

October 12, 2018

## CFTC Continues Enforcement Focus, Forms Insider Trading Task Force

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### **The CFTC Focused a Series of Recent Enforcement Actions on Manipulation, Aiding and Abetting, Spoofing, and Insider Trading; and the CFTC Announced an Insider Trading and Information Protection Task Force**

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#### **SUMMARY**

In recent actions, the U.S. Commodity Futures Trading Commission (the “CFTC”) has continued to pursue cases alleging market manipulation and attempted market manipulation, aiding and abetting of market manipulation, and spoofing. Describing its recent efforts, the CFTC has said that it filed 83 enforcement actions in the last Fiscal Year, representing an approximately 25% increase over each of the prior three years. Notably, the CFTC brought more manipulative conduct and spoofing cases over the past year than ever before, resolving more than 25 such cases.

Separately, and in connection with filing a civil complaint alleging charges related to insider trading in the regulated commodities and derivatives markets, the CFTC’s Division of Enforcement recently announced the formation of an Insider Trading and Information Protection Task Force (the “Insider Trading Task Force”). The Insider Trading Task Force is designed to identify and bring charges against those who engage in insider trading or otherwise improperly use confidential information in connection with the markets overseen by the CFTC. The civil complaint charged an introducing broker and one of its associated persons for allegedly misusing material, nonpublic customer information in connection with block trades of energy futures contracts. Key aspects of the complaint are summarized below. Although the CFTC previously had reached consent resolutions in two matters relating to alleged insider trading, the recently filed complaint is the first such case to be brought by the CFTC on a litigated basis and

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provides valuable insight into the enforcement approach that the CFTC may bring to its pursuit of insider trading cases going forward.

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### ***CFTC V. EOX HOLDINGS LLC AND ANDREW GIZIENSKI***

Since the expansion of the CFTC's enforcement authority under the Dodd-Frank Act,<sup>1</sup> the CFTC has resolved only two cases, both on a consent basis, regarding alleged violations of the prohibition on trading while in possession of material, nonpublic information. Each of those matters addressed employees who had misappropriated the confidential information of their employer for their own trading purposes.<sup>2</sup> On September 28, 2018, in conjunction with the announcement of a new Insider Trading Task Force, the CFTC filed its first civil complaint based on allegations of trading on material, nonpublic information in breach of a pre-existing duty, in a case against EOX Holdings LLC ("EOX"), an introducing broker registered with the CFTC, and one of its registered associated persons, Andrew Gizienski ("Gizienski").<sup>3</sup> The CFTC's complaint alleges that EOX and Gizienski misused material, nonpublic customer information in connection with block trades of energy futures contracts in violation of the Commodity Exchange Act ("CEA") and CFTC rules. The complaint focuses on block trades, less regulated bilateral OTC trades where the scope of the duties to disclose information relating to the trade is not well defined.<sup>4</sup> While brokers are prohibited from disclosing confidential information, there is a well-recognized exception where it is necessary for the facilitation of block trades with other parties.<sup>5</sup> As noted above, the complaint provides useful insight to the approach the CFTC may take going forward in considering when and how to pursue potential charges under CFTC Rule 180.1 for alleged insider trading.<sup>6</sup>

The complaint alleges that, in a departure from existing company policy, EOX permitted Gizienski to exercise discretionary trading authority over the account of one customer ("Customer A"), who was a personal friend and long-standing client of Gizienski's. While exercising his discretionary trading authority, Gizienski continued to facilitate trades for other EOX customers and shared with Customer A material, nonpublic information relating to other customers, such as their identities, trading activity, and positions.<sup>7</sup> According to the complaint, Gizienski's conduct amounted to misuse of material, nonpublic customer information in breach of a pre-existing duty, in violation of CFTC Rule 180.1(a), as well as a violation of CFTC Rule 155.4(b), which governs disclosures by introducing brokers of customer orders; the CFTC has asserted that EOX, as Gizienski's employer, is vicariously liable for the same violations.<sup>8</sup> In addition, the CFTC's complaint asserts claims against EOX for alleged violations of applicable recordkeeping rules<sup>9</sup> and for failure to supervise under CFTC Rule 166.3,<sup>10</sup> as a result of EOX's alleged failure (i) to establish, implement, and enforce policies or procedures to detect or prevent Gizienski's misuse of confidential customer information; (ii) to review Gizienski's discretionary trading, his communications with Customer A, or the brokerage services he provided to Customer A; and (iii) to establish, implement, or enforce policies or procedures governing its brokers' handling of customer

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orders, the preparation and retention of required records, and the protection of confidential customer information .<sup>11</sup>

The CFTC seeks to impose penalties against EOX and Gizienski including trading bans, a disgorgement of all benefits received from acts constituting violations of the CEA or CFTC rules, and civil monetary penalties. In a related action, ICE Futures U.S. has filed and settled charges against EOX and Gizienski for the same conduct.<sup>12</sup>

Among other issues, the complaint highlights the following three key areas of CFTC focus:

- ***Nature of Allegedly Material Nonpublic Information Disclosed*** – The specific information that Gizienski allegedly disclosed to Customer A included: the potential counterparties’ identities, the prices at which they had bought or sold particular contracts, the prices at which they were interested in buying or selling particular contracts, their trading positions, and their trading patterns, and the complaint asserts that such details are information that may affect other traders’ decisions. The CFTC’s characterization of such information as “material,” may have important implications in contexts beyond alleged insider trading cases, particularly in the areas of antitrust and manipulation.
- ***Duty of Confidence*** – Gizienski’s position as a trader provided him with access to confidential information relating to EOX customers and certain block trades they sought to transact. The CFTC alleged that Gizienski owed those customers a duty of trust and confidence with respect to such information, by law or rule, by agreement, and by understanding. Among other things, the CFTC’s complaint highlighted, in particular, EOX’s written agreements with customers which prohibited EOX from using or disclosing confidential customer information, except as necessary for facilitation of block trades with third parties. The CFTC also cited, among other things, CFTC Rule 155.4(b), which imposes restrictions on introducing brokers regarding disclosures of customer orders except where such disclosure is necessary to the effective execution of the order, and a similar rule implemented by the relevant futures exchange where the block trades were transacted.<sup>13</sup> The CFTC’s articulation of the duty allegedly owed by EOX and Gizienski to customers highlights the importance of adhering to written confidentiality agreements and maintaining rigorous internal controls to prevent the misuse of confidential customer information.
- ***Disclosure of Conflict of Interest*** – The complaint also focuses on allegedly undisclosed conflicts of interest that developed between Gizienski (acting on behalf of Customer A) and other EOX customers. According to the CFTC’s complaint, EOX customers gave information to Gizienski to enable him to broker trades on their behalf under the belief that Gizienski was acting solely in the capacity of a broker, without knowledge that he was trading in the same contracts on behalf of Customer A and with a personal interest in Customer A’s success.

Beyond these issues, the CFTC’s complaint also focuses on the supervisory and recordkeeping obligations of EOX, as a registered introducing broker:

- ***Supervision*** – EOX is charged with failing to establish, implement, or enforce any policies or procedures to monitor Gizienski’s trading on behalf of Customer A and failing to detect and prevent Gizienski’s misuse of confidential customer information after waiving the company policy prohibiting grants of discretionary trading over customer accounts. To reduce regulatory risk, companies that are considering granting exceptions to existing policy should consider whether enhanced surveillance or additional control measures may be appropriate.
- ***Recordkeeping*** – The complaint alleged that EOX’s failure to keep all pre-trade communications and written records of customer orders, and failure to produce such records, had hindered the CFTC’s ability to fully investigate the violations of the CEA and CFTC rules. In particular, the

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CFTC's complaint focused on alleged failures by EOX to retain relevant pre-trade communications that were made via mobile devices, although the complaint does not address whether the EOX policy authorized the use of such devices for pre-trade communications. The complaint also alleged that EOX failed to prepare and keep adequate written records of customer orders. The CFTC's focus on these alleged failures illustrates the extent to which recordkeeping violations can compound pre-existing enforcement risk. In addition, the recordkeeping allegations highlight the importance for companies to periodically consider the extent to which new modes of communication may warrant changes in the companies' recordkeeping practices, in order to keep pace with technological change.

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### ENDNOTES

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- <sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, July 21, 2010 124 Stat. 1376; 17 C.F.R. § 180.1 (2018).
- <sup>2</sup> See *In re Jon P. Ruggles*, CFTC No. 16-34, 2016 WL 5682206 (Sept. 29, 2016) (filing and settling charges against Ruggles for misappropriating his employer's confidential, nonpublic trading information for his own benefit); see also *In re Arya Motazed*, CFTC No. 16-02, 2015 WL 7880066 (Dec. 2, 2015) (filing and settling charges against Motazed for misappropriating nonpublic, confidential, and material information in breach of a duty of confidentiality owed to his employer).
- <sup>3</sup> See *CFTC v. EOX Holdings LLC*, No. 1:18-cv-08890 (S.D.N.Y. filed Sept. 28, 2018), <https://www.cftc.gov/sites/default/files/2018-09/enfeoxholdingsllccomplaint092818.pdf>.
- <sup>4</sup> CME Group Market Regulatory Advisory Notice RA1811-5 (Sept. 10, 2018)
- <sup>5</sup> 17 C.F.R. § 155.4(b)(1) (2013) provides that no introducing broker or any of its affiliates shall "[d]isclose that an order of another person is being held by the introducing broker or any of its affiliated persons, unless such disclosures is necessary to the effective execution of such order."
- <sup>6</sup> 17 C.F.R. § 180.1 (2018).
- <sup>7</sup> *EOX Holdings LLC*, No. 1:18-cv-08890, at 7-13.
- <sup>8</sup> *Id.* at 16-21.
- <sup>9</sup> 17 C.F.R. §§ 1.31, 1.35(a)(1)(iii), (b)(1) (2013).
- <sup>10</sup> 17 C.F.R. § 166.3 (2013).
- <sup>11</sup> *EOX Holdings LLC*, No. 1:18-cv-08890, at 20.
- <sup>12</sup> The trades conducted by Gizienski were executed on ICE Futures U.S. ("ICE") and subject to its rules and regulations, resulting in charges being filed and settled by ICE against EOX and Gizienski. The ICE penalties required EOX to pay a \$442,500 monetary penalty and to cease and desist from trading on ICE's markets for six weeks and Gizienski to pay \$50,000 and be denied access to all of the ICE markets for a period of six weeks. See ICE Futures U.S. Settlement of Charges Against EOX Holdings, LLC, Andrew Gizienski, & Eric Torres, Case No. 2014-090 (Dec. 4, 2017).
- <sup>13</sup> See Regulation 155.4(b), 17 C.F.R. § 155.4(b) (2013); ICE Futures U.S. Rule 4.02(i) (2017).

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