

Bridging the Week by Gary DeWaal: July 29 – August 2, and August 5, 2019 (Parallel Spoofing Charges; UK Regulator’s Digital Asset Perimeter)

Article By:

Gary De Waal

Both the Commodity Futures Trading Commission and the Chicago Mercantile Exchange brought and settled charges against a CFTC-registered floor broker, claiming he engaged in spoofing trading activity on the CME. The two regulators’ charges largely echoed each other. Separately, the United Kingdom’s Financial Conduct Authority finalized guidance setting forth which cryptoassets and related activities are likely within its regulatory perimeter. As a result, the following matters are covered in this week’s edition of *Bridging the Week*:

- Alleged Spoofer Agrees to Pay US \$200,000 to Settle CFTC and CME Parallel Enforcement Actions (includes [My View](#));
- UK Chief Financial Conduct Regulator Provides Final Guidance on Interface Between Cryptoassets and UK Regulatory Perimeter (includes [My View](#)); and more.

Video Version:

Article Version:

Briefly:

- **Alleged Spoofer Agrees to Pay US \$200,000 to Settle CFTC and CME Parallel Enforcement Actions:** Both the Commodity Futures Trading Commission and the Chicago Mercantile Exchange brought and settled enforcement actions against Benjamin Cox, a CFTC-registered floor broker, claiming he engaged in spoofing trading activity on CME. The CFTC’s enforcement proceeding addressed Mr. Cox’s conduct from April 2014 through February 2018, while CME’s disciplinary action highlighted his alleged spoofing activity for a lesser period of time – June 2017 through February 2018.

The CFTC and CME each claimed that, during the relevant times, Mr. Cox entered “relatively” large bids or offers on one side of NASDAQ 100 and E-Mini S&P futures markets to encourage trading against smaller orders he placed on the other side of the markets. Both regulators claimed that Mr.

Cox placed his larger orders with the intent to terminate them before execution.

To resolve the enforcement matters, Mr. Cox agreed to pay the CFTC a fine of US \$150,000 and the CME a fine of US \$50,000. He also agreed to a three-month trading prohibition on all CFTC-registered trading facilities, and a three-week access ban on all CME Group trading facilities – a period that overlaps the CFTC's trading prohibition.

Unrelatedly, the CFTC brought and settled an action against Curtis Dalton d/b/a Binary International for acting as a futures commission merchant without being appropriately registered, and offering off-exchange options and swaps contrary to law. The CFTC said such options and swaps had to be traded on or subject to the rules of a designated contract market. The CFTC alleged that from approximately October 2013 through May 2016, Mr. Dalton – acting in the name of Binary International – offered to enter into, entered into, and confirmed the execution of off-exchange binary options with retail persons that permitted investors to make predictive trades on the direction of the price movement of certain foreign currencies over designated time periods. Mr. Dalton resolved his CFTC action by agreeing to pay a fine of US \$200,000 and never to solicit funds from any person for the purpose of trading commodity interests.

My View: Less than two months ago, the CFTC and the Chicago Board of Trade brought and settled parallel enforcement actions against Eagle Market Makers, Inc. for purportedly engaging in prohibited wash sales on multiple occasions during the pre-open trading periods of various agricultural futures products. Eagle agreed to pay US \$350,000 to resolve the CFTC matter and US \$150,000 to settle the CBOT matter.

At the time, I questioned the societal benefit of both the CFTC and the CBOT bringing parallel enforcement actions where all activity occurred on the CBOT and the CFTC and the CBOT charged Eagle with the same offense – wash sales. Additionally, the CBOT charged Eagle with failure to supervise.

Here, both the CFTC and CME charged Mr. Cox with spoofing, albeit the CFTC claimed that such conduct occurred for a longer period than the CME. However, both regulators relied on the same basic facts for their claims, and the time of trading prohibitions imposed by each regulator overlapped.

My thinking in June 2019 has not changed: “The CFTC has limited resources, and it is likely best that it restrict its enforcement activity to matters for which it has unique jurisdiction or a policy rationale to make a powerful statement. Where there is overlapping jurisdiction with [a self-regulatory organization], the CFTC should otherwise defer to the SRO’s handling of an enforcement matter.”

- **UK Chief Financial Conduct Regulator Provides Final Guidance on Interface Between Cryptoassets and UK Regulatory Perimeter:** The UK Financial Conduct Authority issued final guidance regarding how different types of cryptoassets likely fall within its regulatory perimeter and warning that persons conducting regulated activities typically must be authorized, unless exempt.

The FCA initially proposed its guidance in January 2019. (Click [here](#) for background in the article “UK Financial Conduct Authority Proposes Guidance to Help Classify Cryptoassets; Says Cryptocurrencies and Utility Tokens Generally Outside Regulatory Perimeter” in the January 27, 2019 edition of *Bridging the Week*.) The FCA’s final guidance was issued after it received input from over 65 respondents.

Generally, the FCA concluded that cryptoassets that do not provide rights or obligations typically associated with shares, debt instruments or electronic money are not within its regulatory reach. These digital assets typically include what the FCA terms “exchange tokens” or virtual currency in many jurisdictions (e.g., tokens used as a means of exchange but which are not recognized as legal tender). However, certain activities involving exchange tokens will soon be subject to anti-money laundering requirements in the UK.

The FCA said that stablecoins – which it regards as a different type of cryptoasset than an exchange token – are likely to be either regulated or unregulated depending on what rights or obligations a holder may have associated with ownership of such tokens. Generally, there are four types of stablecoins: fiat currency-backed; crypto-collateral-backed; asset-backed; and algorithmically stabilized. According to the FCA, depending on their structure, stablecoins backed by financial assets, physical assets or other cryptoassets might be regulated, if a token holder has any rights to the underlying assets or to payment or profits derived from the underlying asset. Otherwise, the stablecoin is likely unregulated, although soon, certain activities involving such tokens may also be subject to AML obligations in the UK.

Finally, the FCA said that cryptoassets akin to shares or debt instruments (i.e., security tokens) are likely within its regulatory perimeter, while digital tokens that are effectively “electronically stored monetary value” are likely subject to the UK’s e-money regime. Persons issuing their own security tokens are likely subject to prospectus, disclosure and other requirements, while other market participants transacting in security tokens and cryptoassets subject to e-money rules on behalf of others are likely subject to other requirements.

FCA provided many specific examples of characteristics of different cryptoassets and how they might be categorized in its guidance. The FCA also identified various potential market participants (e.g., wallet providers and custodians) and discussed how their activities involving different types of cryptoassets might bring them within the UK conduct regulator's oversight.

In other legal and regulatory developments involving cryptoassets:

- SEC Commissioner Urges Nonexclusive Safe Harbor for Issuers of Digital Assets: In a speech in Singapore, Securities and Exchange Commissioner Hester Peirce cautioned against international regulators adopting a single framework for cryptoasset regulation. She said that “[j]ust as states take different approaches and learn from one another in the U.S., crypto regulation affords international regulators the opportunity to learn from one another.” Although Ms. Pierce acknowledged that having different regulatory schemes “can create regulatory friction,” she claimed that different approaches also encourage “regulatory competition” which she considers healthy.
- Bank Fails to Have Lawsuit Dismissed Claiming It Improperly Reclassified Crypto Purchases as Cash Advances Without Adequate Disclosure: A federal court in New York declined to dismiss a putative class action lawsuit against Chase Bank USA, N.A. that claimed when the bank changed its policy of treating acquisitions of virtual currencies as being “purchases” to “cash advances” on its credit cards beginning in January 2018, it breached its contract with relevant customers. At the time of its change in policy, Chase also began to charge customers higher interest rates on balances and cash advance fees. The court held that it was a reasonable interpretation that the term “cash advances” solely applied to advances pertaining to real money, in which case plaintiffs’ claim was legitimate; Chase had argued that “cash advances” should be more broadly construed to apply to anything that acts as a

medium of exchange. Nonetheless, the court dismissed a separate claim by plaintiffs that, under law, they were entitled to advance notice of a change in the terms of their contract when Chase began first construing their virtual currency purchases as “cash advances.” The court held that Chase, by solely varying its interpretation, did not change a term of a contract. (Click [here](#) for background regarding the initial lawsuit against Chase in the article "Bank Agues Cryptocurrencies Just Like Money to Justify Charging Cash Advance Fees" in the November 11, 2018 edition of *Bridging the Week*.)

My View: The FCA’s final guidance on which cryptoassets fit within its regulatory perimeter provides a succinct exposition of the different types of cryptoassets, and provides useful insight into how they might or might not fit within the regulator’s remit. In many cases, the FCA provides alternative examples of characteristics of a cryptoasset that are critical to such a determination in the form of “case studies” and concludes with a clear statement of the FCA’s legal conclusion (e.g., a token is likely regulated or unregulated).

To date, in the United States, the Securities and Exchange Commission has taken a different route in explaining its thinking regarding cryptoassets that might constitute securities and be within its regulatory remit and market participants whose activities handling such cryptoassets might implicate regulatory requirements. The SEC has generally offered high level advice, e.g., in the form of a so-called “Report of Investigation,” or a “Framework” for investment contract analysis. However, other than in two no action letters and multiple enforcement actions, the SEC has not provided insight into its thinking as applied to specific factual circumstances. It would be helpful for the SEC to issue a document like the FCA’s final guidance that not only provides its high level thinking, but its views as applied to various specific factual circumstances.

(Click [here](#) for background regarding the SEC staff’s views in the article “SEC Staff Outlines Characteristics of Cryptoassets That Could Cause Them to Be Regarded as Securities” in the April 7, 2019 edition of *Bridging the Week*.)

More Briefly:

- **Issuing Position Limits Rules Among New CFTC Chairman’s Top Priorities:** In an opinion article published on FOXBusiness, Heath Tarbert, the new chairman of the Commodity Futures Trading Commission, indicated that issuing the CFTC’s “long-awaited” position limits rules is a top priority. However, he indicated, the “[t]rick will be making sure these rules do not strip [derivatives] markets of the flexibility needed to perform their fundamental risk management function.” Dr. Tarbert also indicated that supervising clearinghouses, developing a holistic framework for virtual currencies, and protecting confidential trading data will be other key priorities of the Commission. Additionally, he expressed a desire for “reinvigorating” the CFTC’s “historical principles-based approach” to regulation.
- **Broker-Dealer Sanctioned US \$1.25 Million for Failure to Conduct Background Checks on Over 10,000 Non-Registered Persons Over Seven Years:** Citigroup Global Markets Inc. agreed to pay a fine of US \$1.25 million to settle charges brought by the Financial Industry Regulatory Authority that, from January 2010 through May 2017, it failed to conduct timely or adequate background checks on approximately 10,400 of its non-registered personnel. As a result, the firm could not assess whether such persons were statutorily disqualified from associating with CGMI. Additionally, FINRA claimed that CGMI failed to fingerprint at least 520 non-registered associated persons, as required until after they commenced working for the firm, and could not find documents confirming fingerprinting of an additional 520 persons. FINRA also alleged that the firm failed to maintain adequate written supervisory procedures to screen non-registered associated persons for potential statutory disqualifications. In settling, FINRA acknowledged CGMI’s efforts to identify and fix its practices regarding non-registered employees prior to the regulator’s intervention, and CGMI’s proactive cooperation.
- **Position Limits Disaggregation Relief Expiration Date Extended by CFTC:** The Commodity Futures Trading Commission’s Division of Market Oversight extended relief

granted in 2017 from a Commission regulation that requires certain persons otherwise required to aggregate their futures and related options positions with those of certain other affiliated persons for CFTC position limit purposes to file a notice of an available exemption from such requirement prior to relying on the exemption. Under the relief, a person may act on an eligible exemption without an advance filing, but must file a notice within five business days after being requested to do so by the Commission or a designated contract market. The next expiration of the no-action relief is August 12, 2022. Without the extension, the relief would have expired on August 12, 2019. (Click [here](#) for background on the relief in the article “CFTC Suspends Advance Notice Filing Requirement to Perfect Disaggregation Relief for Position Limit Calculation Purposes” in the August 13, 2017 edition of *Bridging the Week*.)

- **CFTC Insider Trading Enforcement Action Against Block Trade Execution Firm Transferred From New York to Texas:** A federal court in New York granted EOX Holdings’ and Andrew Gizienski’s motion to transfer an enforcement action brought by the Commodity Futures Trading Commission to a federal court in Texas. The court held that since most of the alleged misconduct by Mr. Gizienski on behalf of EOX occurred in Houston, and the defendants and most of the witnesses, including EOX employees, work and live in Houston, the transfer of the litigation to a federal court in Texas was warranted. In September 2018, the CFTC charged EOX, a Commission-registered introducing broker, and one of its associated persons, Andrew Gizienski, for illegally sharing their clients’ trading information with one customer, as well as impermissibly trading the one customer’s account on a discretionary basis relying on other clients’ trading information. (Click [here](#) for background in the article “Introducing Broker and Associated Person Charged by CFTC With Insider Trading” in the September 30, 2018 edition of *Bridging the Week*.)

For further information:

Alleged Spoofers Agree to Pay US \$200,000 to Settle CFTC and CME Parallel Enforcement Actions:

- Cox:

CFTC:
<https://www.cftc.gov/media/2311/enfbenjamincoxorder073119/download>
CME:
<https://www.cmegroup.com/notices/disciplinary/2019/07/CME-18-0896-BC-BENJAMIN-COX.html#pageNumber=1>
- Dalton:
<https://www.cftc.gov/media/2306/enfcurtisbinaryinternationalorder072919/download>

Bank Fails to Have Lawsuit Dismissed Claiming It Improperly Reclassified Crypto Purchases as Cash Advances Without Adequate Disclosure:

[/ckfinder/userfiles/files/Tucker%20v_%20Chase%20Bank%20MtD%20Opinion.pdf](#)

Broker-Dealer Sanctioned US \$1.25 Million for Failure to Conduct Background Checks on Over 10,000 Non-Registered Persons Over Seven Years:

http://www.finra.org/sites/default/files/Citigroup_AWC_072919.pdf

CFTC Insider Trading Enforcement Action Against Block Trade Execution Firm Transferred From New York to Texas:

[/ckfinder/userfiles/files/CFTC%20v_%20EOX%20MtoTransfer.pdf](#)

Issuing Position Limits Rules Among New CFTC Chairman's Top Priorities:

<https://www.foxbusiness.com/financials/why-the-cftc-is-the-most-important-regulator-youve-never-heard-of>

Position Limits Disaggregation Relief Expiration Date Extended by CFTC:

<https://www.cftc.gov/csl/19-19/download>

SEC Commissioner Urges Nonexclusive Safe Harbor for Issuers of Digital Assets:

<https://www.sec.gov/news/speech/speech-peirce-073019>

UK Chief Financial Conduct Regulator Provides Final Guidance on Interface Between Cryptoassets and UK Regulatory Perimeter:

<https://www.fca.org.uk/publication/policy/ps19-22.pdf>

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