



U.S. Regulation of Futures and Derivatives: Compliance Issues for End-Users

February 16, 2017

Presented by Covington & Burling LLP



Administrative Items

The webinar will be recorded and posted to the FIA website following the conclusion of the live webinar.

A question and answer period will conclude the presentation.

- Please use the “question” function on your webinar control panel to ask a question to the moderator or speakers. Questions will be answered at the conclusion of the webinar.

CLE certificates will be emailed shortly after conclusion of the webinar.

Upcoming L&C Webinars and Events



FUTURES 101: An Introduction to U.S. Futures Markets and Regulation

February 28, 2017 | 2:00 PM – 6:00 PM ET | New York, NY



The Federal Reserve Board's Proposed Rule on Mandatory Contractual Stays for QFCs

March 9, 2017 | 10:00 AM ET | Webinar

Presenters: Conrad Bahlke, Marvin Goldstein and Mark Speiser of Stroock & Stroock & Lavan LLP



39th Annual FIA Law & Compliance Conference

May 3-5, 2017 | Omni Shoreham Hotel | Washington, DC

Learn more and register at FIA.org/lc



Presenters



Stephen M. Humenik
Of Counsel

Washington, DC
+1 202 662 5803
shumenik@cov.com

Stephen Humenik leads Covington's futures and derivatives practice. He has extensive experience on cross-border regulatory, compliance and enforcement matters involving the U.S. Commodity Futures Trading Commission (CFTC) and markets for derivatives and physical and financial commodities. Mr. Humenik applies his business, operational, and technology experience to the implementation of CFTC regulations. Specifically, he advises clients, including swap dealers, financial institutions, asset managers, and end-users, on regulatory and policy matters relating to the registration, trading, clearing and other compliance obligations of the Dodd-Frank Act. Mr. Humenik also represents clients in CFTC enforcement investigations and proceedings. Prior to joining Covington, Mr. Humenik was general counsel and chief regulatory officer of an interest rate swap derivatives market, where he oversaw the legal and regulatory affairs of the exchange, including the exchange's designation as a contract market and ongoing compliance with CFTC regulations. Mr. Humenik previously served as Special Counsel and Policy Advisor to former CFTC Commissioner Scott O'Malia where he assisted on rulemaking, enforcement and legislative matters. Mr. Humenik began his career at the CFTC and primarily served as Senior Trial Attorney for the CFTC's Division of Enforcement where he investigated and litigated complex fraud and market manipulation cases, specifically those involving financial and energy derivatives and physical commodities. Mr. Humenik received his J.D. from the Catholic University of America, Columbus School of Law and B.A. from Pennsylvania State University.



Anne M. Termine
Of Counsel

Washington, DC
+1 202 662 5827
atermine@cov.com

Anne Termine is a member of the firm's futures and derivatives and white collar defense and investigations practices. Prior to joining Covington, Ms. Termine was a Chief Trial Attorney in the CFTC's Division of Enforcement. In this role, Ms. Termine designed and led the CFTC's landmark enforcement program involving the manipulation and false reporting of LIBOR, Euribor and TIBOR that lead to penalties totaling over \$2.8 billion. Ms. Termine was instrumental in developing relationships and coordinating with diverse foreign regulatory and law enforcement agencies throughout Europe and Asia, as well as with divisions of DOJ and a coalition of over 40 State Attorneys General. Ms. Termine has also led investigations and litigations in matters involving the attempted manipulation and false reporting of natural gas prices, multi-million dollar Ponzi schemes, among others. Prior to joining the CFTC, Ms. Termine was a Senior Assistant District Attorney in the Orleans Parish District Attorney's Office where she tried more than 140 jury and non-jury trials, including several first and second degree murder cases. Ms. Termine received her J.D., *magna cum laude*, from Tulane University School of Law and B.A. from Bucknell University.

Objective

- This session will provide general guidance on regulatory and other compliance issues confronted by end-users of commodities and corporate end-users when trading in the derivatives markets.
- This session is designed to introduce you to the CFTC regulatory environment, the futures and swaps markets, common concepts relevant to compliance with CFTC law and regulation, and recent enforcement activities by the CFTC.

Overview

- The Futures and Derivatives Markets: Overview
- The Financial Crisis and Regulatory Response
- Futures and Derivatives: Market Regulation
- Cross-Border Application of U.S. Derivatives Law and Regulation
- CFTC Enforcement Actions and New Dodd-Frank Enforcement Provisions
- Washington, DC Report: CFTC Changes and Outlook for 2017
- Q&A



Overview

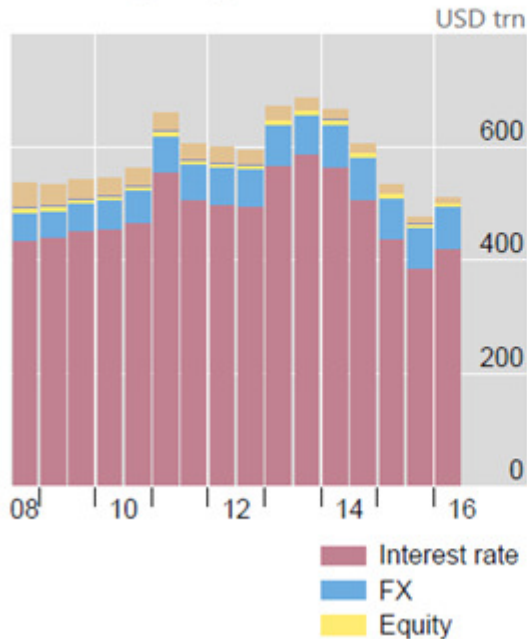
THE FUTURES AND DERIVATIVES MARKETS



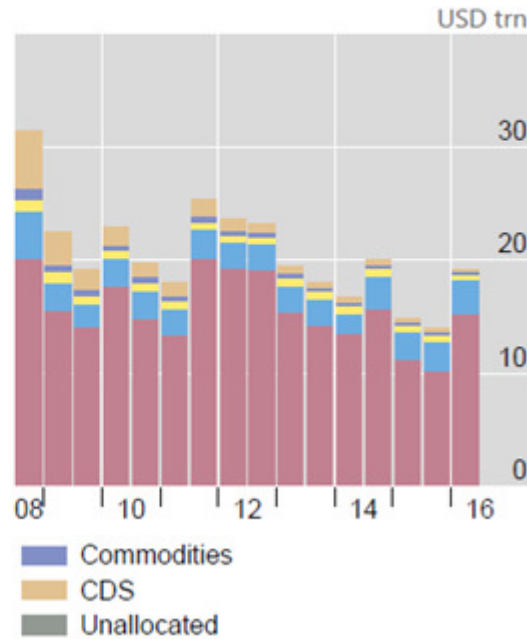
The Global Derivatives Markets: Futures and Swaps

Global OTC derivatives markets

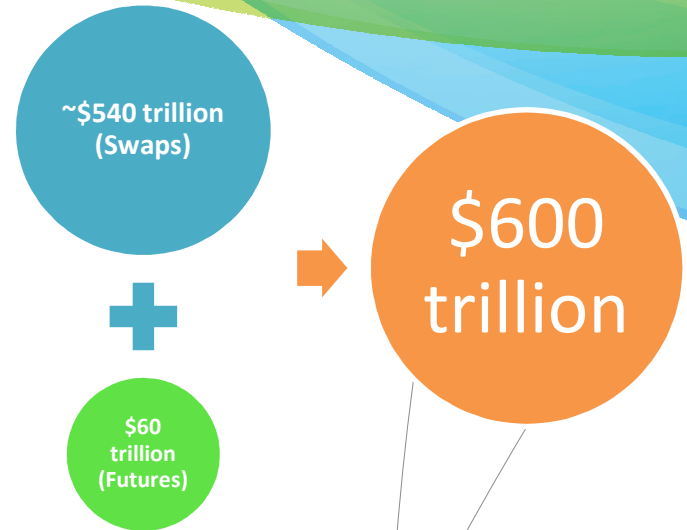
Notional principal



Gross market value



Source: BIS Quarterly Review

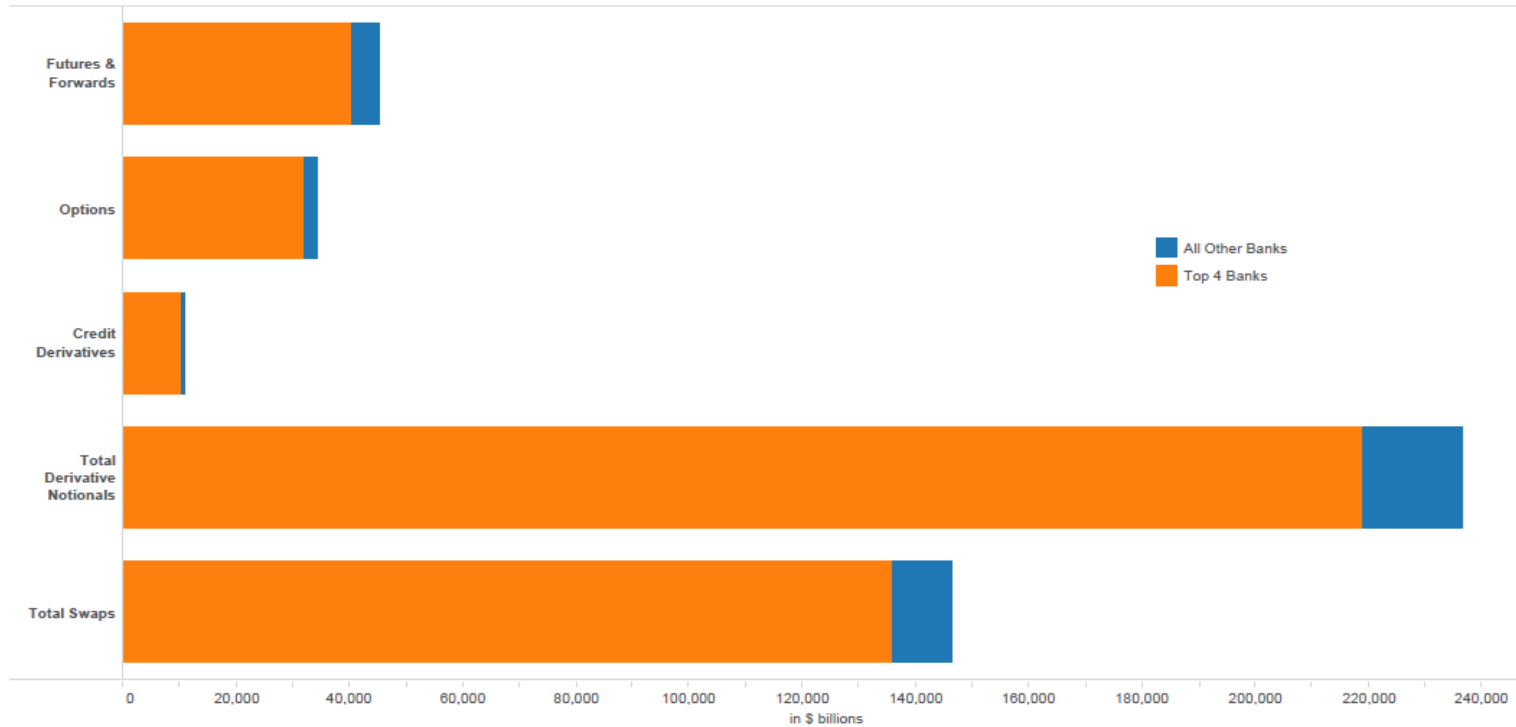


According to CME Group, it is the world's leading and most diverse derivatives marketplace – handling 3 billion contracts worth approximately \$1 quadrillion annually, on average.



Derivatives Usage: U.S. Commercial Banks

Graph 4
Four Banks Dominate in Derivatives
Insured U.S. Commercial Banks and Savings Associations



\$ Top 4 Banks

| | |
|----------------------------|---------|
| Futures & Forwards | 40,143 |
| Options | 33,278 |
| Credit Derivatives | 9,998 |
| Total Derivative Notionals | 221,783 |
| Total Swaps | 138,347 |

\$ All Banks

| | |
|----------------------------|---------|
| Futures & Forwards | 45,059 |
| Options | 35,552 |
| Credit Derivatives | 10,408 |
| Total Derivative Notionals | 239,347 |
| Total Swaps | 148,329 |

***The orange color shows derivatives usage by the top 4 banks in the U.S.
<http://www.occ.treas.gov/topics/capital-markets/financial-markets/trading/derivatives/dq314.pdf>

List of Top CFTC-registered FCMs

| Futures Commission Merchant / Retail Foreign Exchange Dealer | Net Capital Requirement | Excess Net Capital | Customers' Assets in Seg | Funds in Separate Cleared Swap Segregation |
|---|----------------------------|-----------------------|-----------------------------|--|
| GOLDMAN SACHS & CO | 2,380,065,701 | 15,166,936,350 | 21,777,966,191 | 4,364,977,778 |
| JP MORGAN SECURITIES LLC | 2,589,743,590 | 13,296,332,657 | 19,704,771,033 | 10,035,599,807 |
| SG AMERICAS SECURITIES LLC | 1,240,778,466 | 2,772,984,002 | 16,188,363,560 | 510,085,770 |
| MORGAN STANLEY & CO LLC | 2,103,951,099 | 7,506,419,779 | 14,318,515,485 | 13,407,505,106 |
| MERRILL LYNCH PIERCE FENNER & SMITH INCORPORATED | 1,619,986,126 | 10,872,371,174 | 12,613,498,347 | 6,540,328,489 |
| UBS SECURITIES LLC | 1,018,798,237 | 2,968,076,866 | 8,972,777,610 | 1,091,792,579 |
| CITIGROUP GLOBAL MARKETS INC | 1,739,240,569 | 7,898,499,233 | 8,200,423,838 | 14,025,315,840 |
| CREDIT SUISSE SECURITIES (USA) LLC | 1,321,485,318 | 10,326,673,620 | 6,054,267,096 | 12,280,189,413 |
| BARCLAYS CAPITAL INC | 1,178,828,357 | 5,412,538,283 | 5,623,658,953 | 5,858,110,161 |
| ADM INVESTOR SERVICES INC | 189,642,090 | 147,131,759 | 4,719,066,321 | 11,001,579 |
| RJ OBRIEN ASSOCIATES LLC | 150,528,712 | 62,329,149 | 4,267,605,903 | 0 |
| WELLS FARGO SECURITIES LLC | 912,874,663 | 2,333,717,370 | 3,461,312,602 | 8,603,700,203 |
| DEUTSCHE BANK SECURITIES INC | 603,990,453 | 11,410,882,320 | 3,362,293,803 | 1,434,023,393 |
| INTERACTIVE BROKERS LLC | 288,324,595 | 2,940,964,067 | 3,286,529,395 | 0 |
| ABN AMRO CLEARING CHICAGO LLC | 168,505,246 | 439,029,808 | 3,138,983,260 | 0 |
| MIZUHO SECURITIES USA INC | 245,696,731 | 298,733,029 | 3,006,480,474 | 38,376,600 |
| BNP PARIBAS PRIME BROKERAGE INC | 203,863,091 | 1,280,747,741 | 2,765,694,030 | 16,119,525 |
| RBC CAPITAL MARKETS LLC | 232,854,384 | 1,797,338,363 | 2,413,014,700 | 933,921,185 |
| MACQUARIE FUTURES USA LLC | 142,545,499 | 116,243,762 | 2,165,280,941 | 24,125,152 |
| INTL FCSTONE FINANCIAL INC | 77,618,061 | 68,700,359 | 2,148,763,659 | 0 |
| RBS SECURITIES INC | 96,241,586 | 2,599,943,867 | 2,037,646,338 | 0 |
| E D & F MAN CAPITAL MARKETS INC | 60,346,032 | 65,214,871 | 1,591,877,399 | 2,603,682 |
| ROSENTHAL COLLINS GROUP LLC | 55,256,735 | 25,104,393 | 1,371,985,401 | 0 |
| HSBC SECURITIES USA INC | 202,502,248 | 905,323,711 | 1,365,601,732 | 859,853,813 |
| MERRILL LYNCH PROFESSIONAL CLEARING CORP | 471,969,179 | 2,791,677,712 | 1,360,566,273 | 0 |
| BNP PARIBAS SECURITIES CORP | 203,607,875 | 1,378,054,726 | 1,090,517,810 | 1,013,345,286 |

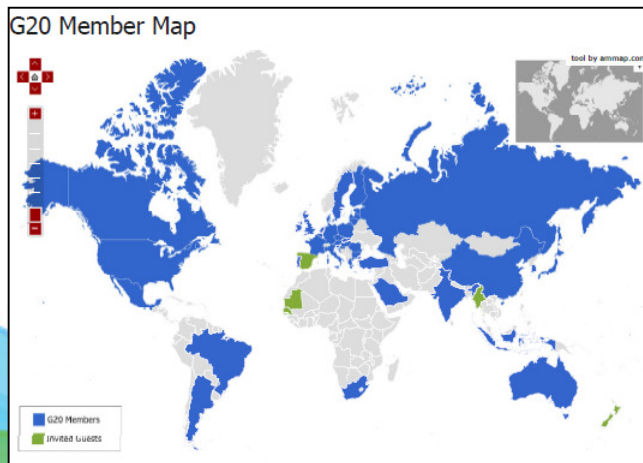


The Financial Crisis and Regulatory Response



The Financial Crisis: International Reaction

- In September 2009 the leaders of the Group of 20 (G-20)—whose membership includes the United States, the European Union, and 18 other countries—agreed to a five part framework for global OTC derivatives reform:
 - Central clearing of OTC derivatives;
 - Increased standardization of OTC derivatives;
 - Exchange trading of standardized derivatives;
 - Reporting derivatives trades to trade repositories, and
 - Increased capital requirements for non-cleared derivatives.



| | |
|------------------|-------------------|
| Argentina | Japan |
| Australia | Republic of Korea |
| Brazil | Mexico |
| Canada | Russia |
| China | Saudi Arabia |
| France | South Africa |
| Germany | Turkey |
| India | United Kingdom |
| Indonesia | United States |
| Italy | European Union |

The Financial Crisis: United States Reaction

- Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd- Frank Act”). – “Super-Regulation” of the Swaps Market, very comprehensive and prescriptive.

| | |
|-------------------|--|
| TITLE I | Financial Stability |
| TITLE II | Orderly Liquidation Authority |
| TITLE III | Transfer of Powers To The Comptroller of The Currency, The Corporation, And The Board of Governors |
| TITLE IV | Regulation of Advisers To Hedge Funds And Others |
| TITLE V | Insurance |
| TITLE VI | Improvements To Regulation of Bank And Savings Association Holding Companies And Depository Institutions |
| TITLE VII | Wall Street Transparency And Accountability |
| TITLE VIII | Payment, Clearing, And Settlement Supervision |
| TITLE IX | Investor Protections And Improvements To The Regulation of Securities |
| TITLE X | Bureau of Consumer Financial Protection |
| TITLE XII | Improving Access To Mainstream Financial Institutions |
| TITLE XIII | Pay It Back Act |
| TITLE XIV | Mortgage Reform And Anti-Predatory Lending Act |
| TITLE XV | Miscellaneous Provisions |
| TITLE XVI | Section 1256 Contracts |

Dodd-Frank Objectives

- To reduce risk, increase transparency, and promote market integrity through:
 - Registration and comprehensive regulation of SDs and MSPs;
 - Clearing and trade requirements for standardized derivative products;
 - Robust recordkeeping and real-time reporting regimes;
 - Enhanced CFTC rulemaking authority respecting registered entities and intermediaries; and
 - Expanded CFTC enforcement powers against manipulation, fraud, and false reporting.

Clearing

Swap Dealer Oversight

Price Transparency

Swaps Market Reform –
Reduction of Systemic Risk

Dodd-Frank's Impact

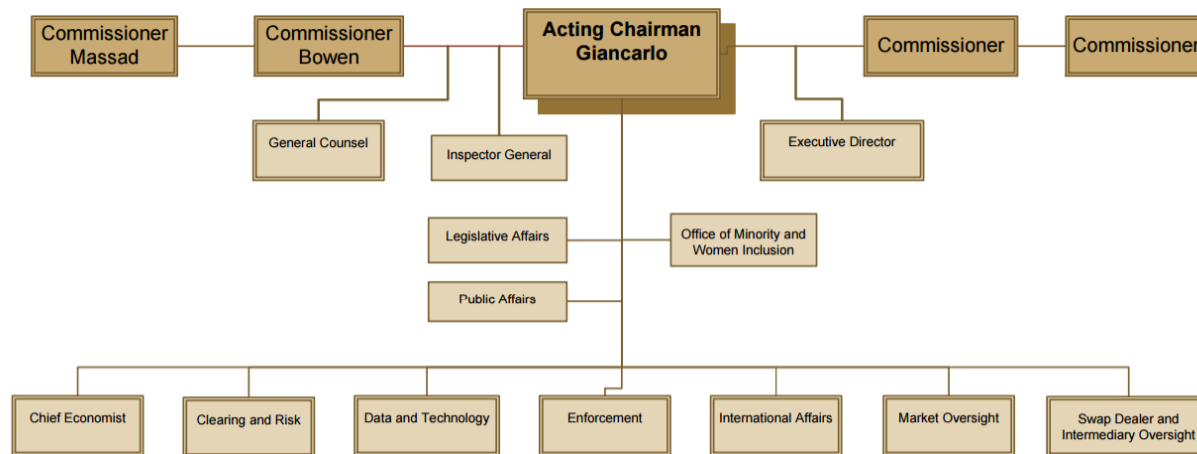
- Comprehensive new regulatory framework for “swaps” (CFTC) and “security-based swaps” (SEC)
- New clearing, capital, recordkeeping, and reporting requirements
- “Swap dealers” and “major swap participants” generally subject to strictest requirements
- **Exceptions for end users from clearing and trading**

CFTC Regulatory Regime

- 5 Commissioners – Nominated by President with the “advice and consent” of the Senate
- Commissioners to change in coming months, awaiting nomination of permanent Chair.

The CFTC Organization

1/20/2017



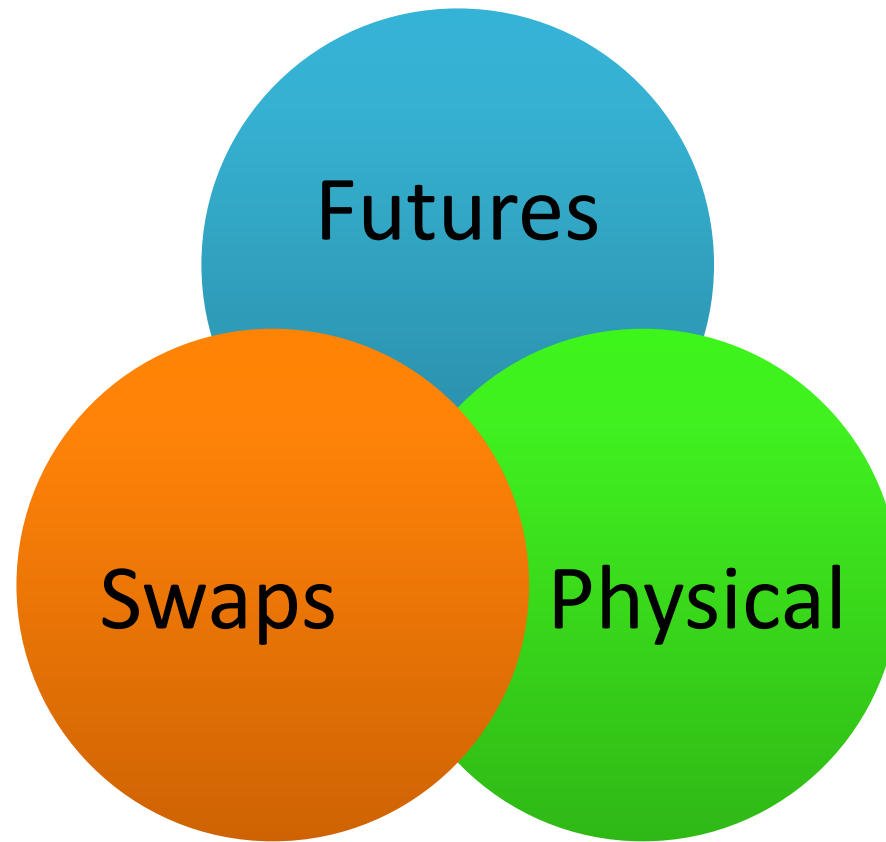
Regional Offices



CFTC Regulatory Regime

- Divisions:
 - Clearing and Risk (DCR): oversees derivatives clearing organizations (DCOs) and other market participants in the clearing process, including futures commission merchants, swap dealers, major swap participants and large traders.
 - Enforcement (DOE): investigates and prosecutes alleged violations of the Commodity Exchange Act and Commission regulations.
 - Market Oversight (DMO): oversees trade execution facilities and data repositories, conducts surveillance, reviews new exchange applications and examines existing exchanges to ensure compliance with applicable core principles.
 - Swap Dealer and Intermediary Oversight (DSIO): oversees the registration and compliance of: intermediaries, futures industry self-regulatory organizations (SROs), swap dealers, and major swap participants.
- Budget/Staff
 - \$250 million budget (SEC's was almost \$1.8 billion)
 - 714 FTE (SEC has 4,800+)

CFTC – Jurisdiction



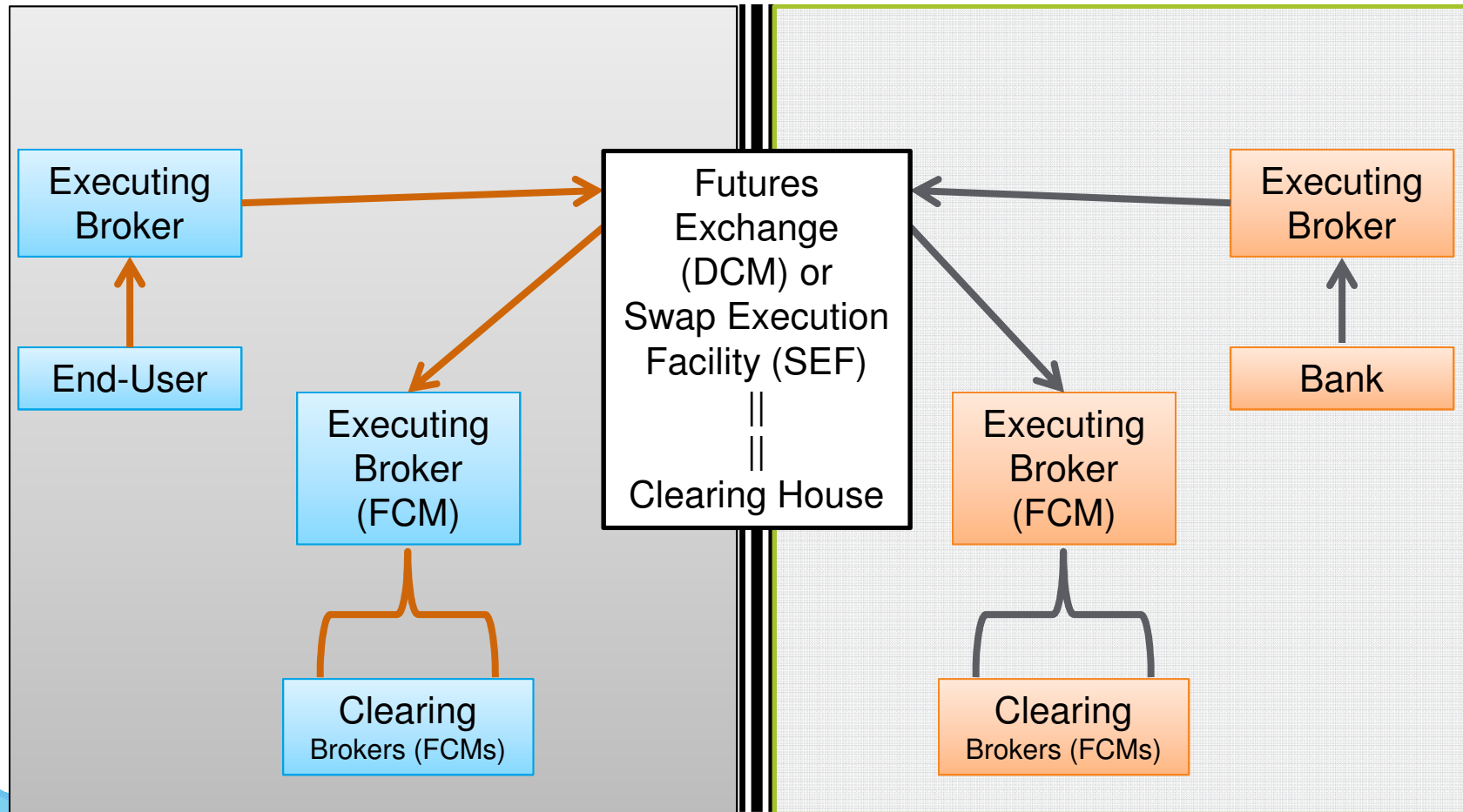
Regulated Products Overview

- Futures – subject to CFTC regulation since the 1920s.
- Options on Futures – subject to CFTC regulation since the 1920s.
- Swaps – subject to CFTC regulation since the passage of the Dodd-Frank Act on July 21, 2010, effective July 16, 2011. Swaps include broad-based indices.
 - Security-Based Swaps – single name CDS and narrow-based indices subject to SEC jurisdiction since the passage of the Dodd-Frank Act.
- Spot, cash, physical or forward transactions – transactions in the “cash market” are not subject to direct regulation, but are subject to some oversight because of the relation to the regulated products.

Futures and Derivatives Markets – Regulatory Oversight

- CFTC
- Futures Exchanges (Self-Regulatory Organizations): CME, CBOT, ICE, etc.
- Swap Execution Facilities (Self-Regulatory Organizations): Bloomberg, Tradeweb, ICAP, etc.
- Derivatives Clearing Organizations (Self-Regulatory Organizations): CME, ICE, etc.
- National Futures Association (Self-Regulatory Organization)
- U.S. Securities and Exchange Commission
- U.S. Department of Justice
- U.S. Department of Treasury
- Office of the Comptroller of the Currency
- The Federal Reserve
- Federal Deposit and Insurance Corporation
- International regulators

Trading and Clearing Market Structure



Key Concepts - Clearing

- Clearing is the procedure through which the Clearing House becomes the buyer to each seller of a future or swap, and the seller to each buyer, and assumes responsibility for protecting buyers and sellers from financial loss by ensuring buyer and seller performance on each contract. This is effected through the clearing process, in which transactions are matched, confirming that both the buyer's and the seller's trade information are in agreement.
- Clearing removes the bilateral credit risk and contractual performance risk when a commodity transaction, such as a forward, is consummated between a buyer and a seller in a one-to-one transaction.

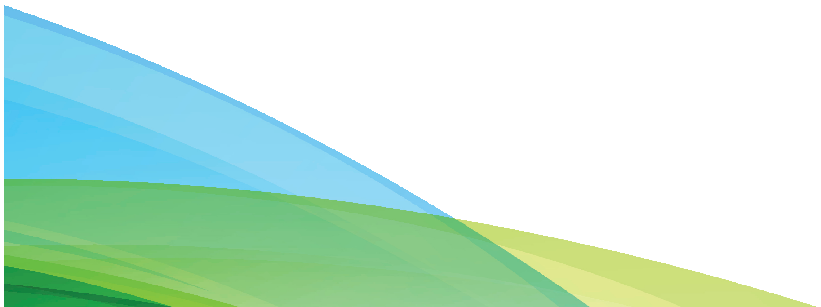
Key Concepts – Clearing (cont'd)

- In summary terms, in order to clear a trade, a market participant must open a trading account with a “Futures Commission Merchant” or “FCM” regulated by the CFTC. The trading account is funded with collateral, either cash or other liquid financial instruments.
- The collateral serves as insurance (called “margin”) to secure the trades entered into on the exchange, which are then cleared at the clearinghouse.
- The margin is passed from the FCM to the clearinghouse and the market participant becomes a counterparty to the clearinghouse.



Market Regulation

FUTURES AND DERIVATIVES



Who is Regulated?

Market Participant Categories

Swap Dealers

- Holds itself out as a **dealer** in swaps;
- **Makes a market** in swaps;
- Regularly enters into swaps with counterparties as an **ordinary course of business** for its own account; or
- Engages in any activity causing it to be commonly known in the trade as a **dealer or market maker in swaps**
- Also referred to as “Dealers” or “Liquidity Providers.”
- 105 Provisionally Registered
- *Examples:*
 - Bank of America
 - Goldman Sachs
 - JPMorgan
 - Mizuho
 - Morgan Stanley
 - Wells Fargo
 - BP
 - Shell
 - Cargill (Limited Designation)

Major Swap Participants

- Not a swap dealer, **and**
- Maintains a **substantial position** in swaps
- No major swap participants currently provisionally registered

Intermediaries

- **Futures Commission Merchants (FCMs)**
- engaged in **soliciting or in accepting orders** for the purchase or sale of futures and swaps;
- **accepts any money**, securities, or property to **margin**, guarantee, or secure any trades
- FCMs are also referred to as Clearing Firms or Clearing Members of a Derivatives Clearing Organization or Clearinghouse.
- **Introducing Brokers (IBs)**
- engaged in **soliciting or in accepting orders** for the purchase or sale of futures and swaps;

Financial Entities

- Swap dealer or security-based swap dealer;
- Major swap participant or major security-based swap participant;
- Commodity pool;
- Private fund;
- Employee benefit plan;
- Banks (total assets of \$10 billion or more)
- *Examples*
 - Hedge funds
 - Commodity pools
 - Insurance companies

Commercial End Users

- For the end user exemption for swaps clearing:
 - *Not a financial entity;*
 - *Using swaps to hedge or mitigate commercial risk; and*
 - *Notifies the CFTC how it meets its financial obligations associated with entering uncleared swaps*
- In general, end-users use futures to hedge or mitigate commercial risk
- *Examples*
 - Food companies
 - Commodity producers
 - Energy companies

Regulation of Market Participants

- Commercial End-Users
 - Generally registration is not required.
 - Futures activities are fully regulated.
 - Interest rate swaps and certain credit default swaps are subject to clearing and trade execution requirements.
 - When entering into such a swap, an entity that is a non-financial end user may “elect” to be exempt from clearing and trade execution requirements, provided that it:
 - is not a “financial entity”;
 - is using the swap to hedge or mitigate commercial risk; and;
 - certain information such as its identity as well as its election, is reported to a registered swap data repository.

Regulation of Market Participants

- Swap Dealers
 - Subject to external business conduct (“EBC”) rules for counterparties.
 - Generally required to collect information from counterparties and providing disclosures, including:
 - Verification of Counterparty Eligibility
 - Know your Customer
 - Scenario Analysis
 - Institutional Suitability
 - Disclosures:
 - Counterparty Clearing Disclosure
 - Characteristics and risks of swap
 - Providing Daily Mark (mandatory for uncleared swaps)
 - Heightened disclosure and additional obligations when dealing with special entities (certain governmental entities)

Regulation of Market Participants

- Swap Dealers (cont'd)
 - Many EBC requirements are already covered in the ISDA Dodd-Frank Protocols.
 - Subject to internal business conduct (“IBC”) rules, including:
 - Terms of swap must be documented in writing.
 - Swap data recordkeeping and reporting.
 - Designation of Chief Compliance Officer (“CCO”) and preparation of annual compliance report.
 - Risk management procedures for managing daily business activities.
 - Position limit monitoring.
 - Supervisory program.
 - Business continuity and disaster recovery plans.

Dodd-Frank Compliance and ISDA Documentation

- ISDA has developed a number of protocols for counterparties to amend existing swap agreements or otherwise bring their swap trading relationships into compliance with current statutes and regulations.
- An ISDA protocol is a multilateral contractual amendment mechanism that allows for various standardized amendments to be deemed made to the relevant ISDA agreements between any two adhering parties.

Dodd-Frank Compliance and ISDA Documentation

- Market participants indicate their participation in the protocol arrangement by following the adherence instructions posted on the ISDA website (www.isda.org), which includes submission of an adherence letter and payment of an adherence fee. Each party submitting an adherence letter and paying the adherence fee is a “Protocol Participant.”
- As the CFTC and SEC continue to implement the Dodd-Frank Act’s swap rules over time, it is expected that ISDA will develop and roll out further protocols.

Dodd-Frank Compliance and ISDA Documentation

- The ISDA August 2012 Dodd-Frank Protocol adds notices, representations, and covenants responsive to the Dodd-Frank requirements that must be satisfied at or prior to the time that swap transactions are offered and executed, as follows:
 - external business conduct standards;
 - real-time public reporting of swap transaction data;
 - swap recordkeeping and reporting requirements;
 - position limits;
 - large trader reporting; and
 - swap dealer internal business conduct standards.

Dodd-Frank Compliance and ISDA Documentation

- The ISDA March 2013 Dodd-Frank Protocol or ISDA Protocol 2.0, addresses CFTC rules that had not been finalized at the time the August 2012 Protocol was launched. Specifically, the March 2013 Protocol facilitates compliance with the CFTC's rulemakings on:
 - swap trading relationship documentation, confirmation, portfolio reconciliation, and portfolio compression;
 - the End-User Exception; and
 - the clearing requirement determination.

Dodd-Frank Compliance and ISDA Documentation

- The March 2013 Protocol provides that the end-user is deemed to represent the following:
 - it has filed the annual end-user disclosures with a SDR (or the CFTC) in a filing that is still effective, or it has notified its counterparty that it has not filed the annual disclosures;
 - it is not a financial entity;
 - it is using the swap to hedge or mitigate commercial risk; and
 - it generally meets its financial obligations associated with entering into swaps.

Dodd-Frank Compliance and ISDA Documentation

- While firms may have to comply with reporting obligations in various jurisdictions, they may also be subject to contractual, statutory, regulatory or other legal limitations which could prohibit the disclosure of relevant information.
- The ISDA 2013 Reporting Protocol, which contains a counterparty's consent to disclosure of information, is intended to facilitate market participants' compliance with these mandatory trade reporting requirements.

Dodd-Frank Compliance and ISDA Documentation

- On August 19, 2013, ISDA issued a “Cross-Border Representation Letter” that allows market participants to provide counterparties with status representations needed to determine whether compliance with various CFTC swap regulations is required by the Cross-Border Guidance.
- The Cross-Border Representation Letter allows an entity to make relevant representations to its counterparties, including whether such entity is a U.S. person or non-U.S. person, and whether such entity is a conduit or guaranteed affiliate.

Dodd-Frank Compliance and ISDA Documentation

- Further, on November 15, 2013, ISDA issued the ISDA 2013 DF Agreement for Non-U.S. Transactions and Annexes (“Non-U.S. DF Agreement”) that is intended to allow market participants to enter into selected provisions of the August 2012 Protocol and/or the March 2013 Protocol that are relevant to transactions that occur at least in part outside of the United States.
- The Non-U.S. DF Agreement provides agreements intended to be useful in circumstances where one party is either a non-U.S. swap dealer or a U.S. bank that is a swap dealer and transacts exclusively out of non-U.S. branches, and the counterparty is a non-U.S. person.

Dodd-Frank Compliance and ISDA Documentation

- On August 16, 2016, ISDA opened the ISDA 2016 Variation Margin Protocol to help market participants comply with new rules on margin for uncleared swaps.
- Under this protocol, parties have the opportunity to amend existing CSAs or enter into new margin rule-compliant CSAs with existing counterparties through the exchange of matching questionnaires.



What is Regulated? – Futures

- Futures are generally defined as an agreement to buy or sell a commodity for delivery in the future:
 - at a price that is determined at initiation of the contract;
 - that obligates each party to the contract to fulfill the contract at the specified price;
 - that is used to assume or shift price risk; and
 - that may be satisfied by delivery or offset.

| | | |
|--------------------------|-------------|----------------------|
| Order Ticket Sample | | 12345 |
| ACCOUNT NO. 11101 | | |
| BUY | SELL | |
| 100 ZOH7 228'6 | | 11:45:26 Dec 8, 2015 |
| | | 11:47:15 Dec 8, 2016 |

| | |
|----------------------------------|--|
| Oats Contract Unit | 5,000 bushels (~ 86 metric tons) |
| Price Quotation | Cents per bushel |
| Trading Hours | Sunday – Friday, 7:00 p.m. – 7:45 a.m. CT and Monday – Friday, 8:30 a.m. – 1:20 p.m. CT |
| Minimum Price Fluctuation | 1/4 of one cent per bushel (\$12.50 per contract) |
| Product Code | CME Globex: ZO; CME ClearPort: O; Clearing: O |
| Listed Contracts | March (H), May (K), July (N), September (U) & December (Z) |
| Settlement Method | Deliverable |
| Termination Of Trading | The business day prior to 15th calendar day of contract month. |
| Settlement Procedures | Oats Settlement Procedures |
| Position Limits | CBOT Position Limits |
| Exchange Rulebook | CBOT 15 |
| Price Limit Or Circuit | Price Limits |
| Vendor Codes | Quote Vendor Symbols Listing |
| Last Delivery Date | Second business day following last trading day of delivery month. |
| Grade And Quality | No. 2 Heavy and No. 1 at par. No. 1 Extra Heavy at 7 cents per bushel over contract price. No. 2 Extra Heavy at 4 cents per bushel over contract price, and No. 1 Heavy at 3 cents per bushel over contract price. No. 2(36 pound total minimum test weight) at 3 cents per bushel under contract price and No. 2 (34 pound total minimum test weight) at 6 cents per bushel under contract price. |

Where is it Regulated?

- Designated Contract Market (DCM) or Futures Exchanges
 - Boards of trade (or exchanges) that operate under the regulatory oversight of the CFTC.
 - Traditional futures exchanges: CME, NYMEX, ICE Futures, Nodal.
 - Can offer the trading of futures and swaps; central limit order book trading is required.
 - Off-exchange transactions permitted for block trades and exchange of physical for futures (EFPs).

CL

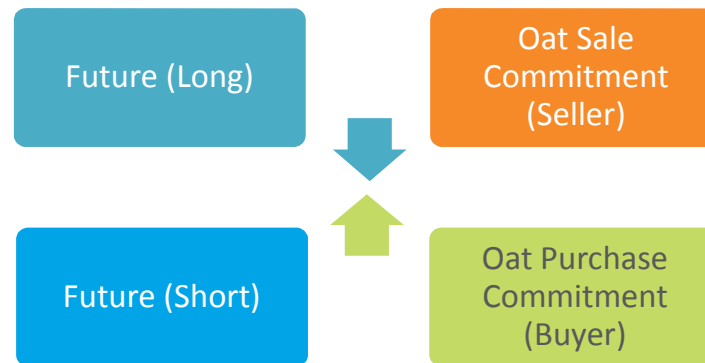
| Buy | Price | Sell |
|-----|-----------|------|
| | \$ 106.35 | 10 |
| | \$ 106.30 | 20 |
| | \$ 106.25 | 70 |
| | \$ 106.20 | 150 |
| | \$ 106.15 | 250 |
| | \$ 106.10 | 300 |
| | \$ 106.00 | |
| 300 | \$ 105.95 | |
| 250 | \$ 105.90 | |
| 150 | \$ 105.85 | |
| 70 | \$ 105.80 | |
| 20 | \$ 105.75 | |
| 10 | \$ 105.70 | |

Have to execute here

Have to execute here

Exchange of Futures for Physical (EFPs)

- The exchanges and CFTC have been focused on the execution of off-exchange transactions, including exchange of futures for physical or EFPs, which is a privately negotiated and simultaneous exchange of an exchange futures position for a corresponding cash position.
- The exchanges and CFTC require that the related position (cash, OTC swap) must be a derivative/related product of the futures that has a reasonable degree of price correlation and quantitative equivalence to the futures.
- The quantity covered by the related position must be approximately equivalent to the quantity covered by the futures contracts.
- The accounts involved must be of different beneficial owners.
- The exchanges and CFTC look for sufficient documentation of the above.



Futures – Block Trades

- Exchanges designate the products in which block trades shall be permitted and determine the minimum quantity thresholds for such transactions.
- The price at which a block trade is executed must be fair and reasonable in light of :
 - the **size** of the block trade,
 - the prices and sizes of **other transactions** in the same contract at the relevant time,
 - the prices and sizes of transactions in **other relevant markets**, including without limitation the underlying cash market or related futures markets, at the relevant time, and
 - the **circumstances** of the markets or the Participants to the block trade.

Futures – Block Trades

- Block trades must be reported to the Exchange in accordance with an approved reporting method.
- Participants involved in the execution of block trades must maintain a record of the transaction.
- A block trade must be for a quantity that is at or in excess of the applicable minimum threshold. Orders may not be aggregated in order to achieve the minimum transaction size.
- A broker for a Person shall not execute any order by means of a block trade for a Person unless such Person has specified that the order be executed as a block trade.

How is it Regulated?

Trade Practice Surveillance

- Conducted on a T+1 basis by exchanges and CFTC
- Non-exhaustive list of transactions types that are monitored:
 - Trading Ahead
 - Front Running
 - Direct Crossing
 - Indirect Crossing
 - Taking the Other Side (Direct)
 - Taking the Other Side (Indirect)
 - Wash Trading
 - Pre-Arranged Trading
 - Direct Money Passing
 - Indirect Money Passing
 - Marking the Close

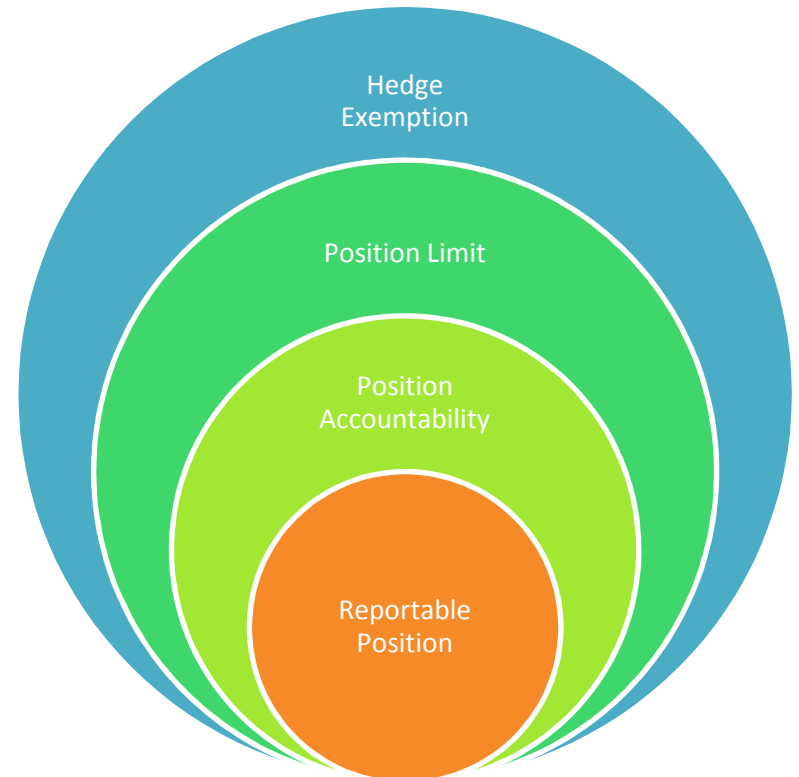
How is it Regulated?

Market Surveillance

- Monitor and analyze position holdings conducted by CFTC and exchanges
- The following is a non-exhaustive list of situations that will trigger an alert:
 - an account is identified as a large trader for the first time
 - large trader positions exceeds the reportable level
 - large trader positions exceeds the accountability level
 - large trader positions exceeds speculative position limits
 - firm open interest exceeds Contract open interest by pre-defined limits

Position Limits and Hedge Exemptions

- CFTC law authorizes the CFTC to impose limits on the size of speculative positions in futures markets.
- CFTC law and regulation requires designated contract markets to adopt speculative position limits or position accountability for speculators.
- Hedge Exemptions:
 - The CFTC and exchanges grant exemptions to their position limits for bona fide hedging. In the several markets with Federal limits, hedgers must file a report with the Commission if their futures/option positions exceed speculative position limits as defined in CFTC Regulation 1.3(z).
 - Hedges must reduce risk for a commercial enterprise and must arise from a change in the value of the hedger's (current or anticipated) assets or liabilities.
 - Hedgers must file a report with the Commission if their futures/option positions exceed speculative position limits.



Position Limits - Aggregation

- For purposes of position limits, a person must aggregate positions in commodities in all accounts in which the person, directly or indirectly, controls trading or holds a 10 percent or greater ownership or equity interest.
- However, a parent company can disaggregate the positions of an “owned entity” if certain standards of independent trading are met.
- In order to take advantage of this exemption, a the company must file a notice with the CFTC explaining the circumstances that warrant disaggregation and certifying that the conditions for disaggregation have been met.

Position Limits - Aggregation

- The following conditions must be met for entities to disaggregate their positions:
 - The entities must not have knowledge of each other's trading decisions;
 - The entities must trade pursuant to separately developed and independent trading systems;
 - The entities must have and enforce written procedures that prevent them from having knowledge, gaining access to, or receiving data about each other's trades, which must include security arrangements, including separate physical locations, to maintain independence of the entities' activities;
 - The entities must not share employees that control the trading decisions of either; and
 - The entities must not have risk management systems that permit the sharing of trades or trading strategy with employees that control the trading decisions of either entity.

Form 204 – Monthly Reports to CFTC of Hedging Positions

| COMMODITY FUTURES TRADING COMMISSION STATEMENT OF CASH POSITIONS IN GRAINS, SOYBEANS, SOYBEAN OIL, AND SOYBEAN MEAL | | CFTC CODE NO. | OMB No. 3038-0009 | | |
|---|--|--|---------------------------------------|-----------------------------|------------------------------------|
| | | Report as of close of business Friday (DATE) | | | |
| <p>NOTICE: Failure to file a report required by the Commodity Exchange Act and the regulations thereunder, or the filing of a false report, may be basis for administrative action under 7 U.S.C. Section 9, and may be punishable by fine or imprisonment, or both, under 7 U.S.C. Section 13, or 18 U.S.C. Section 1001. Public reporting burden for this collection of information is estimated to average 20 minutes per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this, to Agency Clearance Officer, Office of General Counsel, Commodity Futures Trading Commission, 1155 21st Street, NW, Washington, DC 20581; and to the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503.</p> | | | | | |
| <p>PART I: FIXED-PRICE CASH POSITIONS IN TERMS OF COMMODITY FOR FUTURE DELIVERY Report all quantities in thousand bushels, i.e., 000 omitted. Show products and byproducts in terms of '000-bushel equivalents. If you have no cash position, write "None" on the form and return it to CFTC.</p> | | | | | |
| FUTURES MARKET USED FOR HEDGING | CASH COMMODITY HEDGED IN FUTURES | LONG CASH | | SHORT CASH | |
| | | (1) STOCKS OWNED '000 Bushels | (2) PURCHASE COMMITMENTS '000 Bushels | (3) TOTAL LONG '000 Bushels | (4) SALES COMMITMENTS '000 Bushels |
| WHEAT | Wheat | | | | |
| | Wheat Products (in '000 bu. equiv.) | | | | |
| | Other* | | | | |
| | Total | | | | |
| CORN | Corn | | | | |
| | Corn Products (in '000 bu. equiv.) | | | | |
| | Other* | | | | |
| | Total | | | | |
| OATS | Oats | | | | |
| | Oat Products (in '000 bu. equiv.) | | | | |
| | Other* | | | | |
| | Total | | | | |
| SOYBEANS SOYBEAN OIL SOYBEAN MEAL | Beans | | | | |
| | Oil & Oil Products (in '000 bu. equiv.) | | | | |
| | Meal & Meal Products (in '000 bu. equiv.) | | | | |
| | Other* | | | | |
| | Total | | | | |
| (OTHER FUTURES MARKET) | Grain (same as futures) | | | | |
| | Products (of same futures (in '000 bu. equiv.) | | | | |
| | Other* | | | | |
| | Total | | | | |
| <p>* Use "Other" to identify commodities you are cross hedging. Show quantities in 1,000-bushel equivalents of the commodity futures being used for hedging and complete Part II to show the quantities in terms of the actual commodity</p> | | | | | |
| <p>PART II: FIXED-PRICE CASH POSITIONS FOR CROSS HEDGES IN TERMS OF ACTUAL CASH COMMODITY</p> | | | | | |
| FUTURES MARKET USED FOR HEDGING | CASH COMMODITY (Specify Commodity or Product) | UNITS (Specify Tons, Cwt., Lbs., Bu., Etc.) | LONG CASH | | SHORT CASH |
| | | | STOCK OWNED (1) | PURCHASE COMMITMENTS (2) | SALE COMMITMENTS (3) |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |
| <p>FURTHER EXPLANATION/CORRECTION OF PREVIOUS REPORTS</p> | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |

CFTC Form 204 (10-00)
Previous Editions Obsolete

INSTRUCTIONS FOR PREPARING AND FILING REPORTS ON CFTC FORM 204

(See Regulations Under the Commodity Exchange Act)

WHO SHOULD REPORT: (1) All persons (individuals, partnerships, associations, corporations, or trusts) holding or controlling positions for future delivery that are reportable pursuant to regulation 15.00(b)(1)(ii) and any part of which constitute bona fide hedging positions as defined in regulation 1.3(z). (2) All persons holding or controlling positions for future delivery that are reportable pursuant to regulation 15.00(b)(1)(i) who have received a special call from the Commission or its designee, as specified in regulation 19.00(a)(3).

WHEN TO REPORT: Report monthly as of the close of business on the last Friday of the month. Reports must be received in the Commission's Chicago office not later than the third business day following the Friday date of the report. To ensure receipt of the report by its due date, either transmit the report by facsimile or report the information contained on the form to the Commission by telephone and mail the report, post-marked not later than midnight of its due date. Filings made in response to a special call under regulation 19.00(a)(3) shall be made within one business day of that call unless otherwise specified in the call.

WHERE TO REPORT: The CFTC Central Region, Market Information, 525 West Monroe Street, Suite 1100, Chicago, Illinois 60661 (telephone: (312) 596-0700, facsimile: (312) 596-0711), unless otherwise specifically authorized by the Commission or its designee.

WHAT TO REPORT: For each commodity futures contract in which you hold a position as specified above, you must report the following:

Part I. Report in thousands of bushels the entire quantity of cash stocks owned and open fixed-price cash purchases and cash sales of the commodity and its products and byproducts. (Report products and byproducts in terms of 1000-bushel equivalents.) When reportable in soybean futures, soybean oil futures, or soybean meal futures, show the cash positions of soybeans, soybean oil, and soybean meal. If it is your practice to exclude certain source commodities, products, or byproducts in determining your cash positions for bona fide hedging, they should be excluded from the CFTC Form 204 report.

If you are "cross hedging," report the cash commodity hedged in 1000-bushel equivalents in the space labeled "Other" under the futures market used for hedging (for example, if you are cross hedging cash milo in corn futures, convert your milo cash position to 1000-bushel equivalents of corn and report it on the "Other" line of the CORN section.) If you are cross hedging, you must also complete Part II of this report.

Part II. If you included "cross-hedged" cash commodities in Part I of this report, you must also report the entire quantity of stocks owned and open fixed-price purchases and sales of the commodity you are cross hedging in terms of the actual commodity (for example, show your milo cash position in terms of actual quantities of milo). Specify the futures market in which you are hedging.

GENERAL PROVISIONS: Use standards and conversion factors usual and common to your business.

If you own no stocks and have no fixed-price cash position, indicate by writing "None."

If inter-company or inter-office purchases and sales of cash grain are included in your fixed-price cash grain positions, they must be separately identified as such in a footnote at the bottom of the report, showing for each related company or office the quantities of grain or grain products involved.

Form 204 – Fixed-Priced Commitments

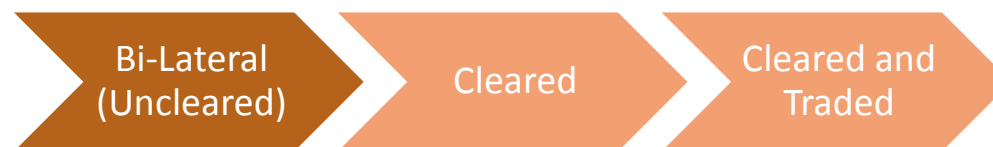
- Form 204 requires that an entity report *only*:
 - Stocks owned of a commodity.
 - Fixed-price purchase and sale commitments of that commodity, as applicable.
- See CFTC enforcement actions in CHS, Toepfer and Marubeni summarized later in the presentation.
- The CFTC and exchanges may also request Form 40 which relates to large trader reporting and Form 105 which relates to the ownership and control of trading accounts.
 - Your organization should have procedures to route requests by the CFTC or an exchange to complete a form, or any other request, to appropriate supervisory, legal or compliance personnel.

What is Regulated? – Swaps

- A SWAP includes any agreement, contract, or transaction that provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level without also conveying a current or future direct or indirect ownership interest in an asset (including any enterprise or investment pool) or liability that incorporates the financial risk so transferred, including any agreement, contract, or transaction commonly known as... (see next slide)

Products – Swaps

| An agreement, contract, or transaction commonly known as: | |
|---|---------------------|
| interest rate swap | debt index swap |
| rate floor | debt swap |
| rate cap | credit spread |
| rate collar | credit default swap |
| cross-currency rate swap | credit swap |
| basis swap | weather swap |
| currency swap | energy swap |
| foreign exchange swap | metal swap |
| total return swap | agricultural swap |
| equity index swap | emissions swap and |
| equity swap | commodity swap |



Clearing Mandate in the U.S. - 2013

- The clearing mandate in the U.S. began on February 11, 2013 with phased compliance over the course of 2013:
 - Category 1 Entities (SDs/MSPs and “Active Funds” that are not managed by third-party investment managers) – March 11, 2013
 - Category 2 Entities (Commodity Pools, Private Funds that are not “Active Funds,” and people “predominantly engaged in” banking activities or activities that are financial in nature, that are not managed by third-party investment managers) – June 10, 2013
 - Category 3 Entities (pension funds, accounts managed by third-party investment managers and all others subject to the mandate) – September 9, 2013
- The 2013 CFTC clearing mandate covers the following products:
 - *Interest Rate Swaps* (Fixed-to-Floating Swaps [USD, EUR, GBP, JPY], Basis Swaps [USD, EUR, GBP, JPY], Forward Rate Agreements [USD, EUR, GBP, JPY] and Overnight Index Swaps) [USD, EUR, GBP]; and
 - *Credit Default Swaps* (North American Untranching CDS Indices and European Untranching CDS Indices)
- Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act (CEA;) Final Rule, 77 Fed. Reg. 74284 (Dec. 13, 2012); *see also* <http://www.cftc.gov/PressRoom/PressReleases/pr6684-13>



Category 1

Category 2

Category 3



Clearing Mandate for IRS in the U.S. - 2017

- In 2016 the CFTC finalized a rule for mandated clearing for additional non-USD denominated interest rate swaps with compliance dates beginning in 2017.
- However, the CFTC did not phase in different types of IRS swaps by market participant category.
- The CFTC has based the compliance date on when the clearing requirement was effective in the respective non-U.S. jurisdiction.



Trading of Swaps – SEFs and DCMs

- Designated Contract Market (DCM)
 - Boards of trade (or exchanges) that operate under the regulatory oversight of the CFTC
 - Traditional futures exchanges: CME, NYMEX, ICE Futures, Nodal
 - Can offer the trading of futures and swaps; central limit order book trading is required
- Swap Execution Facility (SEF)
 - Any trading facility, that facilitates the execution of swaps between persons and is not a DCM
 - Trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system
 - Bloomberg; Tradeweb; trueEX; ICAP; Tullett; GFI; Tradition

Swaps Trading – SEFs and DCMs

- Trade Execution
 - Swaps that are subject to mandatory clearing may be submitted by a SEF or DCM to the CFTC to be deemed “made available to trade”
 - Swaps that are “made available to trade” or “MAT” are subject to mandatory trading (also known as the “trade execution requirement”)
 - Swaps that are MAT must be executed on or pursuant to the rules of a DCM or SEF

SEF Execution Methods

TW Negotiation (Negotiation) (nrsef-Acme Investors, Inc.) Tradeweb W7.27HS USDEMO2
 You are in SEF Mode. Block size: 170,000,000 MAT Swaps
 Trading Status REQUIRED This is a MAT swap
 Clearing Status REQUIRED
 CUST PAY IRS USD 10Y vs 3M LIBOR EFF 03/20/2014 END 03/20/2024
 Composite Quote 2.8020 / 2.8060 Submitted Quote 2.8060
 Execution Panel RFQ RFM Order ARFO TWID: RU00010YL3MS
 Direction Notional ('000) Rate Source
 PAY 10Y 150,000 @2.0000 DLRZ
 150,000,000 Trade # 71 Dir-Quote
 Clearing LCH(FCM) DLRWFCM End Trade EXECUTE
 DF Mid 2.80400
 Supplemental RFQ Plus Orders

| Update | Source | Qty('000) | Dir Pay | Dir Rcv | Qty('000) | Source | Update | NE |
|----------|--------|-----------|---------|---------|-----------|--------|----------|--------|
| 15:38:15 | DLRZ | 50,000 | 2.7850 | -40 | 2.7890 | DLRW | 15:38:17 | -13.47 |
| 15:38:17 | DLRW | 50,000 | 2.7850 | -40 | 2.7910 | DLRZ | 15:38:15 | -40.43 |
| 15:38:21 | DLRX | 50,000 | 2.7850 | -40 | 2.7910 | DLRX | 15:38:21 | -40.43 |
| 15:38:23 | DLRY | 50,000 | 2.7840 | -50 | 2.7920 | DLRY | 15:38:23 | -53.90 |

 RFQ Responses Trade Best

| Dir | DF Mid | State | Notional | Dir Rcv | Action | End | Trd |
|------|---------|-----------|-------------|---------|--------|-----|-----|
| DLRY | 2.80400 | Dir-Quote | 150,000,000 | 2.0000 | EXEC | END | 71 |
| DLRW | 2.80400 | | | | | | |
| DLRX | 2.80400 | | | | | | |

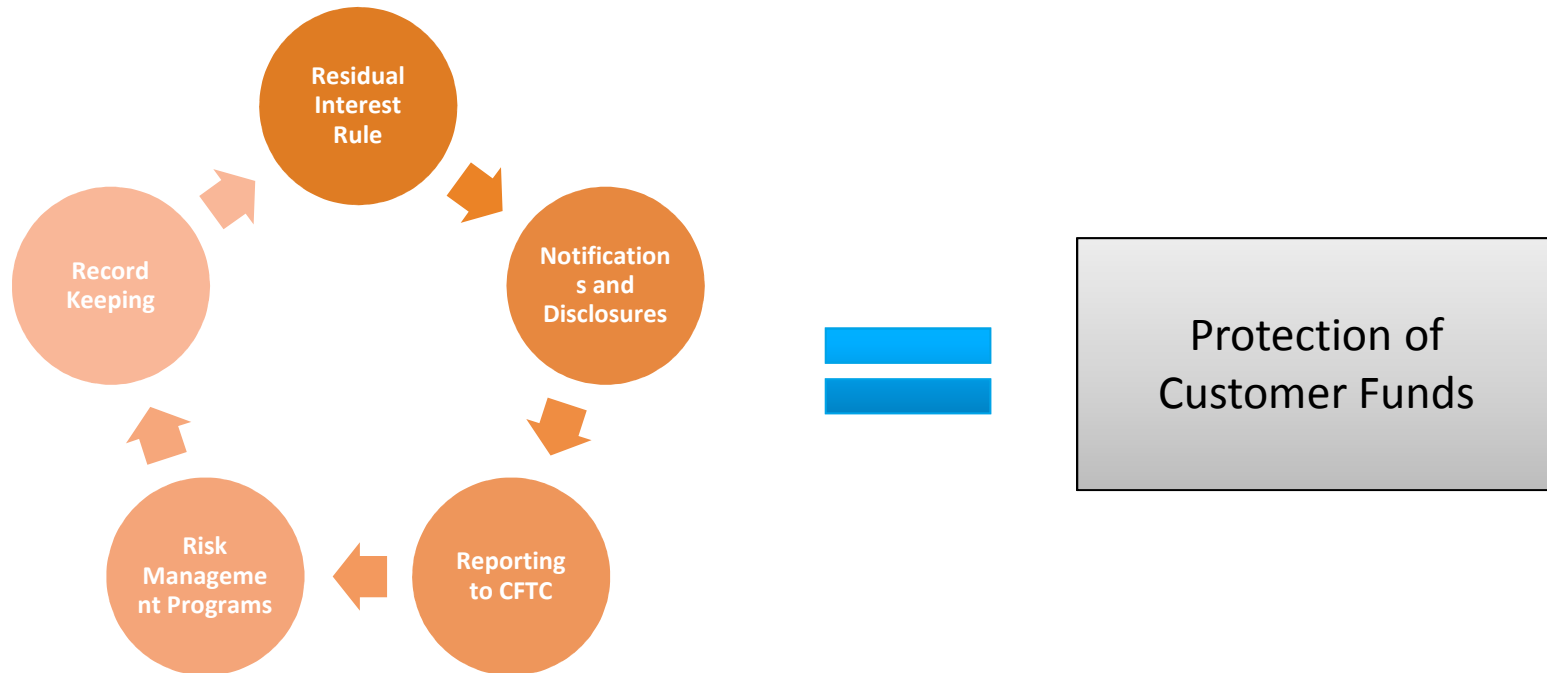
RFQ (3)

Dealer Streams RFQ Plus Orders

| Update | Dir | Size(MM) | Bid | Offer | Size(MM) | Dir | Update |
|----------|------|----------|---------|---------|----------|------|----------|
| 03:00:02 | DLRY | 500 | 76.2500 | 75.7500 | 500 | DLRW | 03:01:00 |
| 03:03:00 | DLRZ | 20 | 76.2500 | 76.3750 | 400 | DLRX | 03:00:00 |
| 03:00:00 | DLRX | 500 | 76.1250 | 76.3750 | 20 | DLRZ | 03:03:00 |
| 03:01:00 | DLRW | 400 | 75.5000 | 76.6250 | 400 | DLRY | 03:00:02 |

Order Book

Clearing – Protection of Customer Funds



- On October 30, 2013 the CFTC voted to finalize additional customer protection rules. See *Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations*; Final Rule, 78 Fed. Reg. 68506 (November 14, 2013). The rules were effective January 13, 2014, however, certain rules have different compliance dates.
- The rules build on customer protections established earlier by the National Futures Association.
- The rules require FCMs to increase the amount of residual interest held in customer funds accounts, restrict the ability to withdraw such residual interest, and impose increased recordkeeping and reporting requirements on FCMs.

Swaps - Recordkeeping and Reporting

- Swap reporting:
 - Under Part 43 of the CFTC Regulations, parties to a swap transaction are required to engage in real-time reporting of its swap data for public dissemination.
 - Swaps subject to this requirement are “publicly reportable swap transactions”, which includes any executed swap that is an arm's-length transaction between two parties that results in a corresponding change in the market risk position between the two parties.
 - Under Part 45 of the CFTC Regulations, information relating to the primary economic terms of the swap and confirmation data with respect to the swap (“creation data”) and any information relating to a change in the terms of the swap (“continuation data”) must be reported to a Swap Data Repository (“SDR”), an entity registered with the CFTC that collects and maintains swaps data and publicly reports certain information.

Swaps - Recordkeeping and Reporting

- Swap recordkeeping:
 - Under Part 45 of the CFTC Regulations:
 - All records relating to a swap must be retained throughout the life of such swap and for a period of at least five years following the final termination of such swap.
- Other obligations:
 - All entities entering into swaps must have legal entity identifiers (“LEI”).
 - Reporting of “level two reference data” consisting of the identity of an entity’s ultimate parent, to a database designated by the CFTC. Currently, the CFTC has not determined the location of a level two reference database.
 - Swaps must also be identified in recordkeeping and reporting using unique product identifiers (“UPI”) under CFTC Regulation 45.7. Guidance on a unique product identifier and product classification system is forthcoming.

General Recordkeeping Provisions

- End-users must comply with CFTC Regulation 1.31, which dictates the manner of preservation for all books and records subject to CFTC recordkeeping requirements. All books and records must be kept in their original form (for paper records) or native file formats (for electronic records) for a period of five years from the dates thereof (or for swaps or related cash or forward transactions, five years from the termination, maturity, expiration, transfer, assignment, or novation date of the transaction).
- All records must be “readily accessible” during the first two years of the five-year period.
- All documents must be subject to inspection by the CFTC or the U.S. Department of Justice.
- CFTC Regulation 1.31 also provides detailed requirements for records in “electronic storage media.”
 - On January 19, 2017, the CFTC proposed revisions to Regulation 1.31 that would alter some of the above requirements.

Margin for Uncleared Swaps

- In the U.S., regulators have promulgated rules requiring that the posting of margin in connection with certain swaps.
- There are three rules on uncleared margin in the U.S.: (1) issued by the Department of the Treasury Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Fed), Federal Deposit Insurance Corporation (“FDIC”), Farm Credit Administration (“FCA”), and Federal Housing Finance Agency (“FHFA”) (collectively, the “Prudential Regulators”) for bank swap dealers (“SDs”); (2) issued by the Commodity Futures Trading Commission (“CFTC”) for non-bank SDs; and (3) issued by the Securities and Exchange Commission (“SEC”) for non-bank security-based SDs.

Margin for Uncleared Swaps (cont'd)

- The Prudential Regulators issued a final rule setting margin, capital, and segregation requirements for uncleared swaps.
 - See Margin and Capital Requirements for Covered Swap Entities, 80 Fed. Reg. 74,840 (Nov. 30, 2015).
- The CFTC also issued a final rule regarding the uncleared margin requirements.
 - See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants; Proposed Rule, 81 Fed. Reg. 636 (Jan. 6, 2016).
- The SEC has not yet adopted an implementing rule concerning SEC registrants.
- Under the CFTC and Prudential Regulator rules, entities that can elect the end-user exception from clearing in connection with a swap generally will not be required to post initial or variation margin in connection with such swap.

Margin for Uncleared Swaps (cont'd)

- In connection with uncleared swaps, entities that are deemed “financial end users” will have an obligation to post variation (and in some cases, initial) margin.
- FEUs include:
 - bank holding companies or their affiliates
 - depository institutions
 - state-licensed/registered credit entities, lending entities, money services businesses
 - A regulated entity as defined in section 1303(20) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992
 - Any institution chartered in accordance with the Farm Credit Act of 1971, as amended, 12 U.S.C. 2001 et seq., that is regulated by the Farm Credit Administration;

Margin for Uncleared Swaps (cont'd)

- FEUs include (cont'd):
 - A securities holding company; a broker or dealer; a registered investment adviser, an investment company registered with the SEC, a BDC
 - a private fund
 - commodity pool, CPO or commodity trading advisor
 - an employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002)
 - certain entities organized as insurance companies

Margin for Uncleared Swaps (cont'd)

- FEUs include (cont'd):
 - an entity, person or arrangement that is, or holds itself out as being, an entity, person, or arrangement that raises money from investors, accepts money from clients, or uses its own money primarily for the purpose of investing or trading or facilitating the investing or trading in loans, securities, swaps, funds or other assets for resale or other disposition or otherwise trading in loans, securities, swaps, funds or other assets;
 - An entity that would be a financial end user or a swap entity, if it were organized under the laws of the United States or any State thereof.

Margin for Uncleared Swaps

- The margin rules have been coming into effect in the U.S. since late 2016 and the rules related to FEUs are effective in March 2017.
- However, earlier this week, on February 13, 2017, the staff of the Division of Swap Dealer and Intermediary Oversight (“DSIO”) of the CFTC issued CFTC Letter No. 17-11 (the “Letter”) providing a time-limited no-action position with respect to swap dealers (“SDs”) who fail to collect and/or post variation margin in connection with uncleared swaps.
- Acting Chair Christopher Giancarlo commented that such relief was necessary because “the facts on the ground cannot be ignored that as much as ninety percent of those end-users are not ready to meet the new requirements despite their best efforts to do so.” Acting Chair Giancarlo continued, stating “[t]his action by the CFTC does not change the scheduled time of arrival for the agreed margin implementation. It just foams the runway to ensure a safe landing.”



CROSS-BORDER APPLICATION OF U.S. DERIVATIVES LAW AND REGULATION



International Issues: Compliance and Recognition

- Under the CFTC law and regulation, U.S. swap rules and regulations apply to activities that “have a direct and significant connection with activities in, or effect on, commerce of the United States.”
- CFTC has issued guidance and rulemaking on certain aspects of cross-border swap transactions.
 - Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations
 - Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements
- A Proposed Rule issued in October 2016 by the CFTC aims to provide additional clarification regarding the cross-border application of the U.S. swap rules with respect to SDs and MSPs.



**CFTC ENFORCEMENT ACTIONS AND
NEW DODD-FRANK ENFORCEMENT PROVISIONS**



CFTC Enforcement Priorities

- Price Manipulation – 9(a)(2), 6(c)(3) and Rule 180.2
- Fraud-based Manipulation – 6(c)(1), Rule 180.1, (e.g., Use of a Deceptive Device; Recklessness Standard; Insider Trading)
- Wash Trading or Fictitious Trades – 4c(a)(1) & (2), Rule 1.38(a)
- Disruptive Trading Practices:
 - Violating bids or offers – 4c(a)(5)(A);
 - Banging the Close (intentional or reckless disregard for the orderly execution of transactions during the closing period) – 4c(a)(5)(B);
 - Spoofing (bidding or offering with the intent to cancel the bid or offer before execution) – 4c(a)(5)(C)
- Position Limits and Reporting (e.g., Swap Transaction Reporting; Cash Position Reporting; Large Trader Reporting) – 4a(b)
- False Statements to CFTC and SROs – 6(c)(2)

Anti-Manipulation Rules

- CFTC has two anti-manipulation rules – one that prohibits price manipulation, and one that prohibits fraud-based manipulation.
- *Price Manipulation*: Section 9(a)(2), 6(c)(3) & Rule 180.2 prohibit manipulating or attempting to manipulate the price of any swap, commodity, or futures contract.
- *Fraud-based Manipulation*: 6(c)(1) & Rule 180.1 prohibits
 - Intentionally or recklessly using or attempted to use manipulative device, scheme, or artifice to defraud; or
 - Intentionally or recklessly making or attempting to make any untrue or misleading statement of fact; or
 - Delivering or attempting to deliver a false, misleading or inaccurate report concerning crop or market information, or conditions that affect the price of any commodity with knowledge or reckless disregard as to its truth.

Price Manipulation

- CFTC's long-standing statutory authority to police price manipulation and attempted price manipulation under Section 9(a)(2) was also codified under 6(c)(3) and Rule 180.2.
- To prove completed price manipulation, CFTC must establish:
 - The wrongdoer had the ability to influence market prices;
 - An artificial price was created that did not reflect legitimate supply and demand;
 - The alleged wrongful conduct caused the artificial price; and
 - The wrongdoer acted with specific intent to cause the artificial price.
- To prove attempted price manipulation, CFTC must establish:
 - An intent to cause an artificial market price*; and
 - Some overt act in furtherance of that intent.

Price Manipulation

- Price manipulation considerations:
 - To show a completed price manipulation, the CFTC show must show the ability to create an artificial price, prove the creation of an artificial price, and that the wrongdoer's conduct caused the artificial price.
 - Although these have typically been difficult elements of proof for the CFTC, they are easier when the alleged wrongdoer is a large user of the commodity in question.
 - Attempted manipulation claims will almost always be brought with manipulation claims – there the CFTC only has to show an intent to create artificial price (and an overt act). The difficult elements of ability, creation, and causation are not required.
 - Artificial price alone is not evidence of manipulation.

Price Manipulation

- CFTC considers wide range of behavior to constitute price manipulation or attempted price manipulation:
 - Aggravating congested markets, or, conversely, manipulating illiquid markets
 - Manipulating settlement prices and indexes
 - Uneconomic trading
- CFTC evaluates:
 - Reasons for the trade
 - Impact of the trade
 - Other contextual factors
- Proof usually rests on some combination of traders' communications, trading analyses, and witness testimony.

Price Manipulation – 9(a)(2) Criminal Provisions

- Section 9(a) contains the following criminal provisions:
 - Manipulation and Attempted Manipulation
 - False Reports concerning Market Information
 - False Statements to CFTC
 - False Statements to Exchanges, SEFs, SDRs, DCOs, and NFA
 - Steal, Embezzle or Convert Customer Funds
 - Fraud and Wash Trading
 - End-User Exception Abuse
 - Willfully Violate any Other Provision or Regulation
- The criminal penalties are:
 - A fine of not more than \$1,000,000, and/or
 - Imprisonment for not more than 10 years and costs of prosecution.

Fraud-Based Manipulation

- Section 6(c)(1) and Rule 180.1 establishes ability to bring fraud-based manipulation cases:
 - Statute and rule are modeled on SEC Rule 10b-5.
 - CFTC must show intentional or reckless conduct in order to establish a violation.
 - Fraud must be in “in connection with” swap or commodity contract, which is defined broadly to mean conduct that is reasonably calculated to influence market participants.
- Important considerations regarding fraud-based manipulation:
 - CFTC will not have to prove common law elements in private securities law claims of reliance, loss causation, and damages, but such elements may be relevant in determining appropriate penalty or remedy.
 - Materiality is an objective test (i.e., whether a reasonable person would have considered fact material).
 - Omissions are considered material if the fact would have been viewed by a reasonable person as having significantly altered the total mix of information available.

Anti-Manipulation – CFTC Enforcement Cases

- *CFTC v. Kraft* (filed in 2015): CFTC alleges that Kraft manipulated and attempted to manipulate the price of wheat futures traded by entering positions far beyond its commercial needs, and committed position limit violations. The CFTC also alleges that Kraft’s committed fraud-based manipulation through the use of a deceptive or manipulative device.
- *CFTC v. Navinder Singh Sarao and Nav Sarao Futures* (filed in 2015): CFTC found that Sarao used a layering algorithm to spoof the E-mini S&P 500 futures contract, contributing to the Flash Crash on May 2, 2010. The CFTC also found that Sarao’s actions constituted attempted and completed price manipulation and fraud-based manipulation. Sarao settled with the CFTC on November 17, 2016 for \$38 Million in Monetary Sanctions and permanent registration and trading bans.
- *CFTC v. Donald Wilson and DRW Investments* (filed in 2013): CFTC alleges that DRW executed a strategy to “bang the close” in the settlement window of the IDEX Interest Rate Swap Futures Contract, moving the contract price to benefit DRW’s long OTC position. The CFTC alleges that DRW’s actions constituted attempted and completed price manipulation.

Fraud-Based Manipulation – Insider Trading

- Like SEC Rule 10b-5, CFTC’s anti-fraud manipulation rule does extend to insider trading under the “misappropriation theory.”
- Elements of misappropriation theory are:
 - Defendant held a relationship of trust and confidence with the source of material nonpublic information;
 - Defendant obtained such information from a person or entity to whom he or she owed the duty to disclose
 - Defendant knowingly or recklessly breached his duty by trading, or attempting to trade a swap, commodities contract, or futures contract
 - while either “using” material nonpublic information, or while in “knowing possession” of material nonpublic information; and
 - will personally benefit from his or her own trading.

Fraud-Based Manipulation – Insider Trading

- Non-public information is any information that has not been disseminated in a manner making it available to investors generally.
- Courts generally agree that the following relationships give rise to the duty to disclose or abstain from trading:
 - Employer-employee
 - Attorney-client
 - Temporary insider to shareholders of a corporation
 - Business relationship
- Insider trading liability also extends to “tippers” and “tippees:”
 - The tipper is the insider with relationship of trust to the source of nonpublic information, who has a duty not to disclose this information.
 - The tippee receives the nonpublic information – and inherits the duty not to disclose the it.
- The tipper becomes liable if he or she receives a personal benefit for disclosing the information.
- The tippee becomes liable if he or she either (1) trades on the information or (2) tips for his or her own personal benefit.

Insider Trading – CFTC Enforcement Cases

- CFTC Orders Arya Motazedì to Pay \$100,000 Penalty and \$216,956 in Restitution for Insider Trading and Other Violations, and Imposed Permanent Trading and Registration Bans (Dec. 2, 2015).
 - CFTC found that Motazedì misappropriated non-public, confidential, and material information to fraudulently trade on his personal accounts to the loss of his employer's accounts through "frontrunning."
 - CFTC concluded that Motazedì's insider trading constituted fraud-based manipulation, and also found that Motazedì's prearranged trading constituted fictitious sales and non-competitive trading.
- CFTC Orders **Jon Ruggles** to Pay \$1.75 Million Penalty and \$3.5 Million in Disgorgement, for Insider Trading, Fictitious Sales and Non-Competitive Trades, and Imposed Permanent Trading and Registration Bans (Sept. 29, 2016).

Wash or Fictitious Trading

- Sections 4c(a)(1) and (2) make it "unlawful for any person to offer to enter into, enter into, or confirm the execution of a transaction" that is:
 - A "wash sale," or
 - A "fictitious sale," or
 - Is a transaction "used to cause any price to be reported, registered, or recorded that is not a true and bone fide price."
- This often involves a violation of Rule 1.38(a):
 - Rule 1.38(a) requires all purchases and sales of commodity futures or commodity options be executed "openly and competitively."
 - There are exceptions for non-competitive off-exchange transactions, such as EFPs, that are set by exchange rules.
 - If a noncompetitive trade does not qualify for an exchange exception, then it violates Rule 1.38(a).

Wash or Fictitious Trading – CFTC Enforcement Cases

- CFTC Orders **SG Americas Securities, LLC** (a subsidiary of Societe Generale Group) to Pay \$750,000 Penalty for Failure to Supervise and for Confirming EFPs that Constituted Wash Trading, Non-Bona Fide Prices and Noncompetitive Trades (Sept. 28, 2016).
- CFTC Orders Russian Bank **JSC VTB Bank** and its UK-Based Subsidiary **VTB Capital PLC** to pay a \$5 Million Penalty for Executing Fictitious and Non-Competitive Block Trades in Russian Ruble/U.S. Dollar Futures Contracts (Sept. 19, 2016).
 - CFTC found that VTB executed block trades in foreign exchange futures contracts with VTB Capital to transfer to it cross-currency risk. VTB Capital would then hedge that risk in the OTC swaps market.
 - CFTC found that the trades constituted fictitious sales and were noncompetitively priced because the trades were not executed “openly and competitively.”

Disruptive Trading Practice Rules

- Commodity Exchange Act prohibits the following disruptive trading practices:
 - *Violating Bids or Offers* – Buying a contract at a price that is higher than the lowest available offer or selling a contract at a price that is lower than the highest available bid. No intent is required.
 - *Banging the Close* – Demonstrating intentional or reckless disregard for the orderly execution of transactions during the closing period.
 - *Spoofing* – Entering bids and offers with the intent to cancel before execution

Disruptive Trading Practices – CFTC Guidance

- CFTC's 2013 Disruptive Trading Guidance clarifies the following points on disruptive trading:
 - Prohibition applies only to trading subject to registered entity's rules (e.g., a DCM or SEF).
 - Not limited to registered entities with order books; also may apply to other trading functionalities.
 - Does not apply to either block trades or exchanges for related positions transacted in accordance with the rules of a DCM or SEF.

Disruptive Trading Practices – Violating Bids or Offers

- Either buying a contract at a price higher than lowest available price or selling a contract at a price lower than highest available bid.
- **No intent required** to establish violation.
- Does not create “best execution” standard across trading platforms but is confined to specific trading venue.
- Nor does prohibition make illegal “buying the board” (i.e., executing sequence of trades to buy all available bids or offers on an order book under facility’s rules).
- Does not apply to trades where a person is unable to violate a bid or offer (e.g., using an order matching algorithm).
- With respect to SEFs, only applies to order book trades and not other order execution methods (e.g., RFQs).
- Does not apply to non-cleared swap transactions, even if transacted on or through a registered entity.

Disruptive Trading Practices – Violating Bids or Offers

- Either buying a contract at price higher than lowest available price or selling a contract at a price lower than highest available bid.

CL

| Buy | Price | Sell |
|-----|-----------|------|
| | \$ 106.35 | 10 |
| | \$ 106.30 | 20 |
| | \$ 106.25 | 70 |
| | \$ 106.20 | 150 |
| | \$ 106.15 | 250 |
| | \$ 106.10 | 300 |
| | \$ 106.00 | |
| 300 | \$ 105.95 | |
| 250 | \$ 105.90 | |
| 150 | \$ 105.85 | |
| 70 | \$ 105.80 | |
| 20 | \$ 105.75 | |
| 10 | \$ 105.70 | |

Cannot buy these 10

Cannot sell these 10

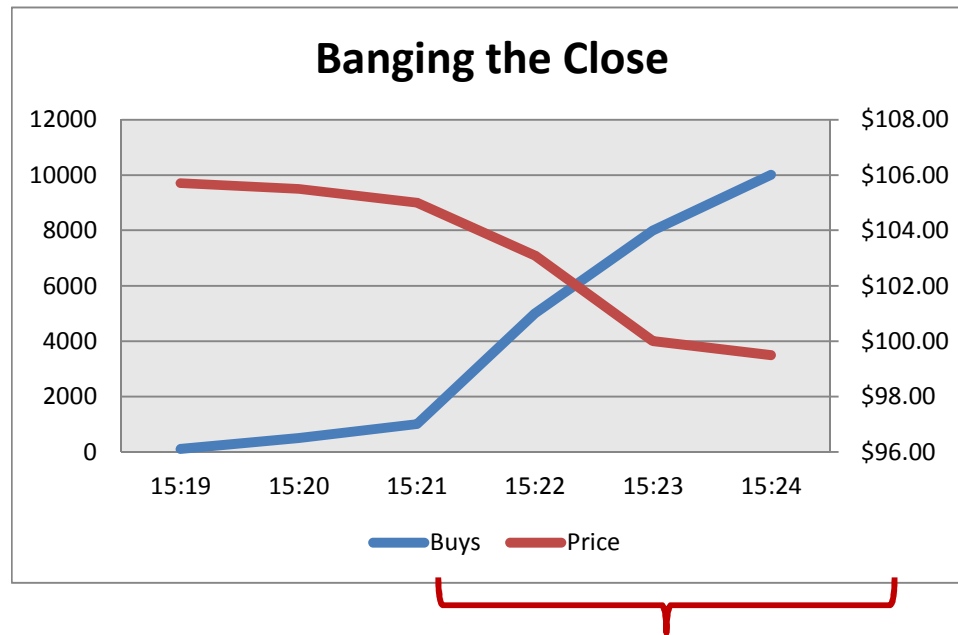
Disruptive Trading Practices – Banging the Close

- “Banging the close” – Disregard for the orderly execution of transactions
 - Requires intentional or reckless conduct.
 - “Closing period”: defined as period when daily settlement is determined under facility rules.
 - Violations can be based on any trading or conduct in closing period and is not limited to executed orders.
 - But, conduct outside closing period could cause investigation of potential CEA violations.

Disruptive Trading Practices – Banging the Close

- To determine whether there is an “orderly market,” CFTC will consider all relevant facts and circumstances, including:
 - Rational relationship between consecutive prices;
 - Strong correlation between price changes and the volume of trades;
 - Accurate relationships between the price of a derivative and the underlying physical commodity;
 - Levels of volatility that do not materially reduce liquidity; and
 - Reasonable spreads between contracts for near months and remote months.

Disruptive Trading Practices – Banging the Close



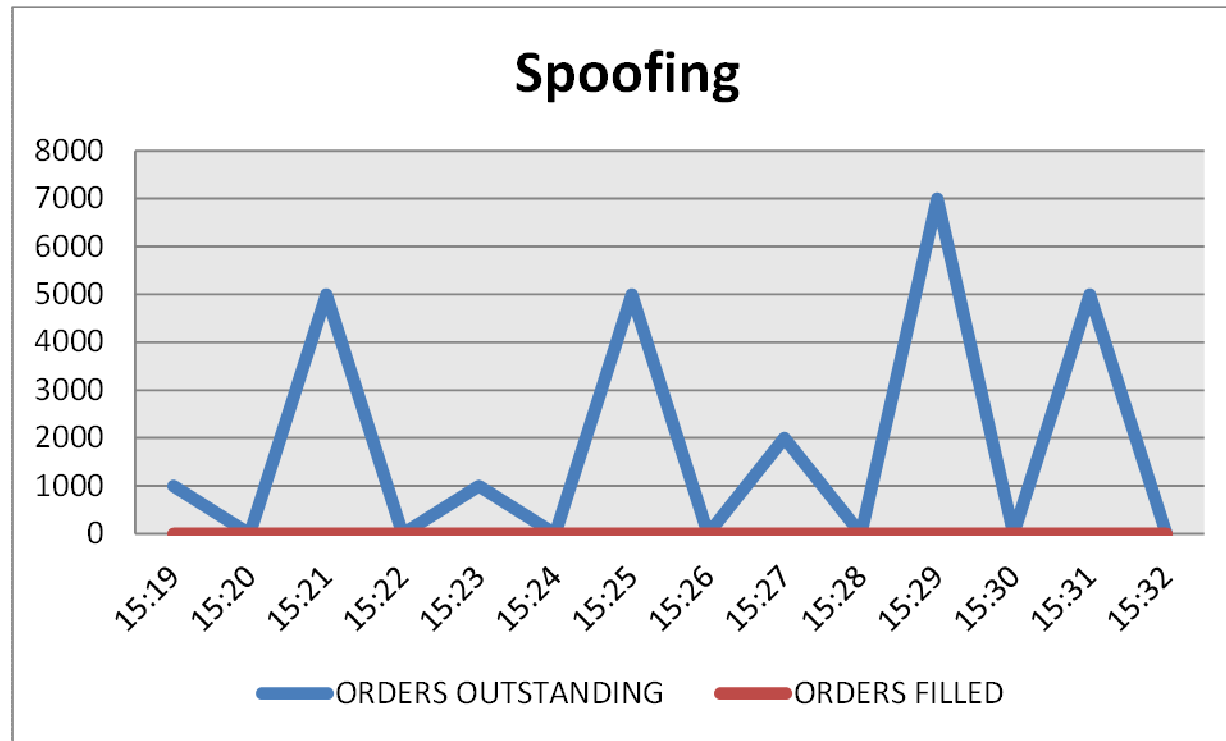
Closing Period

Disregard for the orderly execution of transactions during the closing period (commonly called “banging the close”)

Disruptive Trading Practices – Spoofing

- Spoofing – Submitting or cancelling bids or offers to (1) overload the quotation system of the registered entity, (2) delay another’s execution of trades, or (3) create an appearance of false market depth.
 - Requires specific intent to cancel bid or offer; reckless conduct or good-faith orders or cancellations do not constitute violation.
 - In distinguishing between legitimate trading and spoofing, CFTC will focus on the market context, the trader’s pattern of activity, and all other relevant facts and circumstances.
 - Covers bid and offer activity on all products traded on registered entities (not limited to order books).
 - Does not require a pattern of activity.

Disruptive Trading Practices – Spoofing



Bidding or offering with the intent to cancel the bid or offer before execution

Spoofing – CFTC Enforcement Cases

- ***CFTC v. Igor Oystacher and 3 Red Trading LLC*** (Dec. 20, 2016)
 - CFTC alleged that Oystacher engaged in “spoofing” in the futures market by placing large passive orders intended to be cancelled before execution to create false market depth and move the market price; CFTC further found that Oystacher then placed aggressive “flip” orders using a commercially available platform that allowed him to avoid matching his flip orders against his earlier spoof orders.
 - Oystacher and 3 Red settled with the CFTC on December 20, 2016. The defendants agreed to pay a \$2.5 Million civil money penalty and agreed to an independent monitor of its futures trading for 3 years and to employ certain compliance tools to all of its futures trading for 18 months.

Spoofing – CFTC Enforcement Cases

- CFTC Orders **Michael Coscia and Panther Energy Trading to Pay \$2.8 Million Penalty for Spoofing Numerous Futures Contracts and Imposed 1 Year Trading Ban (July 22, 2013).**
 - This was the CFTC’s first spoofing case.
 - The UK FCA, U.S. DOJ and CME also brought actions against Panther and Coscia; Coscia was criminally convicted in the U.S.

Position Limits and Reporting – CFTC Enforcement Cases

- CFTC Orders **Marubeni America Corporation** to Pay \$800,000 for Inaccurately reporting Multiple Grain Positions (Mar. 23, 2015)
 - Marubeni trades agricultural commodities, and uses futures contracts as a hedge, including futures required to be reported on Form 204.
 - Marubeni included both its fixed priced cash positions and its basis priced cash positions in its Form 204 reports when only fixed price cash positions are to be reported on Form 204.
- CFTC Orders Payment of Penalties Totaling \$665,000 by **Credit Suisse International** for Violating the Speculative Position Limit for Wheat Futures and by Credit Suisse Securities (USA) LLC for Submitting False or Misleading Information to the CFTC (Mar. 22, 2016).

Position Limits and Reporting – CFTC Enforcement Cases (cont'd)

- CFTC Orders **CHS, Inc.** and **CHS Hedging, LLC** to Pay \$1 Million for Inaccurately Reporting Positions in Corn and Soybeans (Mar. 9, 2016).
- CFTC Orders **Golden Agri International Pte Ltd.** to Pay \$150,000 for Failing to Report Cash Positions (July 11, 2016).
- CFTC Orders **Wells Fargo Bank, N.A.** to Pay a \$400,000 Penalty for Inaccurate Large Trader Reports for Physical Commodity Swaps Positions (Sept. 27, 2016).

CFTC Enforcement Environment

- Enhanced oversight and regulation in the context of an aggressive enforcement environment
- Frequent Market Surveillance Inquiries:
 - Special Calls
 - Specific Conduct
 - Large Trader and Position Accountability/Position Limits
- U.S. agency budgetary constraints result in lengthy investigations and high internal investigation expenses for market participants
- Parallel Investigations by multiple agencies
 - NFA, Exchanges and SEFs
 - Criminal Coordination (DOJ; FBI; State AGs)
 - Cross-agency Actions (CFTC; SEC; FERC; others)
 - Cross-border Actions (FCA; FINMA; JFSA; others)
- New Whistleblower provisions will result in higher volume of investigations
- Settlement or litigation in an environment where U.S. agencies and exchanges are looking for “example” cases

Global Compliance Recommendations

There is a greater risk of reputational harm and enforcement costs where compliance programs are not robust and adaptable to the overall international regulatory and enforcement environment.

- Conduct periodic training for relevant employees that covers:
 - Reporting to the CFTC and, as appropriate, International Agencies and Exchanges (e.g., FCA, FINMA, JFSA, etc.);
 - CFTC/Exchange rules and regulations relevant to status as a hedger and end-user;
 - Inappropriate trading conduct, e.g. wash trading, spoofing, insider trading, and how to detect it (where applicable);
 - Standards related to supervisory violations; and
 - Updates on significant regulatory developments, especially enforcement actions.

Global Compliance Recommendations (cont'd)

- Implement formal surveillance procedures for reviewing trading behavior to detect improper conduct.
- Design procedures to detect all improper conduct, not just improper conduct that would be detected from larger than usual trading volume.
- Review procedures on an annual basis and compare to recent Enforcement cases.
- Appoint and Train a person within the organization to be the point of contact for non-routine CFTC/Exchange inquiries.

Compliance: Sample Search Terms

| | | | |
|----------------------------|------------------------------|----------------------|-----------------------|
| allocate | arrest | artificial | bang |
| beat up / beat down | "between you and me" | call me on my mobile | CFTC |
| code of conduct | collude | compliance | congest |
| conspiracy | control | corner | criminal |
| crush | defend | disrupt | dominant |
| don't tell | do not report | drag | drive |
| false | FCA | fix | force up / force down |
| fraud | FSA | gouge | hammer |
| hide | illegal | liar | legal |
| manipulate | market manipulation | market power | mislead |
| move the market | off the record/off the books | personal email | policies or policy |
| power | pressure | private | prosecute |
| pummel | push | report you | reputational risk |
| rig | rip/rip off | risk/risk management | scam |
| scandal | secret | spike | spoof |
| squeeze/squeeze the market | subpoena | test | trading controls |
| trading guidelines | trading policies | unprofessional | withhold |

Key CFTC Enforcement Undertakings

- In recent CFTC cases there have been extensive undertakings incorporated as part of the settlement terms.
- Among the undertakings are the following:
 - Internal Controls and Procedures
 - Monitoring and Exception Reports
 - Periodic and Annual Audits
 - Trading and Risk Management Controls
 - Supervision and control system in connection with swaps trading activity
 - Weekly Reporting to CFTC Enforcement
 - Updated and Strengthened Policies and Procedures
 - System Enhancements

These undertakings should be regularly reviewed by market participants to enhance existing compliance programs and form a part of ongoing testing.

Whistleblower Provisions

- Dodd-Frank provides that, in any judicial or administrative actions brought by CFTC that result in monetary sanctions greater than \$1 million, CFTC shall pay an award of 10-30% of the collected monies to a whistleblower who provided information that led to successful enforcement.
- “Whistleblower” must be an individual(s), not an entity.
- Information must be voluntarily submitted before any request from CFTC.
- Information must be original:
 - Derived from independent knowledge
 - Not already known to CFTC (unless the whistleblower was “original source” of info)
 - Not derived from public information
- Information must lead to settlement or final judgment in favor of CFTC.

Whistleblower Provisions

- The following is relevant to CFTC's determination of the amount of award:
 - Significance of the information to the success of the judicial or administrative action;
 - Degree of assistance provided;
 - CFTC's programmatic interest in deterring CEA violations by making awards to whistleblowers;
 - Whether the award otherwise enhances CFTC's ability to enforce CEA, protect customers, and encourage submission of quality information; and
 - Potential adverse incentives from oversized awards.
- Whistleblowers are not obligated to report violation internally before reporting information to CFTC.

Exchange Rules Overview

- Exchange rules define allowable trading practices. Trading practice rules address the following:
 - Restrictions on discussions prior to trading (pre-execution/pre-arrangement).
 - Fraudulent and manipulative trading practices.
 - Position limits
 - Block Trades
 - Exchange for Related Positions (EFRPs)

Exchange Rules Overview

- Block Trades
 - A large transaction that is negotiated off an exchange's centralized trading facility and then executed on the exchange's trading facility
 - Must meet the minimum threshold, and price of block must be "on market."
 - Also, be aware that block trades must be reported within certain timeframe.
- EFRPs
 - A privately negotiated off-exchange execution of an Exchange futures or options contract and, on the opposite side of the market, the simultaneous execution of an equivalent quantity of the cash product, by-product, related product, or OTC derivative instrument corresponding to the asset underlying the Exchange contract.

Exchange Rules

- Exchange rules also address:
 - Exchange's enforcement authority and processes
 - Trader qualifications
 - Trade cancellations and price adjustments
 - Trading products

Exchange Enforcement

- CME recently amended its rulebook on enforcement and significantly increased potential penalties for rule violations. The changes include the following:
 - Business Conduct Committee Panels’ (“BCC Panel”) monetary sanctioning authority increased from \$1 million to \$5 million for each offense.
 - A BCC Panel may order a party to disgorge any monetary benefit from exchange rule violations.
 - A BCC Panel now may also require a party to pay out-of-pocket expenses incurred arising from “vexatious, frivolous or bad faith conduct” of such party during the course of an investigation or enforcement proceeding.

Exchange Enforcement (cont'd)

- A BCC Panel to prohibit a person from testifying in a subsequent hearing on a matter, if such person failed to appear at a scheduled interview or to answer all of the questions posed during that interview.
- A suspension or expulsion of a member includes the loss of such member's right to directly (or indirectly) access to the Globex platform or other exchange or facility owned or controlled by the CME Group.

Compliance Considerations – Risks for End-Users

- Position limits violations
- Reporting violations – Form 204, Form 40
- Recordkeeping violations
- Exchange of Futures for Physical
- Price manipulation and fraud-based manipulation – Kraft
- Insider trading



**WASHINGTON, DC REPORT:
CFTC CHANGES AND OUTLOOK FOR 2017**

Financial Regulatory Overview

- During the campaign and transition, President Trump has been a frequent critic of regulations, promising to get rid of “regulations that are just destroying us.”
- In the days following his election, Trump said he would “dismantle” Dodd-Frank.
- While it could be challenging for Trump to dismantle Dodd-Frank through legislation given the narrow majority the Republicans have in the Senate, Trump is putting into place nominees for financial regulatory agencies who have indicated they will rollback costly regulations.
 - Trump’s first executive order placed a halt on pending regulations, subject to review by the administration.

Financial Regulatory Overview (cont'd)

- The Financial CHOICE Act provides a potential roadmap Republicans may look to for legislative or regulatory changes.
 - The Financial CHOICE Act was passed out of the House Financial Services committee in September 2016 and proposed to:
 - alter the practices of the CFTC (Commissioner approval of no-action letters; notice and comment for guidance; rulemaking for cross-border application of swaps rules; judicial review of CFTC rules; SEC/CFTC rule harmonization);
 - significantly alter the mission and structure of the CFPB; and
 - allow large banks to escape from some of the more onerous capital and liquidity requirements (off-ramp for SIFIs and simple leverage ratio of 10%) that have been imposed in the wake of the 2008 financial crisis.
 - While the bill never came to a full House vote, it is likely to be reintroduced in some form this year.
- However, in January 2017, the House voted out legislation for the reauthorization of the CFTC, which includes limitations on the agency's ability to impose rules and requires the CFTC to analyze the costs and benefits of all new rules (see next slide).

CFTC Related Legislation

- The House of Representatives passed the Commodity End-User Relief Act (H.R. 238) on January 12, 2017. The bill includes a number of proposed changes to the Commodity Exchange Act such as:
 - Relief for end-users who use physical contracts with volumetric optionality (Sec. 307)
 - Swap dealer de minimis level set at \$8 billion; Commission rulemaking is required to change level (Sec. 308)
 - Rulemaking clarifying the cross-border regulation of derivatives transactions (Sec. 312)
 - Relief from swap rules for certain inter-affiliate transactions (Sec. 320)
- This bill has been sent to the Senate.

CFTC Overview

- The Commodity Futures Trading Commission (CFTC) regulates the derivatives market. This includes direct oversight of the facilities on which derivatives products are traded (designated contract markets and swap execution facilities) and market intermediaries (derivatives clearing organizations, swap dealers, futures commission merchants).
- The Dodd-Frank Act significantly expanded the CFTC's jurisdiction by giving it significant regulatory authority over swaps, which had previously been unregulated, as well as broad new enforcement powers.
- Current Commissioners:
 - Acting Chair – J. Christopher Giancarlo – Term ends April 2019
 - Sharon Y. Bowen (D) – Term ends April 2018
 - Timothy G. Massad (D) – Resigned as Chair effective January 20, transitioning out as a Commissioner
 - Vacancy
 - Vacancy

CFTC Outlook

- There are currently two vacant Commissioner spots.
- Commissioner Giancarlo was named Acting Chair when Chairman Massad stepped down on January 20, 2017. It is possible that Acting Chair Giancarlo could become the permanent Chair.
- The CFTC's outstanding regulatory priorities include finalizing rules on position limits (re-proposed 12/16), cross-border application of swaps rules, automated trading, swaps trading rules, and swap dealer capital requirements for non-banks.
 - The shape of these final rules, if issued under Acting Chair Giancarlo or under a permanent Republican Chair (whether Acting Chair Giancarlo or someone else) are likely to be significantly different from the proposals. In particular, as a Commissioner, Acting Chair Giancarlo dissented from the supplemental proposal to the automated trading rule.

CFTC Outlook

- Acting Chair Giancarlo has been a frequent critic of the CFTC's regulatory approach, urging a more market-oriented, flexible approach.
 - In 2015, he released a white paper proposing significant reforms to the CFTC's swaps regulations that would make those rules much more flexible and less prescriptive. In his recent speech at SEFCON VII, he signaled his intention to implement his white paper proposals as Acting Chair.
 - He has routinely stressed the importance of reducing regulatory burdens on market participants, including end-users.
 - He has consistently urged a more forward-thinking approach to regulation, accusing the CFTC of taking a 20th century approach to regulating 21st century markets.



BACKGROUND INFORMATION



Futures, Derivatives and Commodities – Representation of Diverse Market Participants



Swap Dealers and Financial Institutions

- Advise one of the top four swap dealers in the U.S. in a compliance review related to its swap dealer policies and procedures, including its policies related to the trading of swaps in all asset classes.
- Advise swap dealers on the CFTC's review of its comprehensive registration application, including revisions to policies and procedures and rules related to external business conduct and swap execution facilities.
- Advise several of the world's largest derivatives market participants, including a U.S. investment bank, on separate CFTC enforcement matters related to futures and swaps trading.
- Advise the principal of a commodity brokerage firm in regulatory issues related to a rogue trader.
- Advise a U.S. investment bank with international offices on the regulatory treatment of derivatives, including the CFTC's cross-border guidance.

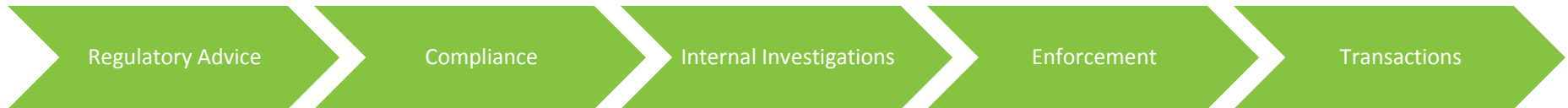
Asset Managers, Hedge Funds and Commodity/Corporate End-Users

- Advise one of the world's largest asset managers on compliance with margin for uncleared swaps rules.
- Advise multiple market participants on compliance with CFTC regulations, including policies and procedures related to futures and swaps trading.
- Conduct real-time and event-driven reviews of futures and swaps trading activity to verify compliance with internal policies and CFTC regulations, including position limits and other CFTC reporting.

Clearinghouses, Exchanges and Trading Platforms

- Advise European financial market infrastructure on potential acquisition of clearinghouse registered with the CFTC and European regulators.
- Advise multiple derivatives trading platforms on the application of the CFTC's core principles for swap execution facilities (SEFs) and designated contract markets (DCMs), including the regulatory implications of business requirements and operational and technology functions and the clearing services.
- Assist a global clearinghouse in its entry into the markets in China and India.
- Advise on the Principles of Financial Market Infrastructures (PFMIs) for central counterparties (CCPs) established by the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO).

Futures, Derivatives and Commodities – Diverse Practice Coverage



Cross-Border Regulatory Advice

- Cross-boarder practice with industry-based understanding of international commodity and derivatives markets.
- Expertise in the Dodd-Frank Act, U.S. regulations and international derivatives reforms, including EU Directives and Regulations.
- Extensive connectivity within the CFTC and other U.S. and international regulatory bodies.
- Assist with swap dealer and SEF analysis and registrations and ISDA documentation.

Compliance Policies and Programs

- Deep understanding of the compliance obligations of market participants, including swap dealers, hedge funds, asset managers and commercial end-users.
- Perform Compliance Reviews of market participant activities.
- Advise on policies and procedures to demonstrate compliance with domestic and international regulations and industry best practices.
- Develop tailored training programs based on civil and criminal enforcement trends.

Internal Investigations and Enforcement Actions

- Focused and rapid review of conduct based on enforcement and industry experience.
- Perform internal investigations and represent companies and employees.
- Part of the leading White Collar Practice in the U.S.
- Cross-agency actions (e.g., CFTC, SEC, DOJ, FERC, State Attorneys General).
- Cross-border actions (e.g., UK-FCA and SFO, France-AMF, Switzerland-FINMA, Japan-JFSA, Singapore-MAS).

Transactional Advice

- Advice on products and transactions involving the futures, commodities, and derivatives markets, including due diligence related to the regulatory implications of M&A transactions.
- Advice related to International Swaps and Derivatives Association documentation and collateral arrangements, prime brokerage agreements, derivative structuring for corporate treasury functions, insolvency issues and transactional due diligence.



Conclusion

Thank you for your attention.

Please use the “question” function on your webinar control panel to ask a question to the moderator or speakers.

Notes



Disclaimer

This presentation is not intended as legal advice. You should seek specific legal advice before acting with regard to the subjects mentioned herein.

© Copyright 2017 Covington & Burling LLP. All Rights Reserved

