

A close-up photograph of an hourglass with blue sand, set against a solid blue background. The hourglass is positioned vertically, with the top bulb containing a small amount of sand. The sand is falling through the narrow neck into the bottom bulb. The lighting is soft, highlighting the texture of the sand and the glass.

This webinar will begin shortly.

**FIA**



# A Transatlantic View of Regulatory Enforcement

—  
20 July 2023



# Reminders

- The webinar will be recorded and posted to the FIA website within 24 hours of the live webinar.
- Please use the “question” function on your webinar control panel to ask a question to the moderator or speakers.



# Presenters

## Host:

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Presentation prepared by





# OVERVIEW

- **Section one: Market abuse enforcement and investigation trends from a US and UK perspective**
  - Trends in Regulators' enforcement focus
    - Latest enforcement approaches by the US and UK Regulators
    - Investigations into market abuse from a US and UK perspective
- **Section two: Compliance and Governance**
  - CFTC: Internal processes and systems and controls
  - FCA: Internal processes and systems and controls
- **Section three: Trends in Regulators' focus on crypto regulation**
  - The US's crypto regulatory landscape
  - The UK's crypto regulatory landscape



# **CFTC: Trends in Regulators' enforcement focus**



# Shift Away From Spoofing

- ▶ Spoofing enforcement actions
  - Peaked in 2018 with 26 enforcement actions
  - Down to 5 enforcement actions in 2022
- ▶ Why?
  - Decline in spoofing
  - Earlier detection due to more sophisticated tools employed by exchanges such as CME Group



# Focus on Unauthorized Methods of Communication

- ▶ “Off-channel” communications
  - Personal text, personal email, WhatsApp
  - Signal – additional concerns for ephemeral messaging apps
- ▶ Regulatory concerns:
  - Failure to keep and maintain written communications as required by recordkeeping rules and regulations



# Unauthorized Methods of Communication

- ▶ Actions brought against 11 of the world's largest financial institutions
  - An enforcement "sweep"
- ▶ Bank of America, Citibank, Credit Suisse, Goldman Sachs, Morgan Stanley, and others
  - Nearly all admitted to
    - Failing to maintain, preserve, or produce records of written communications that were required
    - Failure to supervise
  - Resulted in settlements that totaled \$710 million
- ▶ On the same day that the CFTC brought these actions, the SEC brought actions for "widespread and longstanding failures by the firms and their employees to maintain and preserve electronic communications."
- ▶ Actions brought against:
  - 15 broker-dealers
  - One affiliated investment adviser

# Unauthorized Methods of Communication

- ▶ In light of “sweep”
  - Regulators may consider firms and individuals to be “on notice” regarding off-channel communications
  - Those that fail to proactively address these communications may face harsher regulatory action and higher fines
- ▶ Firms should:
  - Educate employees regarding the need to use authorized methods of communications
  - Develop robust policies regarding unauthorized channels of communications that contain specific penalties for employees who use off-channel communications
  - Collect and preserve any prior off-channel communications and adopt solutions that minimize the potential for off-channel communications in the future



# **FCA: Trends in Regulators' enforcement focus**



# The FCA's data-driven approach to market abuse

## **FCA Business Plan 23/24 and FCA Strategy 2022 to 2025**

- Particular focus on fixed income and commodities market manipulation
- FCA devoting increased resources and investment in technology and big data

## **The FCA's use of data and technology to supervise market abuse in UK financial markets**

- **People:**
  - In 2021 the FCA announced it would invest £120m into its data collection and analysis functions
  - The FCA looks to have hired more than 150 people into its Data, Technology and Innovation division
- **Tools and systems**
  - Use of algorithmic tools to monitor trading in close real time
  - Use of automation when monitoring short selling reports
  - Upgrading market surveillance systems to monitor a wider range of asset classes
  - Data published to provide useful benchmarks.



# The FCA's data-driven approach to market abuse

- **Impact of data and technology on enforcement actions:**
  - Less reliance on firms and their reports; Increased use of data set- MIFID II reporting and STORS- to support investigations into market abuse related conduct
  - FCA has recently built a database that consolidates information from all trading venues for FTSE300 UK equities into a single order book
  - Use of data and market intelligence when working with international partners to assist on enforcement actions on a cross border basis.
- **Suspicious Transaction and Order Reports (STORs) process:**
  - On average over the last three years, **4372 STORs** submitted on an annual basis
  - Across these three years, on average, **15% of STORs related to market manipulation.**



# Recent Tribunal market abuse case

**Spoofing**, a form of market manipulation, prohibited under Art 15 UK MAR

- Trader submits and then cancels an offer or bid on a trading platform, creating misleading or false impressions as to the supply demand of the bonds being traded
- No genuine intention to execute the trade, may take place on a large or small scale

## **Recent Tribunal case:**

- A trader, alongside several other individuals, was sanctioned by the FCA for market manipulation offences in December 2022. The fines ranged from £100,000 to £395,000. One individual was fined 100k, plus banned from performing any regulatory function.
- The characteristics of the orders relied upon by the FCA to evidence that they were abusive?
- The defence of 'Price Discovery' / informational purpose.
- Conduct framed as deliberate and dishonest.



# FCA's approach to '*off-channel communications*'

- The FCA has not yet taken action in connection with “off channel” communications and related breaches of record keeping rules
- The FCA has reminded firms of their obligations to maintain effective record keeping policies and procedures
  - Market Watch, published in January 2021, the FCA set out the risks associated with the use of unmonitored and unencrypted applications like WhatsApp to conduct business
- The FCA had acted against individuals for misconduct involving the use of WhatsApp; e.g. the financial penalty issued in 2017 against an investment banker, who was held to have breached the FCA's Principles for Businesses after disclosing confidential information regarding a client on WhatsApp.



# **CFTC: Internal Processes And Systems And Controls**





# Recent examples of enforcement actions by the CFTC

- ▶ BitMEX, 2021: Parallel civil and criminal litigation against five companies & three individual founders
- ▶ CEA violations:
  - Operating a facility to trade or process swaps without being approved as a Designated Contract Market (DCM) or a Swap Execution Facility (SEF)
- ▶ Regulatory violations:
  - Failure to implement the most basic compliance procedures required of financial institutions that impact U.S. markets
- ▶ Criminal Violations:
  - Willful violations of the Bank Secrecy Act
  - Conspiracy to violation the Bank Secrecy Act
- ▶ Result:
  - Financial Crimes Enforcement Network and the CFTC assessed a \$100 million civil monetary penalty against the companies operating BitMEX

# Recent examples of enforcement actions by the CFTC

- ▶ **Binance Holdings Limited, 2023: a seven-count enforcement action**  
*"a warning to anyone in the digital asset world"*  
- Chairman Benham
- ▶ **CEA violations:** Execution of futures transactions on an unregistered board of trade; illegal off-exchange commodity options
- ▶ **Regulatory violations:** Failure to register as a designated contract market or swap execution facility, failure to diligently supervise, failure to implement customer identification requirements, and acts and omissions to evade regulation
- ▶ **Both CEA and regulation:** Failure to register as a futures commission merchant
- ▶ **Liability for individuals:** Samuel Lim, Binance's former chief compliance officer, charged with aiding and abetting & failure to diligently supervise
- ▶ **SEC Enforcement Action:** Filed about 1 month later, the SEC claims mirror those of the CFTC

# CFTC Expectations & Applications - Crypto & Beyond

1

## Registration requirements & disclosures

Fulsome and accurate

2

## Risk Tolerance

Awareness of most up-to-date approaches to crypto regulation in the US

3

## Recordkeeping & Supervision Failures

Off-channel communication & investigative sweep

4

## Knowledge & Oversight

Failure to supervise

5

## Individual Risk

Enforcement actions holding Compliance Officers liable for regulatory violations



# **FCA: Internal processes and systems and controls**



# Systems and controls

1

**Analysis of new regulatory changes and legal requirements**

2

**Risk assessment**

where can market abuse risks arise in your business lines?

- UK focus (rather than global analysis)

3

**What controls are introduced?**

- Manual controls
- Automated controls
- Trade surveillance

4

**Oversight of controls**

how do you know they are being implemented and are working?

- Resource
- Ongoing monitoring

5

**Governance**

what information flows up to the board and what decisions are taken?



# Recent examples of enforcement actions by the FCA

- **Citigroup Global Markets Limited: fined £12,553,800 for breaching Article 16(2) MAR and Principle 2 of the Principles for Businesses failings**
  - Failed to implement MAR trade surveillance requirements
  - Failed to conduct business with due skill, care and diligence
  - Failed to effectively monitor trading activities for certain types of insider dealing and market manipulation activities
- **BGC and two linked entities were issued with fines for the value of \$4,775,200 for breaching Article 16(2) MAR and Principle 3 of Principles for Businesses failings**
  - Failed to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems
  - Failed to implement the necessary market abuse surveillance systems in place for all their relevant asset classes
  - Failed to have adequate escalation procedures for oversight purposes of market abuse surveillance
- **Sigma Broking Limited fined £530,000, and directors banned and fined for market abuse reporting failures**
  - Failed to report 56,000 CFDs transactions to the FCA and, failed to identify 97 STORs that should have been reported to the FCA
  - The sanctioned directors failed to implement adequate governance and oversight policies and procedures within the business
  - Failed to organise and control its affairs responsibly and effectively with adequate risk management systems, and MiFID transaction reporting requirements.



# **CFTC: Trends in Regulators' focus on crypto regulation and enforcement approach**



# CFTC's Enforcement Approach to Crypto

- **CFTC Strategic Plan 2022-2026**

- Emerging trends include “digital asset commodities, decentralized finance (DeFi), and Environmental, Social, and Governance (ESG) Investing.”
- Discusses use of data, though without the same investments as the FCA, and an emphasis on reporting requirements

- **Keynote Addresses**

- 2022: Called for determination of CFTC's regulatory scope – relying on Congress
- 2023: Re-emphasized position
  - Without it, uncertainty among agencies and market participants
  - Example: Stablecoin





# Cryptocurrency Investigation Trends

- **Prior to 2022**
  - Cases involving virtual currencies began as early as 2015, including at least 49 crypto-related enforcement actions; fines and disgorgements totaling nearly \$900 million
- **2022**
  - Actions involving conduct related to digital assets represented more than 20% of all CFTC actions
  - New ground: First civil action against a DAO
- **2023**
  - Number of cases continues to grow



# Investigative and Enforcement Actions

- CFTC's Division of Enforcement's approach is to *'protect the public and preserve market integrity by detecting, investigating and prosecuting violations of the Commodity Exchange Act (CEA) and CFTC regulations.'*
- Enforcement matters have four potential phases: Lead, Preliminary Inquiry, Investigation, and Litigation
- The litigation stage may include:
  1. Civil litigation or administrative proceedings;
  2. Referrals to Department of Justice for criminal prosecution; and
  3. Parallel or simultaneous civil and criminal proceedings.



# How the CFTC Pursues Crypto Offenses

- Process
  - Digital Assets Task Force – Division of Enforcement
- Detection
  - Customer complaints
  - Market surveillance
  - Whistleblowers
  - Disclosures: Bank Secrecy Act Information Suspicious Activity Reports (SARs)
  - Self-Regulatory Organizations
  - Other governmental agencies – foreign and domestic
- Outcomes
  - Function to deter wrongdoers and include results such as restitution



# How the CFTC Pursues Crypto - Allegations in the Digital Assets Market

- Making false statements:
  - Regarding frequency of auditing reserves and sufficiency of reserves
  - Regarding trade volume
- Registration provisions: “failure to accurately describe”:
  - Aspects of an operation
  - Reserves
  - Volume of trade
- Commodity Pool Fraud
  - Accepting Bitcoin from non-ECPs
- Off-exchange retail commodity transactions
- Price Manipulation
- Compliance Program Failings
  - Three charges in 2022 that include failure to adopt a customer identification program

# CFTC Enforcement Matters - Investigations

- **Voluntary Statements**

- Interviews: May request and receive limited immunity
  - If refusal to speak on basis of self-incrimination, CFTC may request approval of full-immunity
- Written requests for production of information

- **Compelled Statements**

- Subpoenas enforced in federal district courts – will not inform recipient if they are a witness, subject, or target
- May exercise its power to inspect filings, disclosures, books and records

- **Results**

- Wells Letter
- Settlement
- Litigation



# Cooperation & Outcomes: Factors Considered

- Cooperation Factors in Enforcement Division Sanction Recommendations for Individual & Companies:
  - Value of cooperation in specific action
  - Value of cooperation to broader law enforcement interests,
  - Balance of culpability and prior misconduct with responsibility and mitigation



# **FCA: Trends in Regulators' focus on crypto regulation and enforcement approach**

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# The Current Crypto Regulatory Landscape in the UK

## The UK has started to take action in 'high risk' areas of crypto

- **Money laundering regulation**
  - **Registration:** Crypto asset exchange providers and custodian wallet providers must register their business with the FCA
    - Since January 2020, out of 319 applications, only 14% of firms successfully registered with the FCA
  - **Travel Rule:** KYC and customer due diligence requirements for certain crypto related transactions
    - Due to come into force on 1 September 2023
- **Promotional rules for cryptoassets:** 'High risk' investments categorisation for cryptoassets
  - Failure to comply with the marketing rules will be a criminal offence

## The FCA's supervisory approach

- **Binance:**
  - *"Not capable of being effectively supervised"* – FCA on Binance in the UK
  - The FCA issued a consumer warning against two of Binance's subsidiaries in June 2021
    - Restricted from undertaking any regulated activity in the UK without the consent of the FCA
  - Binance requested to cancel its FCA permissions in May 2023
  - Binance has moved its operations to Cyprus





# The Future of Crypto Regulatory Landscape in the UK

## Consultation into the '*Future of financial services regulatory regime for cryptoassets*':

- Consultation period opened in February 2023 and closed in March 2023
- Exploring proposals for a holistic regime to regulate cryptocurrency in the UK
- Proposals to:
  - Create a new type of specified activity covering cryptoassets
  - Potential extension of s.19 FSMA and authorisation requirements
    - Capture activities carried '*in or to the UK*'
  - Designated Activity Regime: use of the new regime to impose regulatory obligations on crypto firms not authorised
  - Extend market abuse regulation obligations
  - FCA may be granted authority to determine whether a physical presence in the UK is required for crypto firms to operate in the UK



# Thank you for joining us today!

## Upcoming Webinar:



**Trends in ETD Trading Q2 2023**  
09:30 – 10:30 AM ET



# Questions?

**FIA**

The logo consists of the letters 'F', 'I', and 'A' in a bold, sans-serif font. The 'F' is dark grey. The 'I' is dark grey. The 'A' is formed by two overlapping shapes: a light green triangle pointing upwards and a light blue triangle pointing downwards. The background features large, overlapping geometric shapes in light green, light blue, and light grey.