Katten

Financial Markets Litigation and Enforcement

Futures Enforcement and Litigation: A Disruptive Year

Top 5 Takeaways

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October 1, Katten hosted the first presentation of the firm's annual Financial Markets Litigation and Enforcement Symposium Series titled, "Futures Enforcement and Litigation: A Disruptive Year." Partner and Chair of Financial Markets Litigation and Enforcement Christian Kemnitz moderated and panelists included Gary DeWaal, Special Counsel in Katten's Financial Markets and Funds Practice and Chair, Financial Markets and Regulation; Neel Chopra, Special Counsel to the Director of Enforcement, Commodity Futures Trading Commission; Natalie Petric, Director, Enforcement Counsel, Legal & Market Regulation, CME Group; and Kristofer Williams, Executive Director, Morgan Stanley.

The discussion included emerging trends and current topics in enforcement and litigation, including manipulation, disruptive trading, trade practices and the investigative process, among other timely issues. Below are the top five takeaways from the program.

1. Current trends in spoofing enforcement

Regulators noted that he number of new, traditional spoofing incidents appear to be declining, but the pursuit of older cases continues, and there is some innovation in trading patterns that are alleged to constitute spoofing, including cases where spoofing occurs across markets, exchanges or traders. Cancelling one side of two-sided pending orders may also be viewed as spoofing under certain circumstances, claimed one regulator. The recent conviction of two precious-metal traders showcases the Department of Justice's (DOJ) commitment to its revised approach to crack down on market manipulation — proceeding solely under the wire fraud statute and without reference to anti-spoofing or commodities-fraud statutes to access a longer statute of limitations — but long deliberation and split verdict may suggest challenges for the government in cases with less direct evidence of intent.

2. CME Rule 575 enforcement

CME Rule 575D is being enforced more frequently and although the exchange's decision to pursue any disciplinary action is very fact-dependent, the cases suggest that market participants should (1) have some process for considering the size of their orders before placing them; (2) compare the size of a potential order to the visible liquidity in the market and be cautious when the quantity of a potential order is greater than the volume shown in the five top levels of visible orders; and (3) be alert to (and surveil for) patterns of large trades that move multiple prices.

3. Be candid with your regulators

There is a pattern of cases focused on the investigatory process, including the care and thoroughness with which respondents provide information to the Commission. Firms should be as transparent as possible to avoid any perception that statements have been false, misleading or incomplete, particularly where more complete information is available in their records and/or has been reported to other regulators. Transparency is also important for market participants dealing with the National Futures Association (NFA) and exchanges too.

4. The importance of proper record-keeping

Market participants should be mindful to ensure that systems (including those provided by third parties) that collect required data and communications, including audio records, do so consistent with Commodity Futures Trading Commission (CFTC) standards and preserve such data for such periods of time, as required and in an easily searchable and recoverable format. The individuals involved in such process, who may be in operations or information technology groups, should be considered part of the compliance effort and trained and resourced accordingly.

5. Regulatory Implications of Innovations in FinTech

Chicago Mercantile Exchange (CME) and Chicago Board of Trade (CBOT) are finding broader liability even where a company creates an algorithm or auto trading system that is misused by subscribers. FinTech firms should pressure test the potential market abusive actions their technologies enable. They should also consider the impact of their algorithms on the number and size of orders placed in a given marketplace and how those impact the available liquidity in those markets.

Panelists also discussed the regulatory implications of new technologies like Decentralized finance (DeFI), which would use blockchain technology to remove intermediaries in transactions.

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