

Regulators And Prosecutors Discuss Securities And Commodities Enforcement Priorities

August 15, 2014 | [SEC, The GEE Blog](#)



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In late July, we attended a seminar at which David Glockner, the new Director of the Securities and Exchange Commission's Chicago Regional Office, Scott Williamson, a Deputy Regional Counsel in the Commodity Futures Trading Commission's Chicago Office, and Cliff Histed, an Assistant United States Attorney in the newly-formed Securities and Commodities Fraud Section in Chicago spoke. The three men shared their views on enforcement trends in the securities and commodities industry. It was an insightful discussion, from which we have distilled a few of the nuggets of wisdom they shared. **SEC**

Enforcement Priorities To begin with, Mr. Glockner shared the SEC's enforcement priorities. He emphasized (no surprise here) that the SEC's traditional mission of investor protection remains paramount. Next, he alerted the audience that the SEC intends to focus on accounting fraud. According to Mr. Glockner, this is an area that has not been in the spotlight and needs to be. The SEC intends to use data analytic techniques in order to spot anomalies that may indicate fraudulent activity. This is not new news, of course, as the SEC announced, in July 2013, that it was launching the Financial Reporting and Audit Task Force. According to the Commission, the Task Force "will focus on identifying and exploring areas susceptible to fraudulent financial reporting, including on-going review of financial statement restatements and revisions, analysis of performance trends by industry, and use of technology-based tools such as the Accounting Quality Model." As a result of the Task Force's work, public registrants and auditors can expect to be subject to informal investigations (largely document requests) when the Accounting Quality Model tools suggest a potential problem. Based on these investigations, we should expect to see—Mr. Glockner said—the SEC pursuing cases against auditors it believes have disseminated false or misleading information or otherwise perpetuated financial wrongdoing. Next, Mr. Glockner highlighted the SEC's scrutiny of the subject *du jour* – high-frequency trading. He explained to the audience that the SEC is investing in software tools and personnel to help it analyze large data sets. Based on its data analysis, the SEC will pursue actions against traders engaged in activity that manipulates the market or is otherwise improper. The SEC also intends to address structural issues in the market that might provide high-frequency traders an improper edge or lead to manipulative trading. This, of course, is concordant with the SEC's current negotiations with BATS, a new exchange that has increased its trading volume over the

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last several years by—at least in part—catering to high-frequency traders with order-types like the “hide not slide” through which traders display phantom liquidity in the market. See, e.g., Mark Melin, “[SEC-BATS Deal Sign of White's Plan In Action](#),” Aug. 6, 2014. Finally, Mr. Glockner noted that the SEC has given “light scrutiny” in the past to municipal securities and public pension funds, but expects that to change given the “volume of investor assets” invested in and through such vehicles. Mr. Glockner’s statement again corresponds with recent SEC activity, including its August 11, 2014, settlement with the State of Kansas over allegations that the Kansas Development Finance Authority raised more than \$273 million through bond sales for the state without disclosing the fact that the Kansas Public Employment Retirement System was the second-most underfunded statewide public pension system.

CFTC Enforcement Priorities Mr. Williamson began his comments by noting the significant changes that have taken place over the past year at the CFTC: Gary Gensler and David Meister, the Chairman and Director of Enforcement, respectively, have been replaced by Timothy Massad and Aitan Goelman. Mr. Goelman is a former prosecutor and is bringing a “new tone” to the CFTC’s Enforcement mission. Although the CFTC’s current funding is “inadequate” for it to carry out its mandate (including regulating an entirely new market – over-the-counter derivatives), Mr. Williamson noted that the CFTC is “not going to shy away” from bringing new cases. To begin with, Mr. Williamson explained that Dodd-Frank enforcement is the Division of Enforcement’s “key goal.” According to Mr. Williamson, the Division of Market Oversight is actively analyzing reporting information from market participants, looking to determine whether market participants are fulfilling reporting obligations and complying with core market principles. In particular, of course, he was referring to swaps reporting—the new area of regulation under the CFTC’s umbrella. Mr. Williamson told the audience to expect “global referrals to Enforcement” for those not complying with core-principles obligations. Next, Mr. Williamson pointed out some already well-known areas on which the Division of Enforcement is focused: index benchmarks with a nexus to the futures market (*i.e.*, LIBOR and the ISDAfix) and the benchmark for currency foreign exchange, known as the WM/Reuters 4pm fix or the “London fix.” See, e.g., Joel Clark, “[FX probe digs the dirt to clean-up market structure](#),” EuroMoney, May 6, 2014. In such investigations, the CFTC (and, often the Department of Justice) are analyzing allegations that traders colluded to fix the benchmarks from which prices are set—allowing them to reap large profits simply by moving the benchmark depending on whether they were buying or selling. Indeed, “a Barclays trader’s instant messages that surfaced during the Libor scandal investigations showed that traders could earn ‘about a couple of million dollars’ for every .01 percent that Libor was manipulated in their favor.” Jesse Colombo, “[This New Libor ‘Scandal’ Will Cause A Terrifying Financial Crisis](#),” Forbes, June 3, 2014. Mr. Williamson reiterated that the CFTC has new tools, including amended Section 6(c) of the Commodity Exchange Act, for addressing alleged market manipulation and fraud. We have discussed these tools elsewhere (see Trace Schmeltz, “[CFTC has new tools and greater authority to pursue wrongdoers](#),” Futures Magazine, May 2014), but Mr. Williamson’s take on these tools is important. He noted that, under Rule 180.1 (promulgated under the authority of new Section 6(c)), the CFTC can now regulate “manipulative devices,” rather than solely purchases or sales, without proving specific intent. Because this is much simpler, Mr. Williamson noted that market participants can “expect that **everything will be a manipulative device**” going forward. Finally, Mr. Williamson made a plea to the audience. He said, in words or substance, that is acceptable for traders

or other market participants to “tell the government what they do and how they do it” rather than to let the CFTC “get all worked up” over particular trading or market activity in the first place. In separate discussion after the conference, he clarified that this would include situations in which trading appears to be, or is actually, manipulative even though it was not intended to be so. The tone, in other words, is one in which the CFTC understands that complex trading systems may not always work as designed, may produce unintended consequences, or may simply be misunderstood—and the CFTC welcomes a dialogue around these issues. **Priorities of the Securities**

and Commodities Fraud Section According to Assistant United States Attorney Cliff Histed, the United States Attorney for the Northern District of Illinois created the new section in order to “put a spotlight” on securities and commodities fraud. The goal is to develop market and trading expertise within a dedicated group of nine assistants—and these assistants are already interfacing with the Chicago-area exchanges and other market participants to become educated. Echoing the same tone Mr. Williamson had offered, Mr. Histed noted that the new section does not want to turn anything “clumsily into a crime,” but would prefer market participants come in and explain what is happening in the market. The new section will employ typical law enforcement techniques, including recording conversations and working with cooperators. The section is currently building cases in Ponzi scheme matters and disruptive trading, such as bidding through an offer or offering through a bid, banging the close, and spoofing. This would suggest that the new task force is looking at high-frequency and foreign exchange traders, among others. **Coordination** Each of the panel members emphasized greater coordination and cooperation between agencies. According to David Glockner, for example, the SEC, CFTC, U.S. Attorney’s Office and others “talk as a regulatory community” on a quarterly basis. Mr. Williamson noted that the CFTC’s relationship with the SEC has been “spotty,” but that they are looking for greater coordination now. He also said that the best deterrence is criminal prosecution, so market participants can expect the recent trend of cooperation between the CFTC and the Department of Justice to increase—something that seems particularly more likely given the CFTC’s budgetary constraints.