelihood Score of the agency proposing and finalizing a new position limits rulemaking is five (i.e., highly probable) within the next 16 months.

Swaps Trading Regulations

In May 2013, the CFTC adopted final rules for the regulation of swap execution facilities (SEFs) and mandatory swaps trading.¹⁶ In general, these rules sought to establish core requirements for SEFs, and processes by which SEFs and designated contract markets (DCMs) may make swaps "available to trade."¹⁷ Market participants expressed concerns that these newly adopted rules would stifle innovation and impose excessive compliance burdens, leading to market fragmentation, low trading liquidity, and as a result, increased risk.¹⁸

In January 2015, then-Commissioner Giancarlo published a white paper (the "2015 Trading White Paper") that was critical of the CFTC's swaps trading rules.¹⁹ The 2015 Trading White Paper echoed many of the same concerns expressed by the industry, adding that the rules hindered technological innovation, created risk regarding algorithmic

¹⁰ See, e.g., 81 Fed. Reg. 96704 (Dec. 30, 2016); 81 Fed. Reg. 38458 (June 13, 2016); 78 Fed. Reg. 75680 (Dec. 12, 2013); 76 Fed. Reg. 4752 (Jan. 26, 2011); 76 Fed. Reg. 71626 (Nov. 18, 2011).

¹¹ 81 Fed. Reg. 91454 (Dec. 16, 2016).

¹² The CFTC formally adopted the final rule on September 16, 2019, with publication in the Federal Register forthcoming.

¹³ See DMO Staff No-Action Letter 19-19, (Aug. 1, 2019), which extend the relief provided by DMO Staff No-Action Letter 17-37 until August 12, 2022.

¹⁴ See US Senate Committee on Agriculture, Nutrition, & Forestry, Nomination Hearing of Heath P. Tarbert (Mar. 13, 2019), available [here](#).

¹⁵ See *id.* See also US Senate Agriculture, Nutrition, & Forestry Committee Hearing, "State of the CFTC: Examining Pending Rules, Cryptocurrency Regulation and Cross Border Agreements" (Feb. 15, 2018), available [here](#) (Former Chairman Giancarlo's responses to questions from US Senator Debbie Stabenow).

¹⁶ 78 Fed. Reg. 33475 (June 4, 2013); 78 Fed. Reg. 33605 (June 4, 2013).

¹⁷ The rules mandate that all SEFs must offer an "order book" in which all market participants have the ability to enter, serve, and transact multiple bids and offers. In addition, all SEFs offering request-for-quote (RFQ) trading functionalities must require each RFQ to be sent to no fewer than three market participants with respect to swaps that have been made "available to trade." Likewise, the rules establish the mechanism by which a SEF or DCM may determine that a swap has been made "available to trade." In conjunction with the issuance of these rules, the CFTC also issued guidance to the Commodity Exchange Act (CEA), prohibiting certain "disruptive trading practices," such as transacting at prices outside of the bid-ask spread, and spoofing.

¹⁸ See International Swaps and Derivatives Association. A Path Forward for Centralized Execution of Swaps. April 2015, available [here](#).

¹⁹ Giancarlo, J. Christopher. Prop-Reform Reconsideration of the CFTC's Swap Trading Rules: Return to Dodd-Frank. January 29, 2015, available [here](#).

trading, threatened job creation in swaps execution and made SEF operation highly expensive and burdensome. He further argued that the existing rules do not align with the letter or intent of Title VII. As a solution, the 2015 Trading White Paper proposed an alternative framework, built upon principles of comprehensiveness, cohesiveness, flexibility, professionalism and transparency.

Once he became chairman, then-Chairman Giancarlo led the CFTC to issue a proposal completely reforming the CFTC's SEF and swaps trading rules in November 2018.²⁰ Consistent with the proposed alternative framework set forth in the 2015 Trading White Paper, the 2018 proposal aimed to clarify that SEFs may offer a much broader range of execution methods (rather than offering only order books and RFQ functionalities) and eliminate the made "available to trade" process in favor of expanding the mandatory trading requirement to cover swaps subject to the CFTC's clearing mandate. The 2018 proposal also sought to regulate a new category of professionals, which the proposal referred to as SEF trading specialists. Finally, the proposal sought to reduce certain compliance and operational burdens on SEFs.

Before former-Chairman Giancarlo had time to finalize the 2018 proposal, however, Chairman Tarbert started his tenure at the agency. Since taking office, Tarbert has not publicly shared his views on swaps trading regulation. We believe that he may not prioritize reforming the CFTC's existing swaps trading like former Chairman Giancarlo. For that reason, we believe that the Likelihood Score for the CFTC to finalize all aspects of the 2018 proposal within the next 16 months is two (i.e., probably unlikely). Chairman Tarbert may, however, decide to finalize certain aspects of the 2018 proposal.

Oversight over Virtual Currencies

The CFTC determined in 2015 that virtual currencies are generally defined as commodities.²¹ While most of the notable virtual currencies exist on a blockchain that serves as a distributed ledger, the CFTC interprets the term "virtual currency" more broadly, to encompass essentially any digital unit of value that is used as a medium of exchange or as a form of currency.²²

In general, commodity spot transactions are not subject to direct CFTC oversight, while transactions in futures, options and other derivatives are. The CFTC directly regulates exchanges for derivatives contracts relating to commodities, including markets for virtual currency derivatives. To the extent that the underlying spot transaction markets for commodities are susceptible to fraud and manipulation, the dysfunction interferes with a healthy derivatives market, and therefore the spot markets become an area of concern to the CFTC. The CFTC holds the view that the spot market for virtual currency transactions is particularly susceptible to fraud due to the lack of any clear "connection between spot prices for virtual currencies and any commercial market or intrinsic value," in addition to the fact that most of the virtual currency markets operate internationally. Accordingly, the CFTC has adopted an approach of heightened review with respect to new listings for virtual currency derivatives contracts, effectively imposing a number of requirements on DCMs, SEFs, and DCOs to access and monitor trade data and information

²⁰ Commodity Futures Trading Commission. Fact Sheet – Notice of Proposed Rulemaking on Swap Execution Facilities and the Trade Execution Requirement and Request for Comment on Post-Trade Name Give-Up. November 5, 2018, available [here](#).

²¹ *In re Coinflip, Inc.*, CFTC No. 15-29, 2015 WL 5535736, Comm. Fut. L. Rep. (CCH) ¶ 33,538 (Sept. 17, 2015).

²² *Id.*

about market participants in the underlying spot transaction markets for the virtual currencies that form the basis of any listed derivatives contracts.²³

Chairman Tarbert has publicly stated that the CFTC should continue to play an active role in regulating virtual currency markets.²⁴ In particular, he has clarified his intention to make virtual currencies an area of focus during his term, stating in a July 29, 2019 press release that “the rise of digital ‘currencies’ has created a new asset class [and] the CFTC must develop a holistic framework for these 21st-century commodities.”²⁵

In terms of regulatory developments, the CFTC will likely finalize its interpretation regarding what constitutes “actual delivery” of virtual currencies for purposes of determining whether a particular transaction in virtual currency is a “retail commodity transaction” that is subject to CFTC oversight. As background, the CEA provides that a spot commodity transaction offered to retail persons on a leveraged or margin basis (and/or involving financing) is deemed a “retail commodity transaction,” and therefore may implicate certain CFTC requirements, including registration requirements by the offeror and a requirement that the products be traded on or subject to the rules of a DCM.²⁶ The key exception from these requirements applies to spot commodity transactions that result in “actual delivery” within 28 days.²⁷ In an effort to clarify how “actual delivery” may occur in the context of a spot virtual currency transaction, the CFTC issued a proposed interpretation on virtual currency “actual delivery” in late 2017 which, among other things, provided that “actual delivery” has not occurred if the offeror retains any interest in or control over the virtual currency after 28 days.²⁸

While the CFTC has not formally adopted its proposed interpretation on “actual delivery,” the CFTC has separately engaged in litigation addressing this very issue. See Section 4(a) below for a more detailed discussion on *Monex*. Given the growing prevalence of this issue, it is anticipated that the CFTC may make a more definitive statement on “actual delivery” in the near future.

The CFTC will also likely continue to develop virtual currency guidance that focuses on greater transparency and access to data about all virtual currency markets and their participants, including data on spot trades. The CFTC has to-date and will continue to coordinate its efforts with other regulatory agencies both foreign and abroad to develop a comprehensive and holistic approach to understanding and regulating virtual currency markets.²⁹

²³ The CFTC approach of heightened review is outlined in a joint staff advisory issued on May 21, 2018 (see CFTC Release 7731-18), and reflects the staff’s view that “[s]ignificant risks associated with virtual currency markets justify close scrutiny by both CFTC staff and registered entities.” The guidance outlines a number of requirements and expected practices imposed on self-regulatory organizations across a range of topics, including: (i) enhanced market surveillance; (ii) coordination with CFTC staff; (iii) large trader reporting; (iv) outreach to stakeholders; and (v) DCO risk management. In essence, the guidance places requirements on CFTC self-regulatory organizations to more actively monitor the underlying virtual currency spot markets than would normally be required by CFTC regulations with respect to a traditional currency spot market, thereby providing additional transparency to regulators and mitigating risk.

²⁴ See CFTC Press Release 7986-19, “ICYMI: Chairman Tarbert Lays Out Priorities in Fox Business Op-Ed” (July 29, 2019).

²⁵ *Id.*

²⁶ See CEA Section 2(c)(2)(D).

²⁷ See *id.*

²⁸ See 82 Fed. Reg. 60335 (Dec. 20 2017).

²⁹ In the CFTC press release accompanying a May 21, 2018 advisory, DMO staff made it clear that heightened review is just one step of many along an evolving regulatory journey, stating that “[a]s the virtual currency market continues to evolve, CFTC staff will seek to provide additional guidance to help market participants keep pace with innovation while complying with CFTC regulations.” See CFTC Press Release 7731-18, “CFTC Staff Issues Advisory for Virtual Currency Products” (May 21, 2018), available [here](#).

As a result of the CFTC's continued focus on virtual currencies, the Chairman's expressed views on these issues, his hiring decisions and the recent court decision in *Monex*, we believe that the Likelihood Score of the CFTC adopting final rules for retail commodity transactions and issuing additional guidance on these issues is four.

Regulation Automated Trading

In November 2015, the CFTC issued a proposal titled Regulation Automated Trading (Reg AT), which sought to govern the automated trading of derivatives on DCMs.³⁰ The Reg AT proposal was intended to codify existing industry best practices, ensure market integrity and prevent market disruptions such as the 2010 flash crash.³¹

In particular, Reg AT proposed to regulate automated trading broadly, regardless of frequency or volume. The proposal included risk controls for DCMs, individuals engaged in automated trading on a DCM (AT Persons) and futures commission merchants (FCMs) that clear trades for AT Persons.³² In addition, the Reg AT proposal sought to impose a variety of regulatory requirements regarding the development, monitoring, and testing of automated trading systems. AT Persons would also be required to maintain a record of the source code of their algorithms, and make the code available upon request to any representative of the CFTC or the US Department of Justice without need for subpoena.

The original Reg AT proposal was considered controversial in many regards. Then-Commissioner Giancarlo questioned the usefulness of the regulations, arguing that they would fail to produce their intended results, while considerably increasing compliance burdens.³³ Many market participants and industry trade associations express concerns with provisions allowing the CFTC broad access to the source code of regulated algorithms without subpoena.³⁴ They also expressed concern regarding whether the government would be able to adequately protect this critical data from potential breaches. Other concerns included whether the definition of AT Persons was too broad, whether the definition of "direct electronic access" was too broad, which entities warranted risk control oversight and complications regarding AT Persons using third party algorithms.³⁵

In response to the criticism on the Reg AT proposal, the CFTC published a supplemental proposal, amending the initial proposal in order to address many of these concerns.³⁶ The supplemental proposal sought to reduce the number of AT Persons subject to many of Reg AT's requirements, provide a more stringent process for CFTC requests of source code and provide a framework for regulating AT Persons using third party algorithmic trading systems.

Despite these adjustments, many in the industry still believed that the Reg AT supplemental proposal was critically flawed. Then-Commissioner Giancarlo stated that while the supplemental proposal was superior in some regards to

³⁰ 80 Fed. Reg. 78823 (Dec. 17, 2015).

³¹ Reg AT as first proposed would require each of these parties to prepare compliance reports regarding risk controls and trading procedures.

³² 80 Fed. Reg. 78823 (Dec. 17, 2015).

³³ See Commissioner J. Christopher Giancarlo, CFTC. Statement of Dissent by Commissioner J. Christopher Giancarlo Regarding Supplemental Notice of Proposed Rulemaking on Regulation Automated Trading. (Nov. 4, 2016), available [here](#).

³⁴ See, e.g., Futures Industry Association Comment Letter (March 16, 2016), available [here](#).

³⁵ See Katten. CFTC Approves Supplemental Proposal to Regulation AT, (Nov. 10, 2016), available [here](#).

³⁶ 81 Fed. Reg. 85334 (Nov. 25, 2016).

the original proposal, it maintained, among other issues, the controversial provisions seeking to unnecessarily strip algorithm owners of intellectual property rights.³⁷

It remains to be seen whether Chairman Tarbert intends to address these concerns or to issue a new proposal focused on the regulation of automated trading. As a result, we believe that the Likelihood Score of the CFTC adopting a proposal and final rule for the regulation of automated trading during the next 16 months is one (i.e., highly unlikely).

The Division of Swap Dealer and Intermediary Oversight

Following the implementation of Dodd-Frank regulations and guidance, no two CFTC regulatory issues have come under more criticism than the CFTC's Final Swaps Cross Border Guidance³⁸ and harmonization of the Dodd-Frank rules as between the CFTC and the Securities and Exchange Commission (SEC). To ensure that he is well informed in addressing these issues, Chairman Tarbert has brought onboard two key staffers within his office and has appointed a new director of DSIO with significant experience with both the securities laws and CFTC regulations.

In his office, Chairman Tarbert kept a key professional staffer, Matthew Daigler, who worked for his predecessor. Mr. Daigler helped write former Chairman Giancarlo's white paper on cross border regulation.

Chairman Tarbert also hired Jaime Klima as his office's chief of staff. Ms. Klima was most recently chief of staff to SEC Chairman Jay Clayton. Presumably, she can assist Chairman Tarbert in his policy discussions with the SEC on issues relating to CFTC-SEC harmonization.

Finally, Chairman Tarbert has named Joshua Sterling as the new director of DSIO. Before serving as director of DSIO, Mr. Sterling was a partner at the law firm Morgan Lewis, where he represented asset managers globally, including the sponsors of exchange-traded commodity pools, registered investment companies, and other pooled investment vehicles. As discussed in more detail below, Mr. Sterling's expertise and background suggest that the division will focus, in part, on issues affecting commodity trading advisors (CTAs) and commodity pool operators (CPOs).

Based on his staffing decisions and the regulatory issues that remain outstanding under prior CFTC leadership, DSIO may likely address the following regulatory topics: (a) promulgating new rules and guidance on the CFTC's swaps extraterritorial jurisdiction; (b) CFTC-SEC harmonization; and (c) general issues pertaining to CTAs and CPOs. A discussion of each of these rulemaking topics follows, along with our assessment of, and rationale for, the respective Likelihood Score.

Cross Border Swaps Regulations and Guidance for Swaps Participants

Since its issuance in 2013, the CFTC's Final Cross Border Interpretive Guidance (the "Guidance")³⁹ — which generally outlines the agency's interpretation of the extraterritorial bounds of its swaps regulatory jurisdiction⁴⁰ — has

³⁷ See *id.* at 85397.

³⁸ 78 Fed. Reg. 45291 (July 26, 2013).

³⁹ *Id.*

been met with criticism from domestic and foreign policy makers,⁴¹ with calls for changes to the entire Guidance and specific aspects thereof through the adoption of formal rulemaking,⁴² and even with a legal challenge.⁴³ DSIO staff also issued Staff Advisory 13-69 (2013 Staff Advisory), which provided further clarification — as well as controversy — around the applicability of certain Dodd-Frank requirements to a swap between non-US swap dealers and non-US persons if the swap is arranged, negotiated or executed by US personnel or agents of the non-US swap dealer.⁴⁴

Amid all of the controversy surrounding the issuance of the Guidance and the 2013 Staff Advisory, two prior CFTC chairpersons had sought to adopt regulations that would supplant the Guidance.

Under former Chairman Tim Massad, the CFTC adopted a proposal at the end of 2016 (2016 Proposal) that attempted to promulgate regulations, clarifying the extraterritorial application of CFTC rules to swaps.⁴⁵ Specifically, the 2016 Proposal sought to define key terms for purposes of applying the CEA's swap provisions to cross-border transactions and address the cross-border application of the registration thresholds and external business conduct standards for swap dealers and MSPs, including the extent to which they would apply to swap transactions that are arranged, negotiated, or executed using personnel located in the United States. The agency received 29 responses to its 2016 Proposal and noted that it would consider further rulemaking proposals to regulate cross-border swaps activities.

Former CFTC Chairman Giancarlo released a white paper in October 2018 titled "Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-US Regulation." (2018 White Paper).⁴⁶ The 2018 White Paper laid out former Chairman Giancarlo's vision for cross-border swaps and was intended to direct the CFTC staff to put forth new rule proposals to address a range of cross-border issues in swaps reform. Although it was widely reported that Chairman Giancarlo was reconsidering some aspects of the 2018 White Paper, DSIO staff began working on a series of proposals largely based on the paper. Those proposals were not introduced before the end of former Chairman Giancarlo's term.

⁴⁰ Specifically, the Guidance establishes, among other things, interpretations of: (1) which persons fall within the definition of "US person" for the purposes of the CFTC's swap regulatory scheme; (2) which swaps a non-US person may/may not exclude from its swap dealer *de minimis* and major swap participant (MSP) threshold determinations; (3) which types of offices the CFTC may consider a "foreign branch" of a US swap dealer or MSP; and (4) how swap-related requirements will be applied to cross-border swap transactions. The CFTC also adopted an exemptive order that set forth the compliance schedule for when its guidance would go into effect. See 78 Fed. Reg. 43785 (July 22, 2013).

⁴¹ See e.g., Silla Brush, *U.S. CFTC to Face Critics of Swaps Market Rules*, BLOOMBERG, Dec. 12, 2012, available [here](#); Silla Brush, *U.S. Swaps Rules Won't Work Overseas, CFTC Is Warned*, BLOOMBERG, Nov. 7, 2012, available [here](#); Silla Brush, *CFTC May Skip Cost-Benefit Analysis for International Oversight*, BLOOMBERG, June 11, 2012, available [here](#).

⁴² See CFTC Chairman J. Christopher Giancarlo, White Paper, CROSS-BORDER SWAPS REGULATION VERSION 2.0: A RISK-BASED APPROACH WITH DEFERENCE TO COMPARABLE NON-U.S. REGULATION (Oct. 1, 2018), available [here](#). See also ISDA Letter to CFTC on Project KISS, 82 Fed. Reg. 23765 (Sept. 29, 2017), available [here](#).

⁴³ See *Sec. Indus. & Fin. Mkts. Ass'n., et al., v. CFTC*, 13-CV-1916 slip op. (D.D.C. Sept. 14, 2014). The Guidance was ultimately the subject of a lawsuit filed by the Securities Industry and Financial Markets Association and others challenging the Guidance and the extraterritorial application of the various CFTC rulemakings under Title VII of Dodd-Frank. The lawsuit was ultimately dismissed, and the court held that the Guidance was not a legislative rule but rather was, in part, a policy statement and, in part, an interpretive rule and, therefore, generally not subject to judicial review.

⁴⁴ See CFTC Staff Advisory 13-69 (Nov. 14, 2013), available [here](#).

⁴⁵ See Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants (Oct. 18, 2016), available [here](#).

⁴⁶ See CFTC Chairman J. Christopher Giancarlo, White Paper, CROSS-BORDER SWAPS REGULATION VERSION 2.0: A RISK-BASED APPROACH WITH DEFERENCE TO COMPARABLE NON-U.S. REGULATION (Oct. 1, 2018), available [here](#).

While it is currently unclear whether Chairman Tarbert shares all of the same views on the cross-border application of the CFTC's swaps regulations as set forth in the 2018 White Paper, he has expressed his belief that the CFTC should defer to foreign regulators in some cross border context. Notwithstanding that there is little transparency into the agency's current thinking on cross-border issues, it is our understanding that DSIO staff continues to work on a number of new cross-border proposals.

As noted earlier, Chairman Tarbert has hired former Chairman Giancarlo's office staffer, Matthew Daigler, who assisted with the drafting of the 2018 White Paper and was principally responsible for liaising with DSIO staff as they prepared new cross-border proposals under the former chairman. We believe that Mr. Daigler's continued role in assisting with the preparation of these proposals signals that Chairman Tarbert may draw from many of the ideas put forth in the 2018 White Paper and will likely introduce new rule proposals within the near term that contain similar concepts as discussed in the paper. Consequently, we believe that the Likelihood Score that the agency will take final action in this area is four (i.e., almost certain).

CFTC-SEC Harmonization for Swaps Participants

Swaps market participants and industry trade associations have highlighted significant challenges to achieving regulatory harmonization and efficiency as between the CFTC's swaps regime and the SEC's security-based swap regime.⁴⁷ The CFTC and its staff are currently considering these calls for regulatory harmonization and have engaged in an ongoing dialogue with the SEC and its staff.⁴⁸ Indeed, the agencies have been working together for over a year under CFTC Commissioner Brian Quintenz and SEC Commissioner Hester Peirce to identify and prioritize areas where the agencies can harmonize specific regulations.

One area where these calls for regulatory harmonization have been the loudest is for developing consistent regulations for firms that must register with the CFTC as swap dealers and with the SEC as security-based swap dealers. The jurisdictional divide adopted by Dodd-Frank to distinguish between swaps and security-based swaps has been cited as aggravating volume and liquidity concerns in the security-based swaps market.⁴⁹ Two trade groups — the International Swaps and Derivatives Association and the US Chamber of Commerce's Center for Capital Markets Competitiveness — have proposed a solution to address these concerns. In particular, they have proposed that the two commissions allow dealer firms to meet the requirements of one commission by complying with comparable rules of the other commission. For example, a security-based swap dealer that otherwise would have been required to register with the SEC would be deemed in compliance with the SEC's security-based swap rules if the security-based swap dealer registers with the CFTC and complies with the CFTC's swap requirements.

While Chairman Tarbert may view regulatory harmonization of the swaps and security-based swaps regimes as a priority — especially considering that he hired Jamie Klima, who was formerly SEC Chairman Jay Clayton's chief of staff, as his chief of staff — we believe the Likelihood Score that the CFTC will propose and adopt final regulations

⁴⁷ See SIFMA, *Promoting U.S. Access to Non-U.S. Swaps Markets: A Roadmap to Reverse Fragmentation* (Dec. 14, 2017), available [here](#).

⁴⁸ Speaking at FIA's 40th Annual Law and Compliance Conference in May 2018, CFTC Commissioner Brian Quintenz highlighted the importance of CFTC-SEC harmonization. See CFTC, Remarks of Commissioner Brian Quintenz at FIA's 40th Annual Law and Compliance Conference (May 2, 2018). He noted that the two agencies have met to discuss harmonizing requirements for dual registrants, the CFTC's coordination of enforcement actions with the SEC and ongoing efforts to update a 2008 Memorandum of Understanding between the agencies.

⁴⁹ See ISDA, *A Regulatory Safe Harbor for Derivatives: Ensuring a Comprehensive and Consistent US Derivatives Regulatory Framework* (Sep. 2018), available [here](#).

and guidance on these issues is two (i.e., not likely). Our view is based on the fact that the breadth of issues that require harmonization as between the swaps and security-based swaps regulations during the next 16 months is quite broad. Additionally, since the SEC's security-based swap regulations will not likely become effective until the end of the 16-month period, the CFTC might prioritize other issues above harmonization of the two regimes.⁵⁰ To the extent that any action is taken in the next 16 months, we anticipate that it would be in the form of no-action relief or guidance by DSIO staff in conjunction with SEC staff since it would be more expedient to do so.

CPO/CTA Issues

As noted above, DSIO staff may likely prioritize regulatory issues affecting CPOs and CTAs given the new division director's expertise and background. Three regulatory issues we could expect to see the Commission act on are: (i) finalization of the CFTC's proposal to streamline Part 4 of the agency's regulations; (ii) amending Form CPO-PQR; and (iii) raising the thresholds on CPO and CTA exclusions and exemptions. Each of these issues are discussed below.

Finalizing Proposal to Streamline Part 4 of the CFTC's Regulations

In October 2018, the CFTC issued a proposal seeking to codify long-standing staff advisories and no-action letter relief affecting various requirements under Part 4 of the CFTC's regulations.⁵¹ This rulemaking proposal was adopted as part of the agency's Project KISS initiative under former Chairman Giancarlo.

Specifically, the proposal sought to amend the Part 4 regulations in three principal ways. First, the proposal would permit CPOs that only solicit and/or accept funds from non-US persons for participation in offshore commodity pools to claim an exemption from CPO registration and compliance requirements with respect to such pools, while permitting the maintenance of registration with respect to commodity pools for which CPO registration is required. Second, the proposal would allow US-based CPOs of offshore commodity pools with US participants to maintain the commodity pool's original books and records in the offshore location of the pool, in lieu of the CPO's main US business location. Third, the proposal would provide registration relief for CPOs and CTAs of entities qualifying as "family offices" and investment advisers of SEC "business development companies."

Chairman Tarbert has not publicly embraced the Project KISS initiative by name, but has expressed his desire to make the CFTC's regulations less complex and prescriptive.⁵² Since the CFTC unanimously approved the proposal,⁵³ we expect that Chairman Tarbert will likely finalize many aspects of this proposal. As a result, the Likelihood Score for this rulemaking is five (i.e., highly probable).

⁵⁰ The SEC has stated that the compliance date for security-based swap dealer registration will be 16 months after the later of (1) the effective date of final rules establishing recordkeeping and reporting requirements for security-based swap dealers and major security-based swap participants; or (2) the effective date of the final rules addressing the cross-border application of certain security-based swap requirements. See 84 Fed. Reg. 43872 (Aug. 22, 2019).

⁵¹ See CFTC, *Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors*, 17 CFR Part 4 (Oct. 18, 2018), available [here](#).

⁵² See Dr. Heath P. Tarbert, Fox Business, *Why the CFTC is the Most Important Regulator You've Never Heard Of* (Jul. 29, 2019), available [here](#).

⁵³ See CFTC Press Release 7825-18 (Oct. 9, 2018), available [here](#).

Amending Form CPO-PQR to Reduces Burdens

The private funds and asset management communities have advocated for amendments to Form CPO-PQR.⁵⁴ Many hedge funds and asset managers have asserted that the form is unduly burdensome and asks a lot of information that can otherwise be obtained from alternative sources, such as from CFTC ownership and control reports.⁵⁵

We believe that DSIO Director Sterling may be somewhat sympathetic to these concerns given his prior industry experience. At this time, however, it is unclear whether the agency under Chairman Tarbert will prioritize adopting and finalizing a proposal to amend Form CPO-PQR within the next 16 months. Thus, the Likelihood Score on this issue is three (i.e., more probable than not).

Raising the Thresholds on CPO Exclusion and Exemption

There is both an exemption and an exclusion for which many managers qualify from CPO requirements or from the CPO definition, respectively, which are tied to whether the underlying commodity pool exceeds certain threshold levels of commodity interest trading. The exemption is provided in CFTC Regulation 4.13(a)(3) and the CPO definition exclusion is provided in CFTC Regulation 4.5. Market participants and industry trade associations have recommended that the CFTC raise these threshold levels.⁵⁶

CFTC Regulation 4.13(a)(3) makes available an exemption from CPO registration for operators of “family, club and small” pools, as those terms are defined in the rule, as well as pools that have limited futures activity of restrict participation to sophisticated persons.⁵⁷ In particular, persons claiming exemption from CPO registration under CFTC Regulation 4.13(a)(3) are required to operate each fund that it advises in accordance with the following requirements at all times: (i) the aggregate initial margin and premiums required to establish commodity positions will not exceed 5 percent of the liquidation value of the fund’s portfolio after taking into account unrealized profits and losses on any such positions; or (ii) the aggregate net notional value of such positions will not exceed 100 percent of the liquidation value of the fund’s portfolio after taking into account unrealized profits and losses on any such positions.⁵⁸ Market participants and industry trade associations have recommended that in calculating the CFTC Regulation 4.13(a)(3) *de minimis* trading exemption, a CPO should conduct the calculation for a commodity pool including any wholly owned subsidiary of the commodity pool, and that the CPO need not conduct the CFTC Regulation 4.13(a)(3) exemption calculation with respect to a wholly owned subsidiary on its own.⁵⁹

CFTC Regulation 4.5 makes available an exclusion from the CPO definition for certain otherwise regulated persons in connection with their operation of specified trading vehicles. In February 2012, the CFTC adopted an amendment to CFTC Rule 4.5 as it applies to registered investment companies requiring registered funds relying on the rule to: (i) refrain from marketing themselves as vehicles for trading in the commodity futures, commodity options or swaps markets; and (ii) other than bona fide hedging transactions, comply with *de minimis* restrictions. Such restrictions

⁵⁴ See e.g., MFA Letter to CFTC Re: A Streamlined Form PF: Reducing Regulatory Burdens (Oct. 9, 2018), available [here](#).

⁵⁵ *Id.*

⁵⁶ See e.g., MFA Letter to CFTC Re: Project Kiss (Sep. 19, 2017), available [here](#).

⁵⁷ 17 CFR § 4.13.

⁵⁸ *Id.*

⁵⁹ See MFA Letter to CFTC Re: Project Kiss (Sep. 19, 2017).

include (i) limiting the aggregate initial margin and premiums required to establish such positions to no more than five percent of the liquidation value of the pool's portfolio after taking into account unrealized profits and losses; or (ii) ensuring that the aggregate net notional value of such positions does not exceed 100 percent of the liquidation value of the pool's portfolio after taking into account unrealized profits and losses.⁶⁰ Market participants and industry trade groups have petitioned the CFTC to remove these additional restrictions in Rule 4.5, noting that registered investment companies already are subject to extensive regulatory oversight by the SEC.⁶¹

Before joining the CFTC, DSIO Director Sterling wrote extensively on the subject of CPOs, as well as CFTC Regulations 4.13 and 4.5 and the exemption and exclusion thresholds.⁶² While it is unclear from his writings whether the new DSIO Director would raise the exemption and exclusion thresholds, DSIO may seriously consider these concerns given his background working with funds. However, it is unknown whether, because of his previous experience, DSIO Director Sterling might be conflicted out of, or otherwise recused from, addressing certain issues CPO/CTA matters. In addition, for reasons similar to the calls to amend Form CPO-PQR, it is unclear at this time whether the CFTC would propose and finalize rules amending the threshold limits in the exemption and exclusion. Thus, we believe that the Likelihood Score on this issue is three (i.e., more likely than not).

The Division of Clearing and Risk

Within the last year, two derivatives clearing-related issues have emerged as the most critical for the CFTC and the industry. The first issue involves rulemakings that were proposed towards the end of former Chairman Giancarlo's tenure. In particular, the agency proposed a series of rulemakings to address the extent to which the CFTC would defer primary supervision over foreign clearinghouses to home country regulators. These proposals were intended to be consistent with the CFTC's 2016 equivalence agreement with the European Union on derivatives clearinghouse supervision.⁶³ The proposals also were aligned with Chairman Giancarlo's view in his 2018 White Paper that the CFTC's swaps regime should defer to comparable and comprehensive foreign regulatory regimes in the cross border context.

A second issue emerged in June 2019 when DCR and DSIO staff jointly issued an advisory and no-action letter in response to two releases issued by a group of derivatives industry self-regulatory organizations known as the Joint Audit Committee (JAC). The releases focused on the CFTC regulations covering margin and loss guarantees for managed accounts. The staff advisory and no-action letter caused quite a stir within the industry since the interpretations set forth therein directly conflict with existing industry practice.

⁶⁰ 17 CFR § 4.5.

⁶¹ See, e.g., Investment Adviser Association Letter to CFTC Re: Recommendations for "Project KISS" to Simplify CFTC Rules (RIN 3038-AE55) (Sept. 29, 2017), available [here](#).

⁶² See, e.g., Commodity Pool Operators and Commodity Trading Advisors: Key CFTC Registration and Compliance Considerations for Private Fund Sponsors, Advisors and Personnel (Jun. 25, 2012), available [here](#); see also A Light Lift: CFTC Proposes to Codify Existing No-Action Relief Applicable to CPOs and CTAs (Oct. 11, 2018), available [here](#).

⁶³ See The United States Commodity Futures Trading Commission and the European Commission: Common approach for transatlantic CCPs (Feb. 10, 2016), available [here](#).

With both of these important issues in the background, Chairman Tarbert appointed M. Clark Hutchison III as the new director of DCR on July 30, 2019.⁶⁴ A derivatives industry veteran, Mr. Hutchinson specialized in clearing and risk management in his most recent position.

Each of these issues are discussed in greater detail the subsections that follow, along with our assessment of, and rationale for, the respective Likelihood Score.

Exemptions for Foreign Clearing Organizations

As noted above, the 2018 White Paper proposed that the CFTC should grant deference to non-US regulatory regimes that have comparable requirements for entities engaged in swap dealing activities.⁶⁵ Following the paper's publication, the CFTC proposed a litany of new rules relating to foreign clearing organizations. Two of these proposals have been welcomed, while the third has been heavily criticized. Each proposal is described in more detail below.

The first of the abovementioned proposals was meant to codify the policies and procedures that the CFTC follows with respect to granting exemptions from registration as a DCO for foreign clearing organizations that clear proprietary swap transactions for US persons and FCMs (2018 DCO Proposal).⁶⁶ Currently, the CEA allows the CFTC to exempt a foreign clearing organization from registration for the clearing of swaps if the CFTC determines that the clearing organization is subject to comparable supervision and regulation by its home country authorities.⁶⁷ The 2018 Proposal was approved unanimously.⁶⁸

On July 11, 2019, the CFTC approved a supplemental proposal to the 2018 DCO Proposal by a vote of three to two that would allow foreign clearing organizations to clear swaps for US customers through foreign intermediaries, in addition to clearing proprietary swaps for US clearing members and FCMs (2019 Supplemental DCO Proposal).⁶⁹ In order to comply with the 2019 Supplemental DCO Proposal, the foreign intermediary would need to: (i) be a clearing member of an exempt DCO; (ii) clear US persons' swap transactions directly at an exempt DCO; and (iii) not otherwise engage in FCM activities or voluntarily register as an FCM. A foreign intermediary would be exempt not only from the registration requirement of section 4d(f) of the CEA, but also from all other provisions and regulations applicable to FCMs, including regulations regarding the holding of customer segregated funds and FCM capital and financial reporting requirements.⁷⁰ In addition to the eligibility requirements proposed in the 2018 Proposal, the 2019 Supplemental DCO Proposal would require that a foreign clearing organization not pose "substantial risk to the US financial system," which would be determined by a two-part test that would focus on the amount of initial margin required at the foreign clearing organization.⁷¹

⁶⁴ See CFTC Press Release 7987-19, "Chairman Tarbert Announces Key Executive Leadership Appointments" (July 30, 2019).

⁶⁵ See generally CFTC Chairman J. Christopher Giancarlo, *A Risk-Based Approach with Deference to Comparable Non-U.S. Regulation* (Oct. 1, 2018), available [here](#).

⁶⁶ See CFTC Press Release 7768-18, "CFTC Proposes Rules to Simplify Process for Foreign Clearing Organizations to Obtain DCO Registration Exemption" (Aug. 8, 2018).

⁶⁷ See 7 U.S.C. § 7a-1(h).

⁶⁸ See CFTC Press Release 7768-18, "CFTC Proposes Rules to Simplify Process for Foreign Clearing Organizations to Obtain DCO Registration Exemption" (Aug. 8, 2018).

⁶⁹ See CFTC Press Release 7967-19, "CFTC Voted on Open Meeting Agenda Items" (July 11, 2019).

⁷⁰ See CFTC Fact Sheet – Notice of Supplemental Proposal on Exemption from Derivatives Clearing Organization Registration (July 11, 2019).

⁷¹ See *id.*

The 2019 Supplemental DCO Proposal was met with harsh criticisms from Commissioners Behnam and Berkovitz. Commissioner Berkovitz stated that the 2019 Supplemental DCO Proposal “creates a Bizarro World for US swaps customers in which the CFTC does not regulate derivatives clearing organizations, only unregistered foreign firms are allowed to serve US customers, and US customers get none of the protections provided by US law.”⁷² In addition, Commissioner Behnam stated that the 2019 Supplemental DCO Proposal “is not the product of internal consensus and its brief history and questionable timeline signal a lack of appropriate scrutiny and evaluation of the potential consequences of taking these first steps towards diverging from the customer protection model provided by the [CEA] and US Bankruptcy Code.”⁷³

Lastly, on July 11, 2019, the CFTC unanimously approved a proposed rule on registration with alternative compliance for foreign clearing organizations (Alternative Compliance Proposal).⁷⁴ The Alternative Compliance Proposal would allow for the CFTC to register (subject to any terms and conditions as the CFTC determines to be appropriate) a foreign clearing organization for the clearing of swaps for US persons if: (1) the CFTC determines that compliance with the clearing organization’s home country regulatory regime constitutes compliance with the core principles applicable to DCOs set forth in the CEA (DCO Core Principles); (2) the clearing organization is in good regulatory standing in its home country; (3) the CFTC determines that the clearing organization does not pose substantial risk to the US financial system;⁷⁵ and (4) a memorandum of understanding or similar arrangement is in effect between the CFTC and the clearing organization’s home country regulator. To the extent that the clearing organization’s home country regulatory regime lacks legal requirements that correspond to the DCO Core Principles, other than those related to risk, the CFTC may, in its discretion, grant registration subject to conditions that would address the relevant DCO Core Principles.⁷⁶ Under the Alternative Compliance Proposal, a foreign clearing organization subject to alternative compliance would be seen as complying with the DCO Core Principles by complying with the corresponding requirements in its home jurisdiction, except with respect to certain CFTC regulations, including critical customer protection safeguards and swap data reporting requirements.⁷⁷

Given the broad support for the 2018 DCO Proposal and Alternative Compliance Proposal, and Chairman Tarbert’s supportive statements regarding deference to foreign jurisdictions in the oversight of foreign entities, we believe that it is highly probable the CFTC will finalize these two proposals within the next 18 months. In contrast, it is unclear whether the Supplemental DCO Proposal will move forward given its controversial approach of disregarding traditional customer protections under the CFTC regulations. As a result, we believe that the Likelihood Score of the CFTC finalizing all three of these proposals within the next 18 months is three (i.e., more probable than not).

⁷² Dissenting Statement of Commissioner Dan M. Berkovitz on the Supplemental Proposal for Exemption from Derivatives Clearing Organization Registration (July 11, 2019), available [here](#).

⁷³ Dissenting Statement of Commissioner Rostin Behnam on the Exemption from Derivatives Clearing Organization Registration; Notice of Supplemental Proposal (July 11, 2019), available [here](#).

⁷⁴ See CFTC Notice of Proposed Rulemaking, *Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations*, 84 Fed. Reg. 34819 (July 19, 2019).

⁷⁵ The Alternative Compliance Proposal contains a two-part test to determine whether a foreign clearing organization poses substantial risk to the US financial system that is identical to the test contained in the 2019 Supplemental DCO Proposal. See 84 Fed. Reg. at 34821.

⁷⁶ See *id.*

⁷⁷ See *id.* These regulations include 4d(f) of the CEA, parts 1 and 22 of the CFTC’s regulations, and CFTC regulation 39.15 (regarding treatment of funds), subpart A of part 39, and the swap data reporting requirements under part 45 of the CFTC’s regulations. See *id.*

Margin and Loss Guarantees for Managed Accounts

Two regulatory alerts released in May 2019 by the Joint Audit Committee (JAC) interpreting CFTC rules covering guarantees against loss and the release of excess margin funds have sent shockwaves throughout the FCM and managed funds communities.⁷⁸

The first JAC regulatory alert addressed CFTC Regulation 39.13(g)(8)(iii), which provides that a DCO must adopt requirements for its clearing members to ensure that their customers do not withdraw funds from their accounts unless the net liquidating value plus the margin deposits remaining in the customer's account thereafter would be sufficient to meet the customer initial margin requirements.⁷⁹ JAC stated that it interpreted CFTC Regulation 39.13(g)(8)(iii) as requiring FCMs to combine all accounts of the same beneficial owner for the same account classification type (e.g., segregated, secured, cleared swaps) for margin purposes.⁸⁰ This interpretation was not stating that all accounts for the same beneficial owner must be margined as a single account on a daily basis, but rather advises that when an FCM is considering whether it may release excess funds from one account of a beneficial owner, it must combine all accounts of the same regulatory classification (even those under different control) to assess what funds may be paid out.⁸¹

The second JAC regulatory alert addressed CFTC Regulation 1.56, which provides that no FCM may: (i) directly or indirectly guarantee a client against loss; (ii) limit the loss of a customer; or (iii) agree not to call for margin as established by the rules of an exchange.⁸² JAC explained that where a beneficial owner has multiple accounts with multiple advisers at an FCM, the FCM cannot agree that it will never look to recover losses in any one account from other accounts beneficially owned by the same owner, even where the other accounts are managed by another adviser, or subject to a different program of the same adviser.⁸³

Industry groups such as the Futures Industry Association, as well as many individual FCMs and asset managers, expressed serious concerns about the industry's inability to comply with JAC's interpretations of the relevant rules. In response to these concerns, staffs in DSIO and DCR jointly issued an Advisory and Time-Limited No-Action Relief Letter 19-17 on July 10, 2019,⁸⁴ which granted no-action relief until June 30, 2021 to any DCO that permits its FCM clearing members to treat certain separate accounts as accounts of separate entities for purposes of CFTC Regulation 39.13(g)(8)(iii) if 16 enumerated conditions are met, including that the FCM and its customers continue to meet margin calls in a timely fashion and are not in bankruptcy, default or financial distress.⁸⁵

⁷⁸ See JAC Regulatory Alert #19-02, "Combining Accounts for Margin Purposes" (May 14, 2019); JAC Regulatory Alert #19-03, "CFTC Regulation 1.56(b) – Prohibition of Guarantee Against Loss" (May 14, 2019).

⁷⁹ See JAC Regulatory Alert #19-02, "Combining Accounts for Margin Purposes" (May 14, 2019).

⁸⁰ See *id.*

⁸¹ See *id.*

⁸² 17 CFR § 1.56(b).

⁸³ See JAC Regulatory Alert #19-03, "CFTC Regulation 1.56(b) – Prohibition of Guarantee Against Loss" (May 14, 2019).

⁸⁴ See DSIO and DCR Staff Advisory and No-Action Letter 19-17, (July 10, 2019), available [here](#).

⁸⁵ See *id.*

In CFTC Letter No. 19-17, DSIO and DCR staff also agreed with JAC's interpretation of CFTC Regulation 1.56, and stated that FCM customer agreements or other documents must not: "(i) preclude the FCM from calling the beneficial owner of an account for required margin; (ii) in the event the beneficial owner fails to meet the margin call, preclude the FCM from initiating a legal proceeding to recover any shortfall; or (iii) otherwise guarantee a beneficial owner against, or limit a beneficial owner's, loss."⁸⁶ To address any potential shortfall, DSIO and DCR staff advised that an FCM must retain the ability to call the beneficial owner for additional funds, and look to funds in other accounts of the beneficial owner, including accounts that may be under different control.⁸⁷

In reaffirming their positions taken in CFTC Letter No. 19-17, staff in DSIO and DCR released a joint statement on September 13, 2019 regarding CFTC Rule 1.56.⁸⁸ In this recent statement, the divisions informed the industry that no further clarification is required. Staff also stated that they expect industry participants to work hard to do what is necessary to conform their documentation, policies, and practices to the CFTC's requirements as memorialized in CFTC Letter No. 19-17 by September 15, 2020 and that there is no inconsistency between the statements included in CFTC Letter No. 19-17 and JAC Regulatory Alert 19-03 regarding FCMs looking to funds in other accounts of the beneficial owner, including accounts that may be under different control.

Although Letter 19-17 provides relief to DCOs and their clearing members beyond the next 16 months, it is unknown whether the CFTC will propose new rules or guidance in connection with the recent interpretation of CFTC Regulation 39.13(g)(8)(iii). Due to the 2021 expiration date of Letter 19-17 and the clear position that the agency has taken on interpretation of CFTC Regulation 39.13(g)(8)(iii), we believe that the Likelihood Score for the CFTC to propose and finalize new rules or guidance on these issues is three (i.e., more likely than not).

The Division of Enforcement

Two recent court decisions on CFTC enforcement actions may likely have an impact on DOE's actions over the next 16 months. In addition, Chairman Tarbert has decided to keep James M. McDonald as DOE's Director. As a result, we believe that DOE's previously announced priorities and established task forces (as further described below) will likely continue over the next 16 months. The two recent court decisions and DOE's priorities and task forces are discussed in more detail in the subsections below.

Fraud Investigations and Enforcement after the Recent Monex Decision

The United States Court of Appeals for the Ninth Circuit (Ninth Circuit) recently issued a decision reaffirming the CFTC's strengthened enforcement power as revised under the Dodd-Frank Act.⁸⁹ More specifically, the Dodd-Frank Act allows the CFTC to bring an enforcement action for "any manipulative or deceptive device or contrivance."⁹⁰ In *CFTC v. Monex Credit Co.*, Monex Credit, a retail precious metals dealer, argued that the relevant law required both

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ See Statement by the Directors of the Division of Clearing and Risk and the Division of Swap Dealer and Intermediary Oversight Concerning the Treatment of Separate Accounts of the Same Beneficial Owner (September 13, 2019), available [here](#).

⁸⁹ See *U.S. Commodity Futures Trading Comm'n v. Monex Credit Co.*, 931 F.3d 966 (9th Cir. July 25, 2019).

⁹⁰ See 7 U.S.C. § 9(1).

manipulative and fraudulent behavior.⁹¹ Monex argued that since the CFTC solely alleged fraud, and not manipulation of the relevant market, the CFTC's charges could not stand. The Central District of California accepted Monex's argument and dismissed the CFTC's lawsuit in May 2018.⁹²

On July 25, 2019, the Ninth Circuit reversed the lower court's decision. The court reasoned that the word "or" in the phrase "manipulative or deceptive device or contrivance" required a disjunctive reading.⁹³ Therefore, the court held that the CFTC may bring an enforcement action by alleging either manipulative or fraudulent behavior.

The Ninth Circuit's decision is a significant victory for the CFTC as it validates the CFTC's broad view of a section of law that allows for enforcement actions. The decision will likely embolden the CFTC in bringing future enforcement actions. In addition, the *Monex* decision will likely help the CFTC finalize its 2017 proposed interpretation on "actual delivery" involving virtual currencies, which has been on hold for some time. The proposed interpretation is discussed in more detail in Section 1(c) above.

The Kraft-Mondelez Decision

Over the coming months, the CFTC's enforcement efforts may be potentially stagnated while Chairman Tarbert and two other commissioners are forced to testify in connection with an alleged breach of a settlement agreement. Recently, Judge John Robert Blakey of the Northern District of Illinois ordered Chairman Tarbert and Commissioners Rostin Behnam and Dan Berkovitz to testify regarding public statements issued following the agency's \$16 million settlement agreement with Kraft Foods Group Inc. (Kraft) and Mondelez Global LLC (Mondelez) regarding Kraft-Mondelez's alleged wheat price-rigging activities.⁹⁴ The order followed Kraft's and Mondelez's allegations that statements made by the CFTC, Chairman Tarbert, Commissioner Behnam and Commissioner Berkovitz violated a provision of the settlement agreement that prohibited the parties from making public comments about the agreement, other than comments referring to information in public records or the terms of a consent order approved by Judge Blakey.⁹⁵ This provision is highly unusual as regulators typically issue press releases following high-profile settlements to highlight deterrence efforts and reinforce regulatory policies.⁹⁶ Agreeing to such a provision potentially shows a willingness by Chairman Tarbert to agree to extraordinary terms in order to obtain settlements in enforcement actions.

Chairman Tarbert, Commissioner Behnam and Commissioner Berkovitz were asked to appear in court on October 2 (previously September 12) for an evidentiary hearing in order to answer questions about their respective statements, and be cross-examined by Kraft's and Mondelez's lawyers.⁹⁷ However, on September 26, the US Court of Appeals for the Seventh Circuit halted the October 2 hearing from moving forward.⁹⁸

⁹¹ See *Monex Credit Co.*, 931 F.3d at 972.

⁹² See *U.S. Commodity Futures Trading Comm'n v. Monex Credit Co.*, 311 F. Supp. 3d 1178 (C.D. Cal. 2018).

⁹³ See *Monex Credit Co.*, 931 F.3d at 976. Additionally, the Ninth Circuit rules that "actual delivery" — as required under the CEA — "unambiguously requires the transfer of some degree of possession or control" to customers. *Id.* The defendants' delivery of metal to its customers "amounts to sham delivery, not actual delivery." *Id.*

⁹⁴ Notification of Docket Entry at 1, *U.S. Commodity Futures Trading Comm'n v. Kraft Foods Grp., Inc.*, No. 1:15-cv-02881 (N.D. Ill. Aug. 19, 2019).

⁹⁵ See Dylan Tokar, *Judge's Order Puts New CFTC Chairman in Unusual Position*, WALL STREET JOURNAL (Aug. 23, 2019), available [here](#).

⁹⁶ See *id.*

⁹⁷ See *id.*

⁹⁸ See *In re: Commodity Futures Trading Commission, Order Granting Writ of Mandamus Petition*, Doc. No. 19-2769 (7th Cir. Sept. 26, 2019).

In the now stayed hearing, the CFTC asserted the Fifth Amendment and Commissioners Berkovitz and Behnam provisionally asserted the Fifth Amendment, “pending further proceedings.”⁹⁹ The district court was scheduled to consider Kraft’s and Mondelez’s motion to: (i) find the CFTC and Commissioners Berkovitz and Behnam in contempt of court for violating the settlement agreement; and (ii) order the CFTC and Commissioners Berkovitz and Behnam to take remedial actions and pay monetary sanctions.¹⁰⁰ The district court’s request of the Chairman and two CFTC commissioners was unprecedented in the agency’s history and could potentially expose the CFTC’s internal processes and deliberations. It is unclear at this time whether the district court’s evidentiary hearing will proceed.

Stated Priorities and Task Forces

Virtual Currencies

In 2018, DOE formed a virtual currency task force to identify potential misconduct.¹⁰¹ In connection therewith, Director McDonald stated that “The story of virtual currency is also about new technology. And it is a story about the need for robust enforcement to ensure technological development isn’t undermined by the few who might seek to capitalize on this development for unlawful gain. New and potentially market-enhancing technologies like virtual currencies and distributed ledger technology need breathing space to survive. Through work across the Agency, the CFTC has shown its continued commitment to facilitating market-enhancing innovation in the financial technology space. But part of that commitment includes acting aggressively to root out fraud and manipulation from these markets. The Virtual Currency Task Force is dedicated to identifying misconduct in these areas and holding bad actors accountable.”¹⁰²

In addition, DMO and DCR issued a joint staff advisory in May 2018 to provide guidance to CFTC registered exchanges and clearinghouses regarding virtual currencies.¹⁰³ The advisory provided guidance on certain enhancements when listing a derivatives contract based on virtual currency, and clarified the CFTC staff’s priorities and expectations in its review of new virtual currency derivatives. DMO and DCR identified five particular areas that require particular attention in the context of listing a new virtual currency derivatives contract.¹⁰⁴ These areas are market surveillance, coordination with CFTC staff, large trader reporting, stakeholders’ outreach, and risk management by DCOs.¹⁰⁵ We would expect for DOE, DMO and DCR to work together to identify misconduct in the virtual currency space and bring enforcement actions, as appropriate.

⁹⁹ See Notification of Docket Entry at 1, *U.S. Commodity Futures Trading Comm’n v. Kraft Foods Grp., Inc.*, No. 1:15-cv-02881 (N.D. Ill. Aug. 19, 2019).

¹⁰⁰ See *id.*; see also *Motion for Contempt, Sanctions, and Other Relief* at 1, *U.S. Commodity Futures Trading Comm’n v. Kraft Foods Grp., Inc.*, No. 1:15-cv-02881 (N.D. Ill. Aug. 16, 2019).

¹⁰¹ See Speech of Enforcement Director James M. McDonald Regarding Enforcement trends at the CFTC, NYU School of Law: Program on Corporate Compliance & Enforcement (Nov 14, 2018), available [here](#).

¹⁰² See *id.*

¹⁰³ See CFTC Press Release 7731-18, “CFTC Staff Issues Advisory for Virtual Currency Products” (May 21, 2018).

¹⁰⁴ See *id.*

¹⁰⁵ See CFTC, Advisory with Respect to Virtual Currency Derivative Product Listings, CFTC Staff Advisory No. 18-14 (May 21, 2018), available [here](#).

Manufactured Credit Events

DCR, DMO and DSIO have previously expressed concern over manufactured credit events in connection with credit default swaps (CDS).¹⁰⁶ DCR, DMO and DSIO are of the view that manufactured credit events may constitute market manipulation and may severely damage the integrity of the CDS markets. The divisions further advised that in instances of manufactured credit events, they will carefully consider all available actions to help ensure market integrity and combat manipulation or fraud involving CDS.¹⁰⁷ To the extent that the CFTC considers a manufactured credit event as constituting fraud or market manipulation, DOE will likely bring an enforcement action in order to restore the integrity of the CDS markets.

Insider Trading

In September 2018, DOE formed an Insider Trading and Information Protection Task Force (Task Force) in connection with a civil enforcement action brought against EOX Holdings LLC, an introducing broker, and one of its registered associated persons accused of misusing material, nonpublic information in connection with block trades of energy contracts on ICE Futures US.¹⁰⁸ The Task Force is meant to serve as a coordinated effort across DOE to identify and charge those who engage in insider trading or otherwise improperly use confidential information in connection with CFTC regulated markets. DOE has expressed an intention to: (i) thoroughly prosecute those who misappropriate confidential information, and (ii) guarantee that CFTC registrants develop and enforce policies prohibiting the misuse of confidential information.¹⁰⁹

Foreign Corrupt Practices Act

DOE has recently joined forces with the SEC and US Department of Justice (DOJ) to investigate foreign bribery and corruption relating to commodities markets under the Foreign Corrupt Practices Act (FCPA).¹¹⁰ Along with announcing their inter-agency coordination efforts, the CFTC issued an Enforcement Advisory on self-reporting and cooperation for violations of the CEA involving foreign corrupt practices. Director McDonald stated that “[w]e at the CFTC will do our job as part of the team to identify this type of misconduct in our markets and hold wrongdoers accountable, working closely with our enforcement partners domestically and abroad. This new advisory provided further clarity surrounding the benefits of self-reporting misconduct, full cooperation, and remediation in this context, and it reflects the enhanced coordination between the CFTC and our law enforcement partners like the [DOJ].”¹¹¹ In addition, the advisory noted that the CFTC encourages whistleblowing of foreign corruption by incentivizing whistleblowers with a reward of an amount somewhere between 10 percent and 30 percent of the monetary sanctions collected.

¹⁰⁶ See Statement on Manufactured Credit Events by CFTC Divisions of Clearing and Risk, Market Oversight, and Swap Dealer and Intermediary Oversight (Apr. 24, 2018), available [here](#).

¹⁰⁷ See *id.*

¹⁰⁸ See CFTC Press Release 7811-18, “CFTC Charges Block Trade Broker with Insider Trading” (Sept. 28, 2018).

¹⁰⁹ See *id.*

¹¹⁰ See CFTC Press Release 7884-19, “CFTC Division of Enforcement Issues Advisory on Violations of the Commodity Exchange Act Involving Foreign Corrupt Practices” (Mar. 6, 2019).

¹¹¹ See *id.*

Spoofing

DOE also has stated in its 2018 annual report that it would focus on detecting, investigating and prosecuting spoofing and other misconduct.¹¹² In fact, division staff has established a specialized task force focusing on this type of misconduct. The agency has increasingly brought more and more enforcement actions against trading firms that intend to inject false information into electronic markets in order to induce others to trade on such information. Under Chairman Tarbert, we expect that DOE staff will continue to conduct investigations into alleged spoofing and to bring enforcement actions against traders who allegedly engage in this conduct.

Conclusion

Chairman Tarbert has taken the helm of the CFTC at an interesting time in its history. Much unfinished business remains from former-Chairman Giancarlo's tenure, and derivatives markets continue to evolve at an ever-increasing pace. In order to take on these challenges, Chairman Tarbert will need to set specific priorities and act quickly to achieve his agenda given the upcoming US presidential election and limited CFTC resources.

The upcoming release of Chairman Tarbert's strategic plan should provide helpful insight into the direction of the CFTC during the coming months and years. And while we wait for Chairman Tarbert to provide specific insights into his priorities, we can take some solace in Chairman Tarbert's willingness to appoint multiple industry experts with a wide range of relevant experience to serve in high-level CFTC staff positions.

As set forth in this report, the assigned Likelihood Scores reflect our personal opinions as of the date of this publication. The Likelihood Score does not necessarily represent the views of the firm, its partners or any of the firm's clients. Each Likelihood Score should serve as a helpful guide on the likelihood that a particular initiative will be accomplished in the next 16 months. Of course, readers should be aware that the likelihood of various initiatives may change in the coming weeks as Chairman Tarbert begins to specify his priorities.

¹¹² See CFTC, Fiscal Year 2018 Annual Report on the Division of Enforcement, (Nov. 2018), available [here](#).

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