



# Practical Advice for Responding to Investigations in the Commodities and Derivatives Space



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# Your Panelists

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# Stage 1 – October 1, 2021

*A trading organization receives a letter from its clearing broker, which attaches an inquiry from the surveillance unit of a U.S. futures exchange. The exchange inquiry identifies three September 2021 trading patterns in which an account for the organization entered and subsequently canceled certain sell orders in a gold futures contract, when that same account had resting buy orders on the opposite side of the same market. The exchange requests the identity of the clearing firm's customer (the trading organization), the identity of the trader(s) who entered the orders, and an explanation for the orders. The exchange inquiry is dated two weeks prior and calls for a response by October 1.*



# Stage 1A

*The organization identifies the trader in question (Trader A), a member of the Precious Metals Desk, which trades various precious metals and interest rate products. On October 1, Compliance asks Trader A and her trading assistant (Assistant B) about the orders. Trader A explains that she sometimes places orders away from the current market price on both sides of the market in order to take advantage of market volatility. Assistant B, a recent college graduate in his first trading job, does not speak during the meeting. Compliance responds to the clearing broker on October 1, relaying Trader A's explanation.*

# Stage 1 Considerations

- Inquiry appears to relate to “spoofing,”
- Spoofing refers to “bidding or offering [on a regulated exchange] with the intent to cancel the bid before execution.” 7 U.S.C. § 6c(a)(5)(C)
- When prosecuted as a civil action by the CFTC, the anti-spoofing provision carries a penalty of up to \$185,242 per violation, or triple the gain. 7 U.S.C. § 9.
- The CFTC may also seek other penalties, including temporary or permanent trading bans. *Id.*
- If the spoofing was for the purpose of affecting market prices, a separate price-manipulation charge may be brought, carrying a civil penalty of up to \$1,212,866 per violation, or triple the gain. *Id.*
- Spoofing and manipulation also constitute criminal violations. 7 U.S.C. § 13(a).
- The rules of all U.S. futures exchanges similarly prohibit spoofing, and the exchange can levy money penalties or enforce temporary or permanent trading bans in response to spoofing.

# Stage 1 Considerations (cont'd)

- By passing along Trader A's explanation without taking steps to ensure its accuracy, the organization could potentially open itself up to a charge of providing false information to the exchange, although to be prosecuted as such, a false statement must be made knowingly.
  - Any entity that knowingly makes a false statement to a CFTC-registered exchange can be charged civilly by the CFTC, **7 U.S.C. § 9(2)**, and subject to a fine of up to \$185,242 per violation, or triple the gain, **7 U.S.C. § 9 (10)**.
  - Knowing misstatements to a registered exchange can also be charged criminally **7 U.S.C. § 13(a)(4)**, carrying penalties including up to \$1 million per violation, *id.*
- The organization appears to have felt pressured to respond quickly. The better approach would be to contact the exchange directly to seek an extension.



## Stage 2 – October 15, 2021

*The organization receives a letter directly from the enforcement unit of the exchange, which includes a case number, and which inquires about an additional seven similar order patterns in gold futures in September 2021. The letter calls for a response in 10 business days. The organization determines that Trader A also entered each of these seven new order patterns. Compliance forwards the request to the Legal Department, which decides to engage outside counsel.*



## Stage 2A

*Outside counsel directs an analysis of the 10 order patterns and conducts a limited communications review, neither of which shed much light on the purpose of the order patterns. Outside counsel, with the Legal Department, seeks to schedule interviews with Trader A and Assistant B.*





## Stage 2B – November 15, 2021

*After procuring individual counsel for Trader A and Assistant B, outside counsel and the Legal Department interview Assistant B. He confirms that while he sometimes entered orders for Trader A, he did not enter any of the orders identified by the exchange. He also discloses that several traders on the Precious Metals Desk communicated in a WhatsApp group chat during the work-from-home period. Some of these traders, including Trader A, sometimes bragged about a “trick” to “beat the algos.” Thereafter, Trader A refuses to be interviewed, and after being told that she will be terminated if she does not participate in the interview, she resigns.*



# Stage 2 Considerations

- At this stage outside counsel should recommend a preliminary expedited investigation to determine the scope of potential liability and to identify any potential defenses.
- The goal of this investigation should be to give the organization's decisionmakers all information necessary to decide on a strategy for responding to the exchange and preparing for any further regulatory or criminal inquiry, taking into account applicable guidance from CFTC and from DOJ on penalty and charging decisions (excerpted on the following slides)
- The investigation would need to include
  - Communications review and analysis
  - Trading data analysis
  - Interviews
- All steps should be taken or directed by outside counsel and / or the Legal Department in order to maintain privilege

# Stage 2 Considerations (cont'd)

## Factors considered by DOJ in corporate charging decisions (excerpted from Justice Manual § 9-28.300)

- The nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime;
- The pervasiveness of wrongdoing within the corporation, including the complicity in, or the condoning of, the wrongdoing by corporate management;
- The corporation's history of similar misconduct, including prior criminal, civil, and regulatory enforcement actions against it;
- The corporation's willingness to cooperate, including as to potential wrongdoing by its agents;
- The adequacy and effectiveness of the corporation's compliance program at the time of the offense, as well as at the time of a charging decision;
- The corporation's timely and voluntary disclosure of wrongdoing;
- The corporation's remedial actions, including, but not limited to, any efforts to implement an adequate and effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, or to pay restitution;
- Collateral consequences, including whether there is disproportionate harm to shareholders, pension holders, employees, and others not proven personally culpable, as well as impact on the public arising from the prosecution;
- The adequacy of remedies such as civil or regulatory enforcement actions, including remedies resulting from the corporation's cooperation with relevant government agencies;
- The adequacy of the prosecution of individuals responsible for the corporation's malfeasance; and
- The interests of any victims.

# Stage 2 Considerations (cont'd)

Factors considered by CFTC in penalty decisions (excerpted from May 20, 2020 Enforcement Memorandum re “Civil Monetary Penalty Guidance”)

- **Gravity of the violation:**
  - Nature and scope of the violations;
  - Respondent’s state of mind, including whether the conduct was intentional or willful; and
  - Nature and scope of any consequences flowing from the violations;
- **Mitigating and aggravating circumstances:**
  - Post-violation conduct;
  - Cooperation and self-reporting;
  - Timeliness of remedial efforts;
  - Existence and effectiveness of pre-existing compliance program;
  - Prior misconduct;
  - Pervasiveness of misconduct within the company, including responsibility of management; and
  - Nature of any disciplinary action taken by the company;
- **Other considerations:**
  - Total mix of remedies and monetary relief to be imposed, including by other regulators, prosecutors and self-regulatory organizations;
  - Monetary and non-monetary relief in analogous cases; and
  - Conservation of CFTC resources, including timely settlement.

## Stage 2 Considerations (cont'd)

- Important to maintain privilege over any employee interviews
- Typically, the corporation's privilege will apply to information learned in interviews only if:
  - The interviewee is an employee;
  - The interview is done at the direction of a corporate superior for the purpose of seeking legal advice for the corporation; and
  - The communication is within the scope of the employee's duties. *Upjohn Co. v. United States*, 449 U.S. 383, 390 (1981).
- In order to ensure that the company can make use of information gained in the interview without the employee asserting privilege, and "Upjohn Warning" should be given at the start of any interview.
  - Counsel should explain that the interview is privileged, but that the privilege belongs to the company, which may in the future choose to waive that privilege
  - Counsel should clarify that s/he represents the company, not the employee

# Stage 2 Considerations (cont'd)

- In light of the information provided in Assistant B's interview, outside counsel should advise the organization to now broaden its investigation to consider whether other traders may have committed spoofing violations. Initially, this broadened investigation should include:
  - Review of WhatsApp communications;
  - Depending on the outcome of that review, potential further data analyses; and
  - Depending on the outcomes of the communications review and data analyses, potential interviews with additional traders
- After those steps are taken, the organization should consider next steps for responding to the exchange, and may also wish to consider remedial steps or self-reporting.
- Self-reporting to CFTC requires the following:
  - **Voluntary disclosure to the Division of Enforcement:**
    - Made prior to imminent threat of exposure of misconduct;
    - Made within a reasonably prompt time after the company becomes aware of the misconduct; and
    - Including all relevant facts known to the company at the time of the disclosure, including relevant facts about the individuals involved in the misconduct;
  - **Full cooperation with the CFTC's investigation; and**
  - **Timely and appropriate remediation of flaws in compliance and control programs.**

CFTC Enforcement Advisory, "Updated Advisory on Self Reporting and Full Cooperation,"



## Stage 3 – January 31, 2021

*Outside counsel has provided high-level responses to the October 15 exchange letter, but has not yet formed a final view on potential liability or available defenses. The organization now receives subpoenas from the CFTC and the DOJ for documents and communications related to the 10 gold futures order patterns identified in the October 15 exchange letter. The subpoenas have a return date of February 14, 2022. Several traders from the metals desk report to the Legal Department that they have received substantially similar individual subpoenas.*



## Stage 3A

*Outside counsel negotiates with the CFTC and DOJ a one-month extension to begin responding to the subpoenas, with a rolling production schedule. As the internal investigation into the 10 order patterns continues, outside counsel forms a view that the organization may have a solid defense to any allegations of misconduct. But in developing this defense, counsel is unable to make productions to the CFTC or DOJ on the previously agreed schedule. The CFTC and DOJ reluctantly agree to multiple additional extensions of the production schedule, but express growing dissatisfaction and impatience. No productions are made until May 2022, and the organization does not endeavor to provide cooperation to the CFTC or DOJ beyond responding to the subpoenas. While rolling productions are ongoing, outside counsel sets a meeting with CFTC and DOJ for June 1, 2022, to explain the results of the internal investigation.*





## Stage 3B

*At the June 1 meeting, outside counsel makes a case for concluding the investigation for lack of wrongdoing. The CFTC and DOJ are unconvinced by counsel's presentation. Counsel concedes that its investigation to date has focused entirely on Trader A's 10 gold order patterns identified in the subpoenas, with no investigation of other dates, other traders or other contracts. The CFTC and DOJ indicate that the investigation will continue. They also ask pointed questions about the organization's pre-existing controls and risk-assessment practices, and exhibit doubt as to their adequacy. On June 15, the organization receives new subpoenas from the CFTC and DOJ, requesting communications and trading data regarding all futures trading by the Precious Metals Desk, in multiple metals and interest rate contracts, for a two-year period.*

# Stage 3 Considerations

- The organization should consider whether to pursue cooperation credit with CFTC and DOJ, which may mitigate any charges or penalties
- **For DOJ, cooperation generally requires:**
  - Identification of all individuals substantially involved in or responsible for misconduct at issue; and **Justice Manual § 9-28.700**
  - Voluntary disclosure of relevant facts gathered through internal investigation. **Justice Manual § 9-28.720**
- **For CFTC, cooperation credit is predicated upon consideration of:**
  - The value of the company's cooperation to the CFTC's investigation or any related enforcement actions, including the materiality, timeliness, nature and quality of information provided;
  - The value of the company's cooperation to the CFTC's broader law-enforcement interests, including encouragement of cooperation from other entities, the importance of the investigation, conservation of CFTC resources, and enhancement of the CFTC's ability to detect and pursue violations of law;
  - The company's culpability, culture and related factors, including the circumstances of the misconduct, history of prior misconduct, efforts at mitigation and remediation and acceptance of responsibility; and
  - The presence or absence of any uncooperative or obstructive conduct.

**CFTC Enforcement Advisory, "Cooperation Factors in Enforcement Division Sanction Recommendations for Companies."**

# Stage 3 Considerations (cont'd)

## Factors considered by DOJ in evaluating corporate compliance programs

*(excerpted from U.S. DOJ Criminal Division Guidance: Evaluation of Corporate Compliance Programs (Updated June 2020))*

- **Whether the corporation's compliance program is well designed, including:**
  - Whether the business conducts periodic risk assessment;
  - Policies and procedures;
  - Training and communications;
  - Confidential reporting structure and investigation process; and
  - Risk-based due diligence to third-party relationships and corporate mergers and acquisitions;
- **Whether the compliance program is adequately resourced and empowered to function effectively, including:**
  - Commitment by senior and middle management;
  - Autonomy and resources; and
  - Incentives and disciplinary measures; and
- **Whether the compliance program works in practice, including:**
  - Continuous improvement, periodic testing, and review;
  - Investigation of misconduct; and
  - Analysis and remediation of any underlying misconduct.

# Stage 3 Considerations (cont'd)

**Factors considered by CFTC in evaluating corporate compliance programs**  
(*excerpted from September 10, 2020 CFTC Enforcement Memorandum re: "Guidance on Evaluating Corporate Compliance Programs in Connection with Enforcement Matters"*)

- **Whether the program is reasonably designed and implemented to prevent misconduct, considering:**
  - Policies and procedures;
  - Training;
  - Prior failures to remediate any identified compliance deficiencies;
  - Adequate resourcing; and
  - Independence of the compliance function;
- **Whether the program is reasonably designed and implemented to detect misconduct, considering:**
  - Internal surveillance and monitoring;
  - Effectiveness of internal-reporting and complaint procedures; and
  - Procedures for identifying and evaluating suspicious activity; and
- **Whether the company has engaged in effective remediation, including:**
  - Effectively mitigating and curing any financial harm created by the company's misconduct;
  - Discipline for individuals directly and indirectly responsible for the misconduct; and
  - Identification and addressing of any deficiencies in the compliance program that may have contributed to or failed to prevent the misconduct.

The image features a stylized logo for 'FIA' centered on a white background. The background is composed of several overlapping, semi-transparent geometric shapes: a light green triangle in the top-left, a light blue triangle in the top-right, a light green triangle in the bottom-right, and a light blue triangle in the bottom-left. The 'F' is a solid dark grey block letter. The 'I' is a solid dark grey block letter. The 'A' is a stylized letter formed by two overlapping triangles: a light green one on the left and a light blue one on the right. The text 'FIA' is positioned in the center of the composition.

**FIA**