

## CLIENT MEMORANDUM

# New CFTC Administration Continues Hard Line Against Spoofing

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## AUTHORS

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On March 30, 2017, the Commodity Futures Trading Commission (“CFTC”) published settlements against two former Citigroup Global Markets Inc. (“Firm”) traders for submitting bids and offers with the intent to cancel them before execution, *i.e.*, “spoofing.” The settlement against Stephen Gola imposes a \$350,000 civil monetary penalty and the settlement against Jonathan Brims imposes a \$200,000 penalty.<sup>1</sup> Each settlement also imposes a six-month futures and swaps trading ban following payment of the penalty. On January 22, 2015, Gola agreed to pay a \$65,000 fine and Brims agreed to pay a \$50,000 fine in connection with a Chicago Board of Trade (“CBOT”) disciplinary action for what appears to be the same spoofing activity.<sup>2</sup> The CBOT disciplinary action included a ten-day trading ban for both traders.

The Gola and Brims settlements with the CFTC also follow the CFTC’s January 2017 settlement with the Firm for the same spoofing activity.<sup>3</sup> The Firm Settlement Order found that pursuant to Section 2(a)(1)(B) of the Commodity Exchange

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<sup>1</sup> A copy of the settlement involving Stephen Gola is available [here](#). A copy of the settlement involving Jonathan Brim is available [here](#).

<sup>2</sup> Notice of Disciplinary Action for Stephen Gola, CBOT 12-8860-BC (Jan. 22, 2015); and Notice of Disciplinary Action for Johnathan Brims, CBOT 12-8860-BC-1 (Jan. 22, 2015).

<sup>3</sup> A copy of the settlement involving the Firm (“Firm Settlement Order”) is available [here](#).

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Act, the Firm was liable for the conduct of its employees. In addition, the Firm Settlement Order found that the Firm violated CFTC Rule 166.3 because it failed to “diligently supervise its employees and agents.”<sup>4</sup> The Firm Settlement Order required the Firm to: (1) pay a \$25 million civil monetary penalty; and (2) comply with certain undertakings, including maintaining controls reasonably designed to prevent spoofing, and conducting annual training addressing spoofing.<sup>5</sup>

The Gola and Brims settlements send a signal that the new CFTC administration is serious about cracking down on disruptive trading activity. As Acting Chairman J. Christopher Giancarlo stated recently, “[t]here will be no pause, let up or reduction in our duty to enforce the law and punish wrongdoing in our derivatives markets.”<sup>6</sup> Acting Chairman Giancarlo also explained that the CFTC will move its market surveillance functions from the Division of Market Oversight to the Division of Enforcement in order to “strengthen our mission to identify and prosecute violations of law and regulation, *such as spoofing*, manipulation and fraud.”<sup>7</sup>

### Alleged Spoofing Activity

The individual settlements against Gola and Brims involve substantially similar facts. Both traders were associated persons of the Firm who traded for the Firm’s U.S. Treasury Desk. Moreover, the settlements cover activity occurring during the same time period – July 16, 2011 to December 31, 2012. The only distinction noted is that Gola was the head trader of the relevant trading desk.

According to the settlements, Gola and Brims submitted small orders on one side of the Treasury futures market (*e.g.*, small buy orders). Thereafter, the traders placed large orders on the other side of the market (*e.g.*, large sell orders of 1,000 lots or more) with the intent to cancel the large orders. Gola and Brims submitted the large orders to create the impression of greater buying or selling interest with the goal of moving the market to execute the small orders on the other side of the market. The traders then canceled the large orders upon executing the smaller orders or if there was a risk that the large orders could be executed. Notably, the settlements do not rely on any “smoking gun” documentation to prove the traders’ intent to cancel the orders prior to execution. Instead, the settlements rely on evidence of trading patterns.

The settlements also note that in addition to executing the above spoofing strategy individually, Gola and Brims coordinated with other individuals on the U.S. Treasury Desk. Furthermore, both settlements note that Brims and Gola knew that a Firm trader in Tokyo engaged in a spoofing strategy, and neither Brims nor Gola reported the spoofing activity to their internal compliance team.

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<sup>4</sup> Firm Settlement Order at 4.

<sup>5</sup> *Id.* at 7-8.

<sup>6</sup> Statement of Acting Chairman Giancarlo before the 42nd Annual International Futures Industry Conference (Mar. 15, 2017). President Trump recently nominated acting Chairman Giancarlo to be the permanent Chairman of the CFTC.

<sup>7</sup> *Id.* (emphasis added).

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### **Piling on the Enforcement Actions**

The individual and the Firm settlements demonstrate the potential expansive scope of a spoofing investigation. The CFTC imposed a sizable fine on the Firm notwithstanding the fact that the CFTC's Division of Enforcement recognized the Firm's cooperation with the investigation, including self-reporting potential spoofing orders beyond the initial suspicious activity and taking corrective action to improve its supervisory systems.<sup>8</sup> Furthermore, the Division of Enforcement continued to pursue the individual traders even after CBOT imposed individual fines in 2015. It remains to be seen whether the criminal authorities will prosecute.

The CFTC and federal prosecutors have a history of working together to prosecute spoofing. For example, federal prosecutors obtained a criminal conviction against Michael Coscia, who was eventually sentenced to a three-year prison term. Federal prosecutors pursued the criminal case against Mr. Coscia even after his company, Panther Trading, agreed to pay a \$1.4 million fine, disgorge \$1.4 million in ill-gotten gains, and accept a one-year trading ban as part of a civil settlement with the CFTC.<sup>9</sup> Mr. Coscia also paid a \$200,000 penalty, disgorged profits, and agreed to serve a six-month trading ban as part of a settlement with CBOT.

### **Mitigating Spoofing Risk**

The most recent settlements demonstrate that the new administration plans to continue to focus on disruptive trading practices, including spoofing. The CFTC's settlements and complaints over the course of several years provide useful guidance regarding how the regulator monitors for and identifies spoofing activity. The CFTC focuses on repeated patterns, high cancellation rates compared to the rest of the market, and large orders that appear to be placed in a manner such that they will not be the best bid/offer. The CFTC also looks for changes in trading activity that may indicate that a person is submitting a bid or offer with the intent to cancel. For example, if a trader ordinarily submits large orders as "iceberg" orders (*i.e.*, an order type that shows only the market a portion of the order size), but the trader begins submitting and canceling large orders visible to the market, the CFTC may infer that the large canceled orders were intended to mislead the market.<sup>10</sup>

In light of the potential regulatory and criminal exposure, companies should review the effectiveness of controls they have in place and consider whether it is necessary to implement additional controls that are reasonably designed to detect and prevent spoofing.

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<sup>8</sup> Firm Settlement Order at 3.

<sup>9</sup> A copy of the Panther Trading settlement with the CFTC is available [here](#).

<sup>10</sup> The CFTC made a similar inference in its settlement with Eric Moncada, which is available [here](#).

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