

## CONTROLLING THE ESCALATING COSTS OF U.S. COMMODITIES AND DERIVATIVES MARKET ENFORCEMENT ACTIONS

The trend of escalating penalties for derivatives and commodities market abuse violations continued in 2020. Civil monetary penalties exceeding \$100 million have become commonplace for serious corporate violations. Moreover, the DOJ routinely conducts criminal investigations in parallel with the CFTC, levying its own very large penalties against corporate targets and seeking convictions and incarceration for individuals. On February 2, the CFTC increased the maximum civil monetary penalties it can seek for violations of the Commodity Exchange Act ("CEA") and the Commission's rules and regulations. However, as explained below, it has also become apparent in recent years that charges and penalties can be mitigated by having in place a well-designed compliance program, and through early detection and remediation of potential violations and cooperation with the authorities. In light of these benefits as well as the ever-increasing penalties, these new figures should serve as a reminder to organizations of the importance of having proper systems in place to prevent and detect misconduct.

To do this effectively, companies must continue to evaluate their compliance functions, and must ensure they have mechanisms in place for investigating, reporting, and remediating misconduct once identified, in line with the CFTC's and DOJ's guidelines (see our [September 2017](#) and [September 2020](#) client briefings). For further detail, please consult our [Guide to United States, United Kingdom, and Hong Kong Derivatives and Commodities Market Enforcement Regimes](#), and for those facing the prospect of a government inquiry, our guide to [Responding to a U.S. Government Investigation in the Derivatives and Commodities Markets](#).

### Key issues

- The CFTC and DOJ continue to aggressively pursue enforcement actions, following a record-breaking year of enforcement.
- Companies should periodically review and assess their internal controls to ensure they are sufficient to prevent violations and to mitigate potential charges and penalties for any trading-related misconduct.
- Companies should conduct a prompt and appropriate internal investigation upon becoming aware of any potential violation, in order to facilitate any needed remediation and to minimize, to the greatest extent possible, the risk of large regulatory penalties and criminal charges.

## PENALTIES

A pair of guidance documents propounded by the CFTC in 2020 demonstrate that the Commission will seek to assess the adequacy of compliance functions in making its charging and penalty decisions.

In May 2020, the CFTC for the first time published guidance for the assessment of civil monetary penalties.<sup>1</sup> This guidance instructs Enforcement staff to consider:

- the gravity of the violation (including the nature and scope of the misconduct and any consequences and the respondent's state of mind);
- any mitigating or aggravating circumstances; and
- "other considerations," including any relief in parallel actions by other authorities and penalties assessed in analogous cases.

Notably, the penalty guidance specifically lists the "[e]xistence and effectiveness of the company's pre-existing compliance program" as a mitigating (or aggravating) factor.

In September 2020, the CFTC elaborated on the compliance element of its penalty guidance, providing Enforcement staff with guidelines for evaluating corporate compliance programs in connection with charging decisions and penalty assessments. This guidance instructs staff to consider whether a company's compliance program "was reasonably designed and implemented to achieve three goals, namely:

- to prevent the underlying misconduct at issue;
- to detect the misconduct; and
- to remediate the misconduct."<sup>2</sup>

Together, these guidance documents make clear that the presence of an effective compliance function will be a mitigating factor in charging decisions and penalty determinations—and that the absence of effective compliance will be an aggravating factor. The DOJ's corporate charging guidelines similarly require prosecutors to assess corporate compliance programs in making charging decisions.<sup>3</sup> Recent settlements demonstrate that the authorities will not hesitate to levy harsher penalties based on perceived compliance shortcomings. For example, in August and September of 2020, the CFTC and DOJ jointly levied fines in the hundreds of millions of dollars against two banks based on patterns of spoofing that continued for several years.<sup>4</sup> Of note: In each of these settlements, the CFTC and DOJ specifically cited failures of compliance in detecting or preventing the misconduct and inadequate cooperation in the early stages of investigation.

The CFTC's recent adjustment to its penalties schedule suggests that its already very large fines could grow even larger. Each year, the Federal Civil Penalties

<sup>1</sup> CFTC, *CFTC Division of Enforcement Issues Civil Monetary Penalty Guidance*, Release No. 8165-20 (May 20, 2020).

<sup>2</sup> For more on recent CFTC guidance on evaluating corporate compliance programs, see our September 2020 briefing [here](#).

<sup>3</sup> U.S. Dep't of Justice, JUSTICE MANUAL, § 9-28.800, <https://www.justice.gov/jm/jm-9-28000-principles-federal-prosecution-business-organizations#9-28.800>; see also Mark Filip, U.S. Dep't of Justice, *Principles of Federal Prosecution of Business Organizations* (Aug. 28, 2008), <https://www.justice.gov/sites/default/files/dag/legacy/2008/11/03/dag-memo-08282008.pdf>.

<sup>4</sup> CFTC No. 20-27 (Aug 19, 2020); CFTC No. 20-69 (Sep. 29, 2020).

Inflation Adjustment Act requires the CFTC to adjust the maximum penalties authorized by the CEA to account for inflation.

The newly-updated figures for 2021 are:

Administrative Action	Registered Entities	Non-manipulation	\$937,161
		Manipulation	\$1,227,202
	Other persons and entities	Non-manipulation	\$170,129
		Manipulation	\$1,227,202
Federal District Court Action	Any person	Non-manipulation	\$187,432
		Manipulation	\$1,227,202

It is important to note that these penalties are for each instance of a violation. Given that a pattern of misconduct (such as spoofing) may involve multiple instances of violation, each of which is separately chargeable, the penalties can quickly balloon to astronomical sums that threaten the viability of a company. For example, as mentioned above, the CFTC and DOJ jointly levied fines in the hundreds of millions of dollars against two banks in August and September 2020, based on thousands of alleged instances of spoofing.

## STEPS TO IDENTIFY AND PREVENT MISCONDUCT

The above should serve as a reminder that companies who trade in markets subject to the CFTC's and DOJ's commodities- and derivatives-enforcement jurisdiction should conduct periodic risk assessments, aimed at evaluating their ability to comply with the laws and regulations that govern trading in these markets, as well as their ability to prevent or detect any potential misconduct.

The first step companies should take in any compliance review is to assess which parts of their trading operations are most susceptible to CFTC enforcement. Based on recent enforcement actions and the CFTC's identified areas of focus, activities to which entities should pay particular attention include:

- Activities that may present greater motive or opportunity for price manipulation, including any proprietary trading, leveraged trading, or trading in products for which, or at times when, market trading volume is relatively low;
- Activities that may present greater motive or opportunity for fraud or manipulation based on false reporting, which include making submissions of data to price-reporting agencies or benchmark publishers;
- Activities that may present an opportunity for front-running, including any trading on behalf of customers or clients (as opposed to arms-length, principal-to-principal trading); and
- Activities that may present greater motive or opportunity for insider trading, including any interactions with government entities or expert networks.

## **STEPS TO MITIGATE PENALTIES**

When potential wrongdoing is detected, companies must act quickly to determine the nature and scope of any violation and to remediate. Any credit that may be available for self-reporting and cooperation will diminish with the passage of time—especially if the CFTC or DOJ learns of the misconduct before the company has ceased the violations and taken remedial steps. Thus, in order to maximize the potential for a favorable outcome, a company must be able, on an expedited basis, to assess the likelihood that wrongdoing occurred and the scope of that wrongdoing, and to determine what remedial steps should be taken. The goal of this assessment should be to advise management of the company's potential exposure quickly enough that management can make informed decisions about self-reporting, cooperation and remediation while maximal self-reporting and cooperation credit remain available.

While each investigation will differ depending on the nature of the potential wrongdoing, expedited assessments will often include:

- Interviews of relevant employees and supervisors within the trading function, to understand whether wrongdoing may have occurred and what defenses may be available, and to determine the products and time periods that should be assessed;
- A review of potentially relevant communications for inculpatory or exculpatory information;
- A review of trading data, to determine whether any pattern or trading suggests violative conduct;
- Interviews of compliance personnel and an assessment of any existing control and surveillance frameworks, to determine whether enhancements are needed.

## **CONCLUSION**

After its record-breaking year of enforcement, the CFTC and DOJ have already begun aggressively pursuing enforcement actions in 2021. As recent enforcement actions show, the consequences of non-compliance can be severe. An effective and up-to-date compliance program can not only identify areas of risk and prevent violations but can also alert leadership and legal and compliance personnel to potential violations. And while the potential penalties of a violation can be costly, quick and decisive action to self-report and cooperate with any investigation where appropriate under the circumstances can significantly mitigate any penalty that is ultimately imposed.

Clifford Chance offers risk-assessment services to companies who trade in the commodities and derivatives markets, as well as expedited preliminary investigations. For more information about these services, please reach out to any of the contacts listed below.

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