

CFTC Whistleblower Reward Program: What Violations Qualify for an Award?

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The CFTC's recent announcement that it is paying a whistleblower a [\\$200 million award](#) for providing information about wrongdoing concerning the manipulation of [financial benchmarks](#) used by global banks is likely to spur more whistleblowers to assist the CFTC in identifying and combating violations of the Commodity Exchange Act (CEA) and CFTC regulations. While many of the violations that result in SEC enforcement actions are commonly known (e.g., lying about earnings, running a Ponzi scheme, engaging in insider trading, etc.), the enforcement work of the CFTC is less known but no less vital.

Indeed, insufficient regulation and policing of the swaps derivatives markets led to the financial crisis that by some estimates [cost the U.S. \\$20 trillion](#). In particular, credit default swaps in the mortgage market that were supposed to protect against the decline in the value of collateralized debt obligations backed by subprime loans proved worthless. In the prescient words of Warren Buffet in the 2002 annual report of Berkshire Hathaway, derivatives became "financial weapons of mass destruction." To avert another financial crisis, Congress enacted the Dodd-Frank Act, which among other things, significantly expanded the role of the CFTC in policing the derivatives markets. Some of the reforms designed to promote market integrity and increase transparency include:

- requiring the registration and comprehensive regulation of swap dealers;
- imposing clearing and trade execution requirements on derivatives;
- creating recordkeeping and real-time reporting regimes; and
- expanding the CFTC's enforcement authority.

In addition to policing derivatives, the CFTC's Division of Enforcement combats fraudulent commodity futures trading, price manipulation, corrupt practices, misappropriation of confidential information, trade allocation schemes, mismarking, and illegal off-exchange activity. A prime example of CFTC enforcement activity is the enforcement action for which a whistleblower

received a \$200 million award. In April 2015, Deutsche Bank agreed to pay [\\$800 million](#) to settle charges that its traders manipulated the LIBOR and Euribor to benefit cash and derivatives trading positions that were priced off of these benchmarks.

Where a whistleblower provides original information to the CFTC that leads to a successful enforcement action in which the CFTC imposes more than \$1 million in monetary sanctions, the whistleblower will receive an award of between 10% and 30% of the total monetary sanctions collected. In determining a whistleblower's award percentage, the CFTC considers the particular facts and circumstances of each case. For example, positive factors that may increase a whistleblower's award percentage include the significance of the information, the level of assistance provided by the whistleblower and the whistleblower's attorney, and the law enforcement interests at stake. If **represented by counsel**, a whistleblower may submit a tip anonymously to the CFTC and remain anonymous, even to the CFTC, until an award determination.

Violations that Qualify for a CFTC Whistleblower Award

The largest CFTC whistleblower awards to date are \$200 million, \$45 million, and \$30 million. The main types of violations that may qualify for a CFTC whistleblower award include:

Spoofing

Spoofing is a form of market manipulation where traders artificially inflate the supply and demand of an asset to increase profits. Traders engaged in spoofing typically place a large number of orders to buy or sell a certain stock or asset without the intent to follow through on the orders. This deceptive trading practice leads other market participants to wrongly believe that there is pressure to act on that asset and "spoofs" other participants to place orders at artificially altered prices.

Spoofing affects prices because the artificial increase in activity on either the buy or sell side of an asset creates the perception that there is a shift in the number of investors wanting to buy or sell. Spoofers place false bids or offers with the intent to cancel before executing so that they can then follow through on genuine orders at a more favorable price. Often, spoofers use automated trading and algorithms to achieve their goals. According to a [CFTC alert](#) on spoofing related to CEA violations, the CFTC is concerned with conduct such as:

- manual and automated trading schemes that place and quickly cancel bids and offers in futures contracts in order to benefit other orders and/or positions;
- orders being quickly placed and canceled at or near the best bid or offer, especially if opposite-side orders are filled;
- multiple orders of the same size repeatedly and simultaneously being placed and canceled; and
- any scheme designed to cause prices to artificially move.

Examples of CFTC spoofing enforcement actions include:

- In November 2019, the CFTC imposed [\\$67.4 million in sanctions against Tower Research Capital LLC](#), a proprietary trading firm, arising from a manipulative and deceptive scheme. On

thousands of occasions, three former Tower traders placed orders to buy or sell futures contracts with the intent to cancel those orders prior to execution. The traders often used an order splitter to enter several smaller, randomly-sized orders in an attempt to obscure their scheme from other market participants. According to a CFTC [press release](#), “[t]he traders engaged in this scheme to induce other market participants to trade against their genuine orders—by intentionally sending a false signal to the market that they wanted to buy or sell the number of contracts specified in the spoof orders and creating a false impression of supply or demand—so that the genuine orders would fill sooner, at better prices, or in larger quantities than they otherwise would.”

- In August 2021, a federal jury convicted Edward Bases and John Pacilio, two former Merrill Lynch traders, for engaging in a multi-year fraud scheme to manipulate the precious metals market. According to a [press release](#) announcing the action, the two traders fraudulently pushed market prices up or down by routinely placing large “spoof” orders in the precious metals futures markets that they did not intend to fill. After manipulating the market, Bases and Pacilio executed trades at favorable prices for their own gain, and to the detriment of other traders. The DOJ’s [Indictment](#) detailed how Bases and Pacilio discussed their intent to “push” the market through spoofing in electronic chat conversations.
- In September 2020, JPMorgan Chase & Co. agreed to pay disgorgement of \$920 million in parallel actions brought before the CFTC, DOJ, and the SEC alleging engaging in manipulative trading of U.S. Treasury securities. According to the SEC’s [order](#), certain traders on J.P. Morgan Securities’ Treasuries trading desk placed genuine orders to buy or sell a particular Treasury security, while nearly simultaneously placing spoofing orders, which the traders did not intend to execute, for the same series of Treasury security on the opposite side of the market. The spoofing orders were intended to create a false appearance of buy or sell interest, which would induce other market participants to trade against the genuine orders at prices that were more favorable to J.P. Morgan Securities than J.P. Morgan Securities otherwise would have been able to obtain.

Corrupt Practices

Although the SEC and DOJ are responsible for enforcing the FCPA, the CFTC can take enforcement actions to combat violations of the CEA connected to corrupt practices, including bribes or kickbacks paid to improperly influence government officials in connection with regulated activities such as trading, advising, or dealing in swaps or derivatives. As explained in a March 6, 2019, [CFTC Enforcement Advisory](#) and [public remarks by Director of Enforcement James M. McDonald](#) at the ABA’s National Institute on White Collar Crime, the CFTC’s anti-fraud authority permits it to police foreign bribes where violations of the CEA carried out through foreign corrupt practices. McDonald explained:

Companies and individuals engaging in foreign corrupt practices should recognize that this sort of misconduct might constitute fraud, manipulation, false reporting, or a number of other types of violations under the CEA, and thus be subject to enforcement actions brought by the CFTC. Bribes might be employed, for example, to secure business in connection with regulated activities like trading, advising, or dealing in swaps or derivatives. Corrupt practices might be used to manipulate benchmarks that serve as the basis for related derivatives contracts. Prices that are the product of corruption might be falsely reported to benchmarks. Or corrupt practices in any number of forms might alter the prices in commodity markets that

drive U.S. derivatives prices. We currently have open investigations involving similar conduct.

In December 2020, the CFTC exercised that authority by imposing a [\\$95 million civil penalty](#) to settle charges against Vitol Inc, for manipulative and deceptive conduct involving foreign corruption and physical and derivatives trading in the U.S. and global oil market. The CFTC found that “Vitol committed fraud by making corrupt payments (e.g., bribes and kickbacks) to employees and agents of certain state-owned entities (SOEs) in Brazil, Ecuador, and Mexico to obtain preferential treatment and access to trades with the SOEs to the detriment of the SOEs and other market participants.” The corrupt payments were concealed by funneling them through offshore bank accounts or to shell entities, and at times, issuing deceptive invoices for purported “market intelligence” or “sell support.” The objective of these illicit payments was to secure unlawful competitive advantages in trading physical oil products and derivatives.

Trading on Material Nonpublic Information

The Dodd-Frank Act expanded the CFTC’s authority to police misappropriation of confidential information and insider trading in commodities markets. Similar to the SEC’s Rule 10b-5, CFTC Rule 180.1 prohibits manipulative and deceptive devices, i.e., fraud and fraud-based manipulative devices and contrivances employed intentionally or recklessly, regardless of whether the conduct in question was intended to create or did create an artificial price.

The fraud or manipulation must be in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity. Examples of prohibited trading include:

- trading on material nonpublic information (MNPI) that was obtained by fraud or deception;
- trading on market-moving information that the source had a duty to protect;
- brokers front running customer orders or taking the other side of any customer order without consent; and
- improperly disclosing MNPI or using MNPI provided by a counterparty without the counterparty’s consent.

An example of the CFTC enforcing its prohibition against the misappropriation of MNPI is a September 29, 2016 enforcement taken against Jon P. Ruggles for engaging in fraudulent, fictitious, and non-competitive trades in crude oil and heating oil futures and options and RBOB gasoline futures on the NYMEX. The [CFTC’s order settling the charges](#) requires Ruggles to disgorge ill-gotten gains totaling \$3,501,306, imposes a civil monetary penalty of \$1.75 million, and permanently bans him from trading and registering with the CFTC. Ruggles, who was responsible for developing his former employer’s fuel hedging strategies and for executing the employer’s trades in certain NYMEX products, misappropriated the employer’s trading information for his own benefit in personal accounts that he controlled.

Benchmark Rates Manipulation

In a benchmark-rate-manipulation scheme, individuals seek to increase or decrease impartial global reference rates for their own financial gain. This misconduct is typically associated with the U.S. Dollar International Swaps and Derivatives Association Fix (USD ISDAFIX), benchmark-swap rates, LIBOR, Euribor, and other foreign interest-rate benchmarks.

On May 25, 2016, the [CFTC ordered Citibank to pay \\$250 million](#) for attempted manipulation and false reporting of USD ISDAFIX benchmark-swap rates. According to a CFTC [press release](#), Citibank traders “attempted to manipulate and made false reports concerning the USD ISDAFIX by skewing the Bank’s USD ISDAFIX submissions . . . in order to benefit the Bank’s trading positions at the expense of its derivatives counterparties.” The CFTC uncovered [numerous instances](#) of Citibank’s USD ISDAFIX misconduct through the bank’s exotic traders’ instant messages. In March 2008, one of Citibank’s exotics traders stated in separate instant messages to other market participants that “[I] moved the screen btw” and “[I] moved the screen to 183 on 2s10s...[One of Citibank’s swaps traders] is pretty good at it,” and “[I] push the 2s10s swap on the screen to 183.4, very proud of myself.”

Whistleblowers Will Continue to Drive Increased CFTC Enforcement Activity

The FY20 reports of the [CFTC Whistleblower Program](#) and [CFTC Division of Enforcement](#) reveal that the CFTC Whistleblower Program continues to grow and is helping to drive record-level enforcement activity. The Division of Enforcement reported a total of \$1,327,869,760 in monetary relief ordered—the fourth-highest total in CFTC history, the third straight year-over-year increase, and the second straight year in excess of \$1 billion. Approximately 30 to 40% of the CFTC’s ongoing investigations now involve some whistleblower component. Since the inception of the CFTC Whistleblower Program, CFTC enforcement actions associated with whistleblower awards have resulted in sanctions orders totaling more than \$3 billion. In light of the CFTC’s recent whistleblower award of \$200 million, whistleblowers will continue to play a pivotal role in enabling the CFTC to carry out its vital enforcement mission.

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