

## NEWSLETTERS

### Regulators, Prosecutors Discuss Securities And Commodities Enforcement Priorities

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In late July, the author had the privilege of attending 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, and some of the thoughts shared by the speakers are summarized in this article.

#### 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, 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

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negotiations with BATS, a new exchange that has increased its trading volume over the 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.

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.” 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.

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, 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.

## 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.

For more information about the enforcement issues discussed in this article, please contact Trace Schmeltz, a member of the Firm’s Commercial Litigation Practice Group, in our Chicago office at (312) 214-4830 or [vschmeltz@btlaw.com](mailto:vschmeltz@btlaw.com). Mr. Schmeltz is a trial lawyer who focuses his practice largely on securities and commodities enforcement work, although he also regularly handles a wide-array of financially-based commercial litigation matters, including in courts and arbitrations.

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