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Bridging the Week: January 30 to February 3 and February 6, 2017 (Making Regulation Great Again; Fraud-Based Manipulation; AML)

Article By:

Gary De Waal

President Donald Trump began to follow through on his campaign promise to reduce the quantity of all federal regulations and took initial steps to ensure that laws and regulations impacting financial services conform to his so-called "core principles" of effective regulation. Taking these steps appears to be the first salvo in an attack against the Dodd-Frank Wall Street Reform and Consumer Protection Act. In addition, apparently at the Commodity Futures Trading Commission's request, CME Group updated one of its rules to mirror the CFTC's fraud-based manipulation rule. As a result, the following matters are covered *this week*:

- Making Regulation Great Again: President Trump Requires Loss of Two Regulations for Every New One and Orders Review of All Financial Services Laws and Rules;
- CME Group Implements Some New Offenses and Makes Technical Amendments to Globex Access Restrictions Rule
- Broker-Dealer Agrees to FINRA Sanction for Miscalculating Rates of Margin Loans to Customers;
- International Bank Fined Over US $625 Million for AML Violations by UK FCA and New York State;
- FCM Resolves CME Clearing House Risk Committee Charge of Failing to Have BCP Procedures; and more.

Video Version:

Article Version

Briefly:

- **Making Regulation Great Again: President Trump Requires Loss of Two Regulations for Every New One and Orders Review of All Financial Services Laws and Rules**: Last week, through the issuance of two executive orders, President Donald Trump began to follow through on his campaign promise to reduce the quantity of all federal regulations and took initial steps to consider the effectiveness of laws and regulations impacting the financial services industry. The first executive order, issued on January 30, requires that, for the remainder of fiscal year 2017, all federal agencies identify at least two existing regulations for repeal whenever they propose or promulgate a new regulation. Moreover, the sum of the incremental costs of any new regulations and repealed regulations must not exceed zero. To assist agencies in implementing this requirement, the Director of the Office of Management and Budget was instructed to provide guidance to help standardize the measurement and forecast of costs and to determine what constitutes a new and offsetting regulation. For future fiscal years, the Director of OMB will tell agencies the amount of incremental costs they each will be allowed in implementing new requirements and repealing old ones. Independent agencies, like the Commodity Futures Trading Commission, do not appear formally covered by this executive order, but may nonetheless voluntarily apply its mandates. Separately, on February 3, President Trump ordered the Secretary of the Treasury to consult with the heads of member agencies of the Financial Stability Oversight Council, which includes, among others, the CFTC and the Securities and Exchange Commission, to assess whether any current laws and regulations are inconsistent with certain enumerated "core principles" for the optimal regulation of financial services. This appears to be a first step in a potential dismantling of all or some provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which the White House has termed "a disastrous policy that's hindering our markets, reducing the availability of credit, and crippling our economy's ability to grow and create jobs." (Click here to access statements made by

Press Secretary Sean Spicer on February 3.) According to the President, optimal regulations should, among other things, "empower Americans to make independent financial decisions and informed choices in the marketplace;" avoid taxpayer-paid bailouts; promote "economic growth and vibrant financial markets through more rigorous regulatory impact analysis"; make sure American companies are competitive with foreign firms and "restore public accountability within Federal financial regulatory agencies and rationalize the Federal financial regulatory framework." The Treasury Secretary is required to report back to the President with his initial findings by June 3. (The US Senate has not yet confirmed President Trump's nominated Treasury Secretary, Steven Mnuchin.)

My View: It is healthy every so often to look back and evaluate the effectiveness of previously adopted laws and regulations. President Ronal Reagan ordered such a review promptly after becoming president in 1981, and President Trump has ordered a similar review now. (Click here to access President Reagan's equivalent executive order.) For the nation as a whole, this review might result in lesser regulation that could result in greater economic growth. For the financial services industry, such a review might result in the rollback of all or some of the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act — including the so-called Volcker Rule — which in retrospect, may have constituted a too hasty and too broad response to the 2007-2008 financial crisis. Hopefully, however, the evaluative process does not become too politicized and regulations previously adopted for legitimate reasons are not eliminated wholesale. We, as a nation, cannot ignore, for example, that the financial crisis of 2007-2008 caused real suffering for many Americans. At its core, this crisis was caused by the over-extension of credit to under-qualified persons buying homes and for other purposes, and by the packaging of their debt into more and more exotic financial instruments that were not well understood or adequately overseen. For sure, the imposition of a myriad of new requirements under Dodd-Frank – including many that had nothing to do with the financial crisis (e.g., amendments to the Commodity Exchange Act regarding position limits) – was too severe and some of these provisions should be adjusted. But many requirements – including the obligation to report swaps transactions to impartial trade repositories to provide better transparency and to impose registration and certain conduct requirements on swap dealers – are sensible measures that will help prevent another similar meltdown. Hopefully, the review of regulations generally and financial services laws and regulations in particular (especially Dodd-Frank) ordered by President Trump will engender thoughtful reflection and result in just the right amount of revisions and not overkill.

- **CME Group Implements Some New Offenses and Makes Technical Amendments to Globex Access Restrictions Rule**: CME Group amended its General Offenses rule for each of its designated contract markets and the Swap Execution Facility Division of the Chicago Mercantile Exchange to add provisions that mirror language in a Commodity Futures Trading Commission rule that prohibits fraud-based manipulation. Under CME Group Rule 432, it will now be prohibited "to intentionally or recklessly use or employ or attempt to use or employ, any manipulative scheme, or artifice to defraud." In addition, attempts to engage in fraud or bad faith as well as attempts "to deliver or cause to be delivered false, misleading or inaccurate information concerning crop or market information or conditions" that may impact the price of any of the CME Group exchanges' futures or options prices are now prohibited – as opposed to, under prior rule, solely actual engagement or delivery. According to CME Group, these rules amendments were made "[a]t the request of the Commission. Separately CME Group also enacted various seemingly technical amendments to its rules for each of its DCMs and its SEF related to Globex access restrictions. Absent CFTC objection, all amended CME Group rules will be effective February 16.

Compliance Weeds: Although the amendments to the CME Group rule regarding

Globex access restrictions seem non-substantive, holistic review of the amended rule is important as the revised provision appears to have expanded somewhat the existing obligations and potential liability of clearing members in connection with customers they guarantee. Among other things, a clearing member must now assist a CME Group investigation into any potential violation of its rules by "requiring any Person to produce documents, to answer questions from the Exchange, and/or to appear in an investigation" (emphasis added). The definition of Person appears to be broad enough to include not only the clearing member's customer (as the rule currently references), but also its customer's employees and agents. As before, if a clearing member has "actual or constructive notice" of a violation of an exchange's rules in connection with a direct access customer and it fails to take "appropriate action" the clearing member "may be found to have committed an act detrimental to the interest or welfare of the Exchange."

- **Broker-Dealer Agrees to FINRA Sanction for Miscalculating Rates of Margin Loans to Customers**: Edward Jones, a broker-dealer registered with the Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority, agreed to pay a fine of US $150,000 to resolve charges that it failed to correctly aggregate related accounts of some of its customers to apply a discounted rate for margin loans available to larger accounts. According to FINRA, beginning in January 2014, Edward Jones based rates for margin loans on the total value in a customers' "relationship pricing group"; this included the customer's accounts and those of related parties. Typically the more assets in a customer's relationship pricing group, the lower margin loan rate it would be charged. However, claimed FINRA, Edward Jones's computer system only aggregated accounts that were mailed together to determine members of a relationship-pricing group, as opposed to accounts that were more broadly related. As a result, charged FINRA, from January 2014 through January 2016, 6,127 owners or accounts were overcharged US $708,000 – although the firm has since reimbursed this amount plus interest to the affected customers. FINRA claimed that this error by Edward Jones resulted from a failure of supervision in that the firm did "not test its automated system for grouping accounts for the assignment of interest rates on margin loans," among other reasons. Edward Jones did not admit or deny FINRA's findings in agreeing to its settlement.

My View: The Commodity Futures Trading Commission recently brought and settled a case grounded on a failure to supervise theory against JP Morgan Securities, a Commission-registered futures commission merchant, claiming that the firm failed to "diligently" supervise its staff when the firm did not remit exchange fee rebates totaling US $7.8 million to relevant customers from 2010 to 2014. The CFTC claimed this was because the firm did not have, during the relevant time, automated systems to reconcile its exchange and clearing fees and utilized solely one employee to perform its fee reconciliation process. (Click here for further details regarding this enforcement action in the article "FCM Agrees to Settle With CFTC Related to Purported Exchange Fees Overcharges") Unlike FINRA's charges against Edward Jones that derived from the firm's alleged misapplication of its own rules and failure to catch its own mistake, the CFTC's charges against JP Morgan related to the assessment of exchange and clearing fees that the CFTC conceded were "typically complicated because of the myriad applicable rates, surcharges and fee structures." The CFTC said that JP Morgan's failure to supervise derived from its purported failure to catch its error through a reconciliation process. This seems like quite a stretch, but in any case, rather than bring enforcement actions against FCMs for managing the best they can with a very broken process, the CFTC should encourage exchanges to institute less complicated fee and discount structures and implement tools to help firms conduct reconciliations more easily and reliably.

- **International Bank Fined Over US $625 Million for AML Violations by UK FCA and New York State**: Deutsche Bank AG agreed to pay sanctions of slightly more than GB £163 million (approximately US $203 million) to the UK Financial Conduct Authority and US $425 million to the New York State Department of Financial Services to resolve charges that it failed to follow applicable anti-money laundering requirements when it allowed unknown customers to use its Moscow, London and New York offices to move approximately US $1o billion from Russia to offshore bank accounts. The action brought by the NYS DFS also named Deutsche Bank's New York branch. According to the NY DFS, between 2011 and early 2015, corporate clients of DB Russia on multiple occasions purchased Russian blue chip stocks, paying rubles, while shortly afterwards, a related entity (including a number of entities registered in Cyprus or the British Virgin Islands) sold the identical stock in London and was paid US dollars. However, claimed the FCA, the Moscow-side customers "had a number of high risk characteristics that were not categorized as high risk by Deutsche Bank" and insufficient

information was obtained by the firm "to ensure that appropriate due diligence was performed" on London-side customers. As a result, said FCA, DB was not able to assess whether there were connections between the Moscow-side and London-side customers. This helped facilitate potential money laundering by the DB customers, charged the regulators. All the US dollar transactions flowed through Deutsche Bank Trust Company, a subsidiary of the bank's NY branch, alleged the NYS DFS. Both FCA and the NYS DFS claimed that flaws in the bank's know your customer policies and procedures, insufficient compliance and internal audit resources, lack of an automated AML system to detect suspicious trades, and a number of missed red flags, all contributed to the bank's failure to timely detect the suspicious transactions. DB began an internal investigation of the suspicious trading in March 2015 and self-reported its initial findings to FCA and the NYS DFS. As part of its settlement with NYS DFS, DB also agreed to the appointment of an independent monitor to review its AML policies and procedures.

- **FCM Resolves CME Clearing House Risk Committee Charge of Failing to Have BCP Procedures**: On January 27, the CME Group Clearing House Risk Committee publicized four disciplinary actions that were settled by clearing members. In one action, Nanhua USA LLC agreed to pay a fine of $50,000 to resolve charges that it failed comply with a Chicago Mercantile Exchange, Inc. requirement that it maintain business continuity policies and procedures that include certain enumerated elements. Among other things, clearing members are required to periodically test their disaster recovery and business continuity plans; duplicate "critical systems" at back-up locations; and periodically back-up "critical information." Separately, SG Americas Securities LLC consented to remit a fine of US $50,000 for violating a CME rule related to the retention and making available of certain books and records, while R.J. O'Brien & Associates, LLC and CHS Hedging LLC agreed to pay fines for financial offenses. None of the four entities admitted or denied any rule violation on which a sanction was based.

Compliance Weeds: In addition to its requirement that all members maintain a written business continuity and disaster recovery plan specific to their operations, the National Futures Association has required all members since March 1, 2016, to have adopted and begun enforcing formal written policies regarding cybersecurity.

These policies must be “reasonably designed by members to diligently supervise the risks of unauthorized access to or attack of their information technology systems, and to respond appropriately should unauthorized access or attack occur.”

And more briefly:

- **CFTC Staff Authorizes Swap Dealers to Comply With EU Uncleared Swaps Margin Rules When Dealing With EU Counterparties in Lieu of US Rules for Interim Period**: The Commodity Futures Trading Commission’s Division of Swap Dealer and Intermediary Oversight authorized certain registered swap dealers engaging in swaps transactions with counterparties subject to European Union margin requirements for non-cleared swaps to apply only European margin rules through May 7, 2017. Without this relief, as of February 4 – the effective date of the first phase of margin requirements under EU rules – such CFTC-registered swap dealers would have to apply both US and EU margin requirements. This relief will only apply to swap dealers who are not supervised by a prudential regulator (i.e., non-banks). DSIO said this delay is to accommodate comparability determinations (which have not yet been made) by the CFTC and EU regulators related to each other’s uncleared swaps margin rules.

- **LME Issues Clarifications Regarding Introducing Broker Arrangements**: The London Metal Exchange issued clarifications to its rules related to introducing brokers to accommodate situations where a non-LME member IB facilitates inter-office transactions between two counterparties that maintain accounts at one or more LME clearing members and the counterparties desire to remain anonymous to each other. Under LME rules, an IB is a person who introduces prospective counterparties to a member to transact on a principal-to-principal basis; a person who acts as agent for a counterparty and enters into transactions on behalf of the counterparty with LME members; or a person who acts on behalf of an LME member and enters into transactions for the member with counterparties. Because LME is a principal-to-principal market, a non-member client can never trade directly with another non-member. IBs can facilitate the flow of LME trades among non-member clients to LME members.

- **Another Day, Another CFTC ISDAFIX Fine**: The Royal Bank of Scotland plc agreed to pay a US $85 million fine to the Commodity Futures Trading

Commission to resolve charges that, from 2007 through 2012 it attempted to manipulate the US Dollar International Swaps and Derivatives Association Fix. Among other things, in the RBS Settlement Order, CFTC quoted from transcripts of telephone conversations where RBS employees humorously referenced their alleged efforts to manipulate the ISDAFIX. Just recently, The Goldman Sachs Group, Inc. and Goldman, Sachs & Co. settled charges also brought by the CFTC that, from January 2007 through March 2012, they too attempted on multiple occasions to manipulate the ISDAFIX.

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