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2018 CFTC Year-In-Review

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I. INTRODUCTION

For the Commodity Futures Trading Commission (CFTC or Commission), 2018 was characterized by (1) an active enforcement program emphasizing cooperation and self-reporting, (2) increasing cross-border tension over supervision of central counterparties (CCPs), (3) publication of a far-reaching proposed rule to restructure the framework governing swap execution facilities (SEFs), (4) evolving Commission oversight of virtual currencies, and (5) publication by Chairman J. Christopher Giancarlo of his vision for market structure reform and cross-border harmonization. We discuss these five areas of Commission action in 2018 and what may be ahead in 2019.

II. ENFORCEMENT

The CFTC filed 83 enforcement actions in Fiscal Year 2018 (ended in September), obtaining \$947 million in civil monetary penalties, restitution and disgorgement.¹ These numbers are a significant increase over the prior fiscal year—more than double the dollar amount and nearly double the number of actions. The dollar amount of fines in Fiscal Year 2018 approximates the amount collected in 2016 but is well short of the \$3.27 billion in monetary fines collected in 2014 and the \$3.14 billion collected in 2015, when the Commission obtained record-setting fines relating to the manipulation of benchmark interest rates and other high-profile misconduct following the financial crisis. The CFTC has also announced a settlement or judgment in an additional 14 actions from the end of Fiscal Year 2018 through the end of the calendar year.

A. Cooperation and Self-Reporting

In 2018, the CFTC continued to encourage cooperation and self-reporting to the Division of Enforcement (the Division). There were clear steps toward the implementation of Director James

¹ Staff of Commodity Futures Trading Commission, *Annual Report on the Division of Enforcements* (2018) available at https://www.cftc.gov/sites/default/files/2018-11/ENFAnnualReport111418_0.pdf (Annual Enforcement Report).

McDonald's public statements from 2017. We discussed last year the Division's use of nonprosecution agreements with cooperating parties.²

On November 8, 2018, the Division issued its first public declination letter, indicating it was closing its investigation of Deutsche Bank AG, citing the bank's voluntary self-disclosure in the investigation of an individual managing director, its full cooperation in the matter and its proactive efforts to strengthen its swaps valuation process.³ The CFTC settled charges brought against an individual related to the investigation for fraudulently mismarking swap valuations.⁴ The declination letter adds another tool to the Division's potential resolutions for a cooperating party.

The Division stated in its letter that the misconduct was identified through Deutsche Bank AG's internal compliance, after which the bank commenced its own investigation and promptly reported its findings to the Division. Also, Deutsche Bank AG, among other things, provided updates of the investigation to the Division and responded completely and expeditiously to the Division's requests.

Director McDonald discussed the success of the cooperation and self-reporting program in a speech in November.⁵ The Director noted that through the end of the fiscal year, three orders had been issued that involved self-reporting, with each receiving a significantly reduced civil monetary penalty.⁶ Further, the Division recently accepted a bifurcated settlement, in which liability was set in the order but the amount of the penalty, if any, was to be determined after cooperation had been completed.⁷ Director McDonald stated that he expects this type of settlement to increase and that it is more similar to the criminal system, where sentencing is separate from the guilty plea.

Reliance on the cooperation and self-reporting program can be seen as a way for the CFTC to maintain an active and effective enforcement regime with fewer staff resources. Look for the CFTC and the Division to continue to leverage the self-reporting program in the coming year in response to the Commission's budget constraints.

² For a more detailed discussion regarding the first nonprosecution agreements, see Paul M. Architzel, Anjan Sahni, Matthew Beville and Daniel J. Martin, *2017 CFTC Year-in-Review* (Feb. 6, 2018) available at <https://www.wilmerhale.com/en/insights/client-alerts/2018-02-06-2017-cftc-year-in-review-and-a-look-forward>.

³ Letter from James M. McDonald, Director, Division of Enforcement, Commodity Futures Trading Commission, to Andrew Stemmer, Deutsche Bank AG (Nov. 8, 2018) (Declination Letter).

⁴ See *In re Jacob Bourne*, CFTC Docket No. 18-51 (Sept. 28, 2018).

⁵ James M. McDonald, Director, Division of Enforcement, Commodity Futures Trading Commission, *Speech Regarding Enforcement Trends at the CFTC*, NYU School of Law: Program on Corporate Compliance and Enforcement (Nov. 14, 2018) (McDonald Summary Speech).

⁶ See *In re The Bank of Nova Scotia*, CFTC Docket No. 18-50 (Sept. 28, 2018) (imposing a civil monetary penalty of \$800,000); *In re UBS AG*, CFTC Docket No. 18-07 (Jan. 29, 2018) (imposing a civil monetary penalty of \$15 million); *In re The Bank of Tokyo-Mitsubishi UFJ, Ltd.*, CFTC Docket No. 17-21 (Aug. 7, 2017).

⁷ *In re Gandhi*, CFTC Docket No. 19-01 (Oct. 11, 2018).

B. Enhanced Coordination

Another means of stretching constrained staff resources is through better internal coordination and increased cooperation with other authorities. In discussing year-end enforcement metrics, both Chairman Giancarlo and Director McDonald stressed the increased level of coordinated enforcement between the CFTC, law enforcement and other regulatory organizations, both domestic and foreign.⁸ The increased focus on coordinated actions and on parallel enforcement and criminal actions is clear with respect to the spoofing cases (discussed below) that have been brought this year.

Coordination is not just with other agencies and regulators, but also across offices. Four new task forces were created during the year: Spoofing and Manipulative Trading, Virtual Currency, Insider Trading and Protection of Confidential Information, and Bank Secrecy Act.⁹

C. Notable Spoofing Enforcement Cases

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) made it unlawful for any person to engage in “spoofing”—broadly defined as “bidding or offering with the intent to cancel the bid or offer before execution.”¹⁰ Over the past several years, the Division has aggressively enforced its antispoofing authority, and this past year was no different.

In January 2018, Director McDonald announced the Division’s new Spoofing Task Force, “which is a coordinated effort across the Division—with members from our offices in Chicago, Kansas City, New York, and Washington, DC—to root out spoofing from our markets.”¹¹ He noted that, over the past year, the CFTC has developed new, sophisticated data analysis tools to identify spoofing and other unlawful trading activity.¹²

That same month, the CFTC filed eight antispoofing actions, including settlements by three banks (Deutsche Bank,¹³ HSBC¹⁴ and UBS¹⁵), and five complaints against six individuals and one

⁸ See J. Christopher Giancarlo, Chairman, Commodity Futures Trading Commission, *Remarks at Economic Club of Minnesota* (Oct. 2, 2018) (Giancarlo Enforcement Speech) and McDonald Summary Speech.

⁹ Annual Enforcement Report at 5-6.

¹⁰ Section 747 of the Dodd-Frank Act codified at Commodity Exchange Act Section 4c(a)(5).

¹¹ James M. McDonald, Director, Division of Enforcement, Commodity Futures Trading Commission, *Statement* (Jan. 29, 2018) available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/mcdonaldstatement012918> (McDonald Spoofing Speech).

¹² *Id.*

¹³ *In re Deutsche Bank AG and Deutsche Bank Securities Inc.*, CFTC Docket 18-06 (Jan. 29, 2018) (imposing a civil monetary penalty of \$30 million, the largest for spoofing-related conduct).

¹⁴ *In re HSBC Securities (USA) Inc.*, CFTC Docket 18-08 (Jan. 29, 2018) (imposing a civil monetary penalty of \$1.6 million).

company.¹⁶ The three settled bank actions were all seven-figure settlements, and Deutsche Bank was the largest spoofing-related settlement; however, in announcing the settlements, Director McDonald noted that “the fines would have been substantially higher but for each bank’s substantial cooperation, and for UBS, its additional self-reporting of the conduct.”¹⁷

Of particular note is that spoofing has also fostered greater coordination between the CFTC and law enforcement. On the same day that the CFTC announced the above enforcement actions, the Department of Justice announced that it had charged eight individuals with deceptive trading practices, including seven for spoofing.¹⁸ Some of these traders have chosen to plead guilty; one trader agreed to cooperate with the CFTC in further enforcement investigations as well.¹⁹

D. Setbacks to the Enforcement Program

1. Manipulation

The Division also experienced setbacks during 2018. As we previously discussed,²⁰ a court again rejected a market manipulation charge when the trading was motivated by good faith economic analysis and reflected bona fide interest in transacting on the terms submitted to the market, or where the trading did not create an “artificial” price. The court succinctly noted that “[i]t is not illegal to be smarter than your counterparties in a swap transaction, nor is it improper to understand a financial product better than the people who invented the product.”²¹ The facts regarding the actual trading activity were largely undisputed. However, the court held that the CFTC failed to prove that the trading created an artificial price or intended to manipulate the market. Rather, while the trader had the ability to influence, sought to influence and did influence the price of the particular contract, there was no evidence that the resulting price was artificial or did “not reflect the basic forces of supply and demand.”²² The court found that the particular contract had been undervalued and that other market participants had come to agree with the trader’s valuation theory. Ultimately, the court

¹⁵ *In re UBS AG*, CFTC Docket No. 18-07 (Jan. 29, 2018) (imposing a civil monetary penalty of \$15 million; this case is one of those cited for a reduction due to self-reporting).

¹⁶ *CFTC Files Eight Anti-Spoofing Enforcement Actions against Three Banks (Deutsche Bank, HSBC & UBS) & Six Individuals*, CFTC Release No. 7681-18 (Jan. 29, 2018) available at <https://www.cftc.gov/PressRoom/PressReleases/pr7681-18>.

¹⁷ McDonald Spoofing Speech.

¹⁸ Department of Justice, *Eight Individuals Charged with Deceptive Trading Practices Executed on US Commodities Markets* (Jan. 29, 2018) available at <https://www.justice.gov/opa/pr/eight-individuals-charged-deceptive-trading-practices-executed-us-commodities-markets>.

¹⁹ See generally <https://www.justice.gov/opa/pr/two-traders-plead-guilty-60-million-commodities-fraud-and-spoofing-conspiracy>.

²⁰ Paul M. Architzel and Matthew Beville, *Court Again Rejects a CFTC Manipulation Claim* (Dec. 18, 2018) available at <https://www.wilmerhale.com/en/insights/client-alerts/20181218-court-again-rejects-a-cftc-manipulation-claim>.

²¹ Memorandum and Order, *CFTC v. Wilson & DRW Investments*, No. 13-cv-7884, 26 (S.D.N.Y. Nov. 30, 2018) (*Wilson*).

²² *Wilson* at 15–16.

found that there was no intent to create an artificial price, that there was bona fide interest to fill every order submitted and that the orders were consistent with the trader's valuation model.

Following *Wilson*, manipulation cases remain difficult to sustain under current law if the case relies solely on market data and without affirmative evidence of manipulative intent; this is in contrast to recent trends in spoofing cases. We do note that the lack of intent was particularly difficult to prove in *Wilson* because the market generally accepted the particular valuation method; if the valuation method were to have been viewed skeptically, intent may have been easier to prove.

2. Criminal Spoofing

As we discussed above, the CFTC has enjoyed several successes in prosecuting spoofing and the Department of Justice has brought successful parallel criminal actions, including a victory in *United States v. Coscia*. However, the case of Andre Flotron identified the limits to criminal prosecution.²³ Flotron was alleged to have engaged in a manipulative and deceptive scheme and spoofing in the precious metals futures markets on a registered entity. However, by the time of trial, only a single count survived—conspiracy to commit commodity fraud by means of spoofing. The direct spoofing charges had been dismissed due to lack of venue in Connecticut. Ultimately, Flotron was acquitted of the remaining conspiracy charge.

Although Flotron avoided a criminal conviction, an executed consent order was filed with the court on December 20, 2018, to resolve the outstanding civil enforcement action.²⁴ Under the order, Flotron would be subject to a one-year trading ban and a \$100,000 civil monetary penalty.

E. Other Notable Enforcement Cases

The CFTC also continued to resolve matters regarding benchmark manipulation. In particular, several enforcement actions for attempted manipulation of the US Dollar International Swaps and Derivatives Association Fix (ISDAFIX) benchmark (a leading global benchmark referenced in a range of interest rate products) were resolved.²⁵

²³ Order, *United States v. Flotron*, No. 3:17-cr-00220 (D. Conn. Feb. 19, 2018).

²⁴ Joint Motion to Reopen Case and Enter Final Judgment and Consent Order, *CFTC v. Flotron*, No. 3:18-cv-00158 (D. Conn. Dec. 20, 2018).

²⁵ See *Deutsche Bank Securities Inc.*, CFTC Docket No. 18-09 (Feb. 1, 2018) (imposing a civil monetary penalty of \$70 million); see also *JPMorgan Chase Bank, N.A.*, CFTC Docket No. 18-15 (June 18, 2018) (imposing a civil monetary penalty of \$65 million); *BNP Paribas Securities Corp.*, CFTC Docket No. 18-19 (Aug. 29, 2018) (imposing a civil monetary penalty of \$90 million); *ICAP Capital Markets LLC*, CFTC Docket No. 18-33 (Sept. 18, 2018) (imposing a civil monetary penalty of \$50 million); *Bank of America, N.A.*, CFTC Docket No. 18-34 (Sept. 19, 2018) (imposing a civil monetary penalty of \$30 million).

F. Continuation of Retail Enforcement Regime

The CFTC also brought many actions to protect retail investors, including an emphasis on virtual currencies.²⁶ Chairman Giancarlo emphasized this “commitment to protect customers and root out retail fraud in our markets.”²⁷ Nearly half of the actions from last year were primarily based on retail fraud, a failure to register or illegal off-exchange contracts.²⁸ According to the Chairman, the total number of retail-based actions is consistent with the enforcement regime of the past decade.²⁹

III. REGULATORY DEVELOPMENTS

There have been several regulatory developments during the year. Tensions emerged regarding cross-border comparability of CCPs. The Commission engaged in limited, though significant, rulemaking, including a far-reaching but controversial SEF proposal. The Commission continued to define its oversight of virtual currencies, particularly in relation to the Securities and Exchange Commission (SEC). And the Chairman published white papers on market structure reform and cross-border harmonization.

A. Cross-Border Tensions

In 2017, the European Union (EU) passed legislative proposals that would expand the regulatory and supervisory authority of the European Securities and Markets Authority over third-country CCPs to include, inter alia, ongoing surveillance and on-site inspections. The proposal would also provide the European Central Bank and other EU central banks with new oversight authority over third-country CCPs.³⁰ During 2018, Chairman Giancarlo was vocal about his objection to these proposals.³¹ He made it clear that he viewed this proposal as a betrayal of the agreement that the

²⁶ Virtual currencies are discussed in greater detail below.

²⁷ Giancarlo Enforcement Speech.

²⁸ See Annual Enforcement Report (noting that 41 of 83 cases were primarily for retail fraud, a failure to register or illegal off-exchange contracts).

²⁹ Giancarlo Enforcement Speech. See also J. Christopher Giancarlo, Chairman, Commodity Futures Trading Commission, *Remarks of Chairman J. Christopher Giancarlo at FIA Expo Chicago, Illinois* (Oct. 10, 2018) available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo58>.

³⁰ Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 with respect to the procedures and authorities involved for the authorization of CCPs and requirements for the recognition of third-country CCPs available at https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-331_en. These proposals were a byproduct of the Brexit negotiations as the EC expressed concerns about the concentration of European customers at the UK clearinghouse, LCH. This concern led to proposed limitations on all non-EU or third-country CCPs.

³¹ See, e.g., J. Christopher Giancarlo, Chairman, Commodity Futures Trading Commission, *Remarks of Chairman J. Christopher Giancarlo at the Association of German Banks, Berlin, Germany* (May 7, 2018) available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo45> (Berlin Speech); see also J. Christopher Giancarlo, Chairman, Commodity Futures Trading Commission, *Remarks of Chairman J. Christopher Giancarlo at FIA Expo Chicago, Illinois: A Week in the Life of the CFTC* (Oct. 17, 2018) available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo58> (FIA Chicago Speech).

CFTC and European Commission (EC) made over transatlantic CCPs in 2016,³² and an encroachment on the CFTC's jurisdiction over US-based CCPs. In his remarks to the Futures and Options Expo, Chairman Giancarlo noted:

Make no mistake: the CFTC cannot and will not allow its regulated markets and market participants to become subject to conflicting or overly burdensome regulation from abroad. No sovereign regulator would agree to it, let alone a regulator overseeing the world's largest derivatives markets. The CFTC will not allow US market participants to be put in the completely untenable position of having to choose between violating domestic laws and regulations or violating foreign laws and regulations. It is completely irresponsible for European regulators to seek to put US market participants in this position.³³

The Chairman even threatened retaliatory action if the EU finalized the proposals, stating that:

If a satisfactory resolution of this situation cannot be found, the CFTC will have no choice but to consider a range of readily available steps to protect US markets and market participants. Be assured that the CFTC has a range of options, short of further legislative action, that it can execute unilaterally in response to an extraterritorial overreach by a non-US authority. They include revisiting the CFTC's Part 30 regime to withdraw existing exemptions in particular overseas jurisdictions. They also include delaying or withholding CFTC staff relief for non-US entities from such jurisdictions. Other effective options are available in conjunction with fellow US regulatory agencies.³⁴

Chairman Giancarlo was not alone in voicing his concerns. Commissioners Rostin Behnam and Brian Quintenz raised similar objections to the EU's proposals.³⁵ In December 2018, the EC appeared to move in a more conciliatory direction, issuing a statement acknowledging the compromise position on CCP supervision, particularly to account for Brexit.³⁶ Chairman Giancarlo welcomed these actions.³⁷

³² Berlin Speech (discussing *The United States Commodity Futures Trading Commission and the European Commission: Common approach for transatlantic CCPs* (Feb. 10, 2016) available at https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/speechandtestimony/eu_cftcstatement.pdf).

³³ FIA Chicago Speech.

³⁴ *Id.*

³⁵ See Rostin Behnam, Commissioner, Commodity Futures Trading Commission, *Keynote Remarks of CFTC Commissioner Rostin Behnam at the Federal Reserve Bank of Chicago's Fifth Annual Conference on CCP Risk Management, Chicago, Illinois: A Decade After the Financial Crisis: Remaining Challenges and New Approaches for the Next Ten Years and Beyond* (Oct. 16, 2018) available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam10>; see also Brian Quintenz, Commissioner, Commodity Futures Trading Commission, *Keynote Address of Commissioner Brian Quintenz before FIA Annual Meeting, Boca Raton, Florida* (Mar. 14, 2018) available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opaquintenz9>.

³⁶ *Capital markets union: Council agrees stance on supervision framework for clearing houses* (Dec. 3, 2018) available at <https://www.consilium.europa.eu/en/press/press-releases/2018/12/03/capital-markets-union-council-agrees-stance-on-supervision-framework-for-clearing-houses/>.

Also, in December, the Commission staff issued three no-action letters to Eurex Clearing AG permitting it to begin clearing swap transactions on behalf of customers of futures commission merchants (FCMs), providing US customers with another option for clearing their swap transactions. The first letter, issued by the Division of Clearing and Risk, confirms that Eurex has demonstrated compliance with the straight-through-processing requirements of Regulation 39.12(b)(7) and approves certain Eurex rules.³⁸ The second letter, issued jointly by the Division of Clearing and Risk and the Division of Swap Dealer and Intermediary Oversight, provides conditional relief from certain Commission regulations to allow Eurex's FCM clearing members to deposit and hold customer margin in the form of securities at Clearstream Banking AG, a central securities depository based in Germany.³⁹

This relief was unusual in that it was conditioned on the absence of any material increase in EU legal or supervisory obligations imposed on US derivatives clearing organizations and further required agency staff to determine regularly whether any such increase has occurred.⁴⁰ Although the letters stated that Commission staff would only reconsider rescinding the no-action relief in response to such a material increase in EU oversight of US CCPs, this condition points to the Commission's desire to reach an accommodation with the EU as well as the seriousness of the cross-border issue if no accommodation can be reached.

B. Rulemaking

1. Proposed Rule—Swap Execution Facilities and Trade Execution Requirements

The Commission on November 5, 2018, in a 4–1 vote, proposed to fundamentally redesign the regulatory framework governing SEFs and the trade execution requirement.⁴¹ If adopted, these

³⁷ See, e.g., J. Christopher Giancarlo, Chairman, Commodity Futures Trading Commission, *Statement of Chairman J. Christopher Giancarlo on Financial Stability Concerns regarding Brexit* (Dec. 6, 2018) available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement120618>.

³⁸ *Eurex Clearing AG*, CFTC No-Action Letter, CFTC Letter No. 18-30 (Dec. 20, 2018) available at <https://www.cftc.gov/sites/default/files/idc/groups/public/%40rlettergeneral/documents/letter/2018-12/18-30.pdf>.

³⁹ *Eurex Clearing AG*, CFTC No-Action Letter, CFTC Letter No. 18-31 (Dec. 20, 2018) available at <https://www.cftc.gov/sites/default/files/idc/groups/public/%40rlettergeneral/documents/letter/2018-12/18-31.pdf>. The third letter, issued by the Division of Clearing and Risk, provides no-action relief permitting modifications to the acknowledgment letter that Eurex is required to obtain from the Deutsche Bundesbank in order to deposit customer margin in the form of cash at the Deutsche Bundesbank. *Eurex Clearing AG*, CFTC No-Action Letter, CFTC Letter No. 18-32 (Dec. 20, 2018) available at <https://www.cftc.gov/sites/default/files/idc/groups/public/%40rlettergeneral/documents/letter/2018-12/18-32.pdf>.

⁴⁰ Commissioner Quintenz objected to the relief that was granted and issued a statement describing the reasons for his objection. See Brian Quintenz, Commissioner, Commodity Futures Trading Commission, *Statement of Commissioner Brian Quintenz on Staff No-Action Relief for Eurex Clearing AG* (Dec. 20, 2018) available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement122018>.

⁴¹ *Swap Execution Facilities and Trade Execution Requirement*, Proposed Rule, 83 Fed. Reg. 61946 (Nov. 30, 2018). For a detailed description of the proposal and discussion of the issues therein, see Paul M. Architzel, Petal P. Walker and Edward Meehan, *CFTC Proposes Sweeping Changes to Swap Execution Facilities and Trade Execution Requirement* (Dec. 6, 2018) available at <https://www.wilmerhale.com/en/insights/client-alerts/20181206-cftc-proposes-sweeping-changes-to-swap-execution-facilities-and-trade-execution-requirement>.

proposed rules would affect virtually all market participants and market infrastructure providers. In a companion release, the Commission requested comment on the practice of post-trade name give-up for anonymously executed swap transactions that are intended to be cleared.⁴²

The proposal would revamp the regulatory framework for executing swaps by: (1) scrapping the current “Made Available to Trade” process and requiring that all transactions for cleared swaps that are listed on a SEF or a designated contract market (DCM) be traded on a SEF or a DCM, absent an explicit exemption; (2) requiring that all broking activities—activities of entities, including interdealer brokers that facilitate swaps trading between multiple market participants through nonregistered voice or electronic platforms—be performed by a registered SEF and its “trading specialist” employees; (3) removing restrictions on SEF execution rules or trading protocols, such as the current Order Book and RFQ requirements in favor of disclosure-based trading and execution rules that apply to any execution method offered by a SEF; (4) prohibiting pre-trade communications and certain forms of off-facility swap transactions; and (5) permitting SEFs to establish eligibility requirements that enable a SEF to serve particular market segments or participants. The overall effect of the proposed changes is to substantially broaden the number of transactions required to be traded on a SEF or a DCM while at the same time removing many of the substantive restrictions on the trading mechanics under which SEFs now operate.

In addition to fundamentally restructuring the regulatory framework for swap transactions, the Commission also proposed to codify several staff interpretive and no-action letters and to streamline several processes and compliance requirements. Comments on the proposed rule must be received on or before February 13, 2019. It is clear that aspects of the proposed rules will meet substantial industry resistance.

2. Proposed and Final Rules—De Minimis Threshold

On November 13, 2018, the Commission amended the de minimis exception within the “swap dealer” definition in the Commission’s regulations by setting the aggregate gross notional amount threshold for the de minimis exception at \$8 billion in swap dealing activity entered into by a person over the preceding 12 months.⁴³ The final rule, however, did not include some of the other proposed revisions raised in the original proposal, including (1) replacing gross notional exposure as the measurement to determine the swap dealer de minimis threshold, (2) providing an exception for exchange-traded or cleared swaps from being counted toward the threshold, and (3) providing an exception for nondeliverable forwards from being counted.⁴⁴

⁴² *Post-Trade Name Give-Up on Swap Execution Facilities*, Proposed Rule, 83 Fed. Reg. 61571 (Nov. 30, 2018).

⁴³ *De Minimis Exception to the Swap Dealer Definition*, Final Rule, 83 Fed. Reg. 56666 (Nov. 13, 2018).

⁴⁴ *Compare id. with De Minimis Exception to the Swap Dealer Definition*, Proposed Rule, 83 Fed. Reg. 27444 (June 12, 2018).

3. Proposed Rule—“Volcker Rule”

On June 4, 2018, the Commission also proposed identical amendments to the prohibitions and restrictions on proprietary trading as required by the Dodd-Frank Act (the Volcker Rule) as those proposed by the prudential banking regulators and the SEC.⁴⁵ Although the Commission did not immediately release the text of the amendments considered during its June 4 meeting, the text of the proposed amendments had been released by the banking regulators. The proposed amendments would modulate the compliance requirements depending on the amount of trading by covered entities, which include insured depository institutions, their holding companies, certain foreign banking organizations and their affiliates. The proposed rule would create three regulatory tiers. Most CFTC-regulated swap dealers and FCMs within the scope of the Volcker Rule fall within the highest tier and therefore will experience the least impact from relaxation of the requirements. However, the proposal’s preamble is expected to make clear that a bank affiliate may clear swaps for others, giving greater certainty to FCMs in connection with their clearing activities. Proposed exclusions from the definition of “covered funds” may provide those entities covered by the Volcker Rule additional opportunities to operate pools or provide services to funds.

4. Final Rule—Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants

On November 26, 2018, the Commission approved amendments to its margin requirements for uncleared swaps for swap dealers and major swap participants for which there is no prudential regulator (CFTC Margin Rule).⁴⁶ The Commission adopted these amendments in light of the rules recently adopted by the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the QFC Rules) that impose restrictions on certain uncleared swaps and uncleared security-based swaps and other financial contracts.

Specifically, the Commission amended the definition of “eligible master netting agreement” in the CFTC Margin Rule to ensure that master netting agreements of firms subject to the CFTC Margin Rule are not excluded from the definition of “eligible master netting agreement” based solely on such agreements’ compliance with the QFC Rules. The Commission also amended the CFTC Margin Rule such that any legacy uncleared swap (i.e., an uncleared swap entered before the applicable compliance date of the CFTC Margin Rule) that is not now subject to the margin requirements of the CFTC Margin Rule will not become so subject if it is amended solely to comply with the QFC Rules. These amendments are consistent with amendments that the Board, FDIC, OCC, Farm Credit Administration and Federal Housing Finance Agency jointly published in the Federal Register on October 10, 2018. The Commission also proposed and adopted other rules for

⁴⁵ *Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, Proposed Rule, 83 Fed. Reg. 33432 (July 17, 2018).

⁴⁶ *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, Final Rule, 83 Fed. Reg. 60341 (Nov. 26, 2018).

swap data repositories (SDRs) and approved amending its regulations regarding certain duties of chief compliance officers of swap dealers, major swap participants and FCMs.⁴⁷

5. Unfinished Rulemaking

Notably, the Commission did not repropose or finalize two critical rules that have been much anticipated by the industry—capital rules for swap dealers⁴⁸ and the position limits rules.⁴⁹ Despite indications to the contrary,⁵⁰ these rules did not make it onto the Commission’s agenda in 2018. The capital rules were initially proposed in December 2016, and a revised proposal was published in March 2017. They are the last major rulemaking for the CFTC’s swap dealer regime such that their finalization would trigger permanent registration, as opposed to the provisional registration to which swap dealers are currently subject. The position limits rule was initially adopted in October 2011, but following litigation was repropose in December 2016. Both proposals engendered active market reaction and had vocal detractors.

C. Evolving Oversight of Virtual Currencies

In 2018, through its enforcement actions, guidance and public meetings, the CFTC further established its oversight of virtual currencies by expanding and clarifying its role. As the SEC increased its attention on virtual currencies through its own enforcement actions, guidance and published speeches, the CFTC sought to maintain clarity along the jurisdictional lines.

The CFTC filed a number of cases this year relating to virtual currency fraud. Director McDonald emphasized the CFTC’s commitment to act aggressively to root out fraud and bad actors in the virtual currency space, which is particularly important in such an undeveloped space as Director McDonald noted that “some fraudsters evolve, as they sought to use new products or new

⁴⁷ On June 4, 2018, the Commission proposed another rule under the Dodd-Frank Act to amend its rules to permit the sharing of data held by an SDR pursuant to a confidentiality agreement between a requesting regulator and the Commission. This change is likely to enhance cross-border regulatory cooperation and market surveillance. The Commission on June 12, 2018, adopted amendments to its regulations relating to access to swap data held by SDRs. These amendments implemented pertinent provisions of the FAST Act and made associated changes to the Commission’s regulations governing the grant of access to swap data to certain foreign and domestic authorities by SDRs, as well as changes to certain other regulations unrelated to such access. See *Amendments to the Swap Data Access Provisions of Part 49 and Certain Other Matters*, Final Rule, 83 Fed. Reg. 27410 (June 12, 2018). Lastly, on August 27, 2018, the Commission approved amending its regulations regarding certain duties of chief compliance officers of swap dealers, major swap participants and FCMs (collectively, “Registrants”); and certain requirements for preparing, certifying and furnishing to the Commission an annual report containing an assessment of the Registrants’ compliance activities. See *Chief Compliance Officer Duties and Annual Report Requirements for Futures Commission Merchants, Swap Dealers, and Major Swap Participants*, Final Rule, 83 Fed. Reg. 43510 (Aug. 27, 2018).

⁴⁸ See *Capital Requirements of Swap Dealers and Major Swap Participants*, 82 Fed. Reg. 13971 (March 16, 2017).

⁴⁹ See *Position Limits for Derivatives: Certain Exemptions and Guidance*, Proposed Rule, 81 Fed. Reg. 38458 (June 13, 2016); see also *Position Limits for Derivatives; Re-proposal*, 81 Fed. Reg. 96704 (Dec. 30, 2016).

⁵⁰ See, e.g., J. Christopher Giancarlo, Chairman, Commodity Futures Trading Commission, *Keynote Address of Chairman J. Christopher Giancarlo before FIA Annual Meeting, Boca Raton, Florida* (Mar. 14, 2018) available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo40>.

technologies to target unwitting customers in markets like virtual currencies.”⁵¹ This aggressive stance was evident in the many cases brought in 2018. For instance, in *Gelfman Blueprint*, it was found that the defendants fraudulently misstated their success in trading Bitcoin.⁵² In a separate instance, the court found that the defendants fraudulently misrepresented their trading in Bitcoin and Litecoin, and misappropriated customer funds.⁵³ In *McDonnell*, the trader and his associated firm were ordered to provide restitution and to pay a civil monetary penalty that was three times the amount of restitution. Several other virtual currency cases have been filed that need to wind their way through the court processes.⁵⁴

In 2018, in *My Big Coin Pay*, the CFTC survived a challenge to its jurisdiction over virtual currencies.⁵⁵ In this case, the CFTC brought charges against defendants for fraudulently claiming that My Big Coin was a “fully-functioning virtual currency” that could be used to purchase goods and services, was traded on multiple exchanges, was part of a partnership with Mastercard and was backed by gold.⁵⁶ In a motion to dismiss, the defendants claimed, inter alia, that the Commission did not have jurisdiction over the matter because the coin at issue was not subject to a futures contract and therefore was not a commodity.⁵⁷ The court disagreed, noting that, at the pleading stage, the CFTC had sufficiently established that since one virtual currency was subject to futures trading, the whole category of virtual currencies were also commodities.⁵⁸

Beyond enforcement, the Commission issued three Customer Advisories covering the topic of virtual currencies, advising investors to be cautious of sales pitches touting “IRS approved” retirement accounts,⁵⁹ highlighting pump-and-dump schemes⁶⁰ and warning would-be purchasers to conduct research before purchasing virtual currency.⁶¹ The Commission also held a series of

⁵¹ McDonald Summary Speech.

⁵² See *CFTC v. Gelfman Blueprint, et al.*, Case No. 17-7181 (S.D.N.Y. Oct. 8, 2018).

⁵³ See Memorandum & Order, *CFTC v. Patrick K. McDonnell, et al.*, Case No. 18-CV-361 at 2 (E.D.N.Y. Mar. 6, 2018).

⁵⁴ See, e.g., *CFTC v. Kantor*, Case No. 18-cv-02247 (E.D.N.Y. filed Apr. 16, 2018).

⁵⁵ See Complaint, *CFTC v. My Big Coin Pay, Inc.*, Case No. 1:18-cv-10077 (D. Mass. Jan. 16, 2018); see also Order, *CFTC v. My Big Coin Pay, Inc.*, Case No. 1:18-cv-10077 (D. Mass. Sept. 26, 2018).

⁵⁶ See *id.*

⁵⁷ Defendants and Relief Defendants’ Memorandum in Support of Their Joint Motion to Dismiss, *CFTC v. My Big Coin Pay, Inc.*, Case No. 1:18-cv-10077 (D. Mass. Mar. 30, 2018).

⁵⁸ Order, *CFTC v. My Big Coin Pay, Inc.*, Case No. 1:18-cv-10077 (D. Mass. Sept. 26, 2018).

⁵⁹ See *Customer Advisory: Beware of “IRS Approved” Virtual Currency IRAs* (Feb. 2, 2018) available at https://www.cftc.gov/sites/default/files/idc/groups/public/%40customerprotection/documents/file/customeradvisory_irs020218.pdf.

⁶⁰ See *Customer Advisory: Beware Virtual Currency Pump-and-Dump Schemes* (Feb. 15, 2018) available at https://www.cftc.gov/sites/default/files/idc/groups/public/%40customerprotection/documents/file/customeradvisory_pumpdump0218.pdf.

⁶¹ See *Customer Advisory: Use Caution When Buying Digital Coins or Tokens* (July 16, 2018) available at https://www.cftc.gov/sites/default/files/2018-07/customeradvisory_tokens0718.pdf.

public meetings on virtual currency, including two Technology Advisory Committee meetings⁶² and a fintech conference.⁶³

LabCFTC, the department in the Commission tasked with fintech development, also issued two substantial publications in 2018. In November, it published *A CFTC Primer on Smart Contracts*, in which, inter alia, the Commission noted that virtual currencies that are smart contracts could be considered not only commodities or securities, but also derivatives.⁶⁴ Later, in December, the Commission issued a request for information (RFI) on Ethereum.⁶⁵ The RFI stated that it was in part “to understand similarities and distinctions between certain virtual currencies, such as Ether and Bitcoin.”⁶⁶ The CFTC asked questions in its RFI about, inter alia, the Ethereum network’s anticipated change from a “proof of work” consensus mechanism to a “proof of stake” mechanism.⁶⁷ The questions demonstrate the CFTC’s concern that this change may inhibit the efficient validation of blocks and potentially lead to a fork in the network.

LabCFTC has become a very active office within the Commission, mainly as a clearinghouse for information. Although disseminating information regarding the impact of regulation on the development of new technologies is an important function, it remains to be seen whether LabCFTC in the coming year will operate similar to the regulatory sandboxes in other jurisdictions by affirmatively reducing the regulatory impediments to enterprises as they experiment with new approaches.

D. Chairman’s White Papers

1. Swaps Regulation Version 2.0

On April 26, 2018, Chairman Giancarlo released a white paper titled *Swaps Regulation Version 2.0: An Assessment of the Current Implementation of Reform and Proposals for Next Steps*.⁶⁸ The white paper took a comprehensive review of five swap-related areas: (1) CCPs, (2) reporting, (3) swap dealer capital, (4) the end-user exception to the clearing requirement and (5) execution.

⁶² Technology Advisory Committee, Notice of meeting, 83 Fed. Reg. 4643 (Feb. 1, 2018). Webcast available at <https://youtu.be/qinevlp2g2Y>. Technology Advisory Committee, Notice of meeting, 83 Fed. Reg. 47608 (Sept. 20, 2018). Webcast available at <https://www.wirestream.tv/customer/cftc/2018/10-05/>.

⁶³ CFTC to host First FinTech Conference on October 3–4, 2018: <https://www.cftc.gov/LabCFTC/Events/opaeventfintechconference100318>.

⁶⁴ *A Primer on Smart Contracts*, LabCFTC (Nov. 27, 2018) available at https://www.cftc.gov/sites/default/files/2018-11/LabCFTC_PrimerSmartContracts112718_0.pdf.

⁶⁵ *Request for Input on Crypto-Asset Mechanics and Markets*, 83 Fed. Reg. 64563 (Dec. 17, 2018).

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ See J. Christopher Giancarlo and Bruce Tuckman, *Swaps Regulation Version 2.0: An Assessment of the Current Implementation of Reform and Proposal for Next Steps – White Paper* (Apr. 26, 2018) available at https://www.cftc.gov/sites/default/files/2018-04/oce_chairman_swapregversion2whitepaper_042618.pdf.

Regarding CCPs, the Chairman noted, inter alia, the need for increased liquidity of funded resources and more transparent recovery plans.⁶⁹ Regarding reporting, he recommended, inter alia, revising the requirements for SDRs to verify and validate data, and the use of distributed ledger technology to allow regulators to efficiently access data.⁷⁰ The Chairman also recommended reform of the standardized models used for swap dealer capital⁷¹ and revision of the definition of “material swaps exposure” as it applies to margin.⁷² His most extensive recommendations, however, were in regard to SEFs⁷³ and, as noted, were incorporated into a proposed rulemaking described above.

2. Cross-Border Swaps Regulation Version 2.0

On October 1, 2018, Chairman Giancarlo released another white paper titled *Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-US Regulation*.⁷⁴ In this white paper, the Chairman directed the staff to propose rules regarding cross-border issues in swaps reform. Mainly, the Chairman proposed a territorial approach⁷⁵ to derivatives oversight where the regulator of each jurisdiction has plenary oversight of its domestic market participants and foreign market participants operating within the jurisdiction, with all other jurisdictions “deferring” to its authority.⁷⁶ The Chairman advocated this territorial approach for jurisdictions that he defined as “comparable” jurisdictions, describing them as “jurisdictions that have adopted the G20 reforms.”⁷⁷

Consistent with this general principle, the Chairman proposed ways through which the CFTC could defer to foreign regulators and require deference from other jurisdictions concerning foreign CCPs, execution venues, swap dealers (and their US personnel) and counterparties. For instance, regarding clearing, the Chairman proposed to use exemptive authority to allow comparable non-US CCPs that do not “pose substantial risk” to the US to “provide clearing services to US customers indirectly through non-US clearing members, without the non-US CCP or its non-US clearing members having to register as a [derivatives clearing organization] or FCM, respectively.”⁷⁸

⁶⁹ See *id.* at 13–15 and 19.

⁷⁰ *Id.* at 34–37.

⁷¹ *Id.* at 58.

⁷² *Id.* at 77–80.

⁷³ *Id.* at 43–56.

⁷⁴ See J. Christopher Giancarlo, *Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-US Regulation – White Paper* (Oct. 1, 2018) available at https://www.cftc.gov/sites/default/files/2018-10/Whitepaper_CBSR100118.pdf.

⁷⁵ See *id.* at v.

⁷⁶ See *id.* at 1 and 76–77.

⁷⁷ *Id.* at 23.

⁷⁸ *Id.* at 44.

Similarly, the Chairman also proposed using exemptive authority to allow US persons to trade swaps (including those subject to mandatory trade execution) on comparable non-US trading venues without the venues having to register as SEFs.⁷⁹ Moreover, in keeping with this territorial paradigm, the Chairman advocated that trades that are “arranged, negotiated and executed” in the US by personnel of non-US dealers should be subject to US rules since they occur within the US, but not count toward the non-US dealer’s de minimis requirement.

IV. LOOKING FORWARD

Chairman Giancarlo’s term in office ends in April. His successor, who has already been named, inherits a Commission with a full complement of commissioners⁸⁰ and a full docket of significant challenges and rulemakings. The new Chairman, in deciding his agenda and priorities, may find that many of the pressing issues facing the Commission in 2019 have already been determined for him.

Cooperation and self-reporting, along with cooperative enforcement efforts with other authorities, are likely to remain a focus for the Division of Enforcement. This approach has succeeded in enabling the Commission to address large-scale, complex matters, despite its limited budget. Similarly, the Commission will most likely continue its current course in regard to oversight of virtual currency. With the continued volatility of virtual currency and the interest of multiple regulators, the CFTC will likely continue to steer a balanced approach—maintaining an appropriate degree of oversight while not encroaching on the jurisdiction of its sister agencies.

Resolving the cross-border dispute with the EC over the CCP harmonization agreement will likely present an early and important challenge. Recent steps by both the EU and the Commission signal a softening of positions. Nevertheless, resolving this issue will require a significant degree of diplomatic skill.

Another impending issue is the advent of the final two phases of the margin rules.⁸¹ Market participants have been vocal about the change these two phases will cause in the industry and have asked for a delay of implementation dates. It is possible that, as in the case of the variation margin phase-in deadline, the CFTC and other regulators may come under pressure to act in concert to delay implementation.

⁷⁹ *Id.* at 51–52.

⁸⁰ In December 2018, the White House announced President Trump’s intent to nominate Heath P. Tarbert as the next Chairman of the CFTC. He is currently the Assistant Secretary of the Treasury for International Markets and Investment, where, among other duties, he manages the Committee on Foreign Investment in the United States.

⁸¹ *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 636 (Jan. 6, 2016).

Another challenge in the coming year will be the move from the London Interbank Offered Rate (LIBOR) to the Secured Overnight Financing Rate (SOFR).⁸² Market participants have already requested that the Commission allow exceptions to its regulations in order to encourage increased use of SOFR derivatives. The new Chairman and Commission will likely have to determine what exceptions, if any, are appropriate.

In regard to rulemaking, the new Chairman may be faced with the decision whether to finalize the pending SEF proposed rules and what changes, if any, to make in response to comments. The proposal was controversial, lacking unanimity. The Chairman would also have to determine whether to dedicate resources to reproposing the capital rules for swap dealers and/or the position limits rules. These two rules are the two key Dodd-Frank Act rules remaining.

Finally, Congress has signaled that it will consider reauthorizing the Commission this year, now that the Farm Bill has been completed. As in reauthorizations past, the reauthorization process, once underway, is likely to absorb a substantial amount of the Commission's resources. The new Chairman, and the Commission, thus will face quite a few challenges in the coming year.

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⁸² In July, the Market Risk Advisory Committee held panels discussing LIBOR reform, SOFR, SOFR derivatives and the effect of LIBOR reform on the derivatives market. Market Risk Advisory Committee, Notice of meeting, 83 Fed. Reg. 29762 (June 26, 2018). Webcast available at <https://youtu.be/3hOHOZQgwPA>.

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