

# CFTC Enforcement and Regulatory Report: 2017 Activity and Outlook

August 28, 2017

CFTC; Derivatives

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The U.S. Commodity Futures Trading Commission (the “CFTC” or the “Commission”) has been very active since the beginning of this year, despite the change in Presidential Administration, the lack (until recently) of appointed Commissioners, and the turnover of leadership at both the Commission and Division level. Notably, the Commission has announced over 20 enforcement actions, proposed four rules, and launched two new initiatives. This report describes enforcement activity by the Division of Enforcement (“CFTC Enforcement”) and the recent final rule concentrating surveillance and other investigative authority in the CFTC Enforcement, provides an update on Commissioner nominations, and discusses the Commission’s regulatory agenda going forward, recent CFTC initiatives, and pending proposed rules.

## I. CFTC Enforcement Actions

Consistent with newly confirmed Chairman Giancarlo’s stated priority to “oversee robust enforcement of our rules,”<sup>1</sup> CFTC Enforcement has remained active since January 20, 2017, when Chairman Giancarlo first assumed the role of acting Chairman. In March 2017, when announcing the appointment of James McDonald as Director of CFTC Enforcement, Chairman Giancarlo warned that “there will be no pause, no let up and no relaxation in the CFTC’s mission to enforce the law.” From the end of January through May 2017, CFTC Enforcement announced approximately three enforcement actions (i.e., consent orders and complaints) per month. Then, in June and July 2017, the number of enforcement actions matched the total from the previous five months. While the rise in the number of enforcement actions could be related to the upcoming end of the fiscal year in September 2017, when CFTC Enforcement seeks to wrap up outstanding investigations, it also reflects an increased focus on regulating market misconduct.

The enforcement actions announced since [Commissioner] Giancarlo’s appointment as [Acting] Chairman of the Commission include allegations of manipulation, spoofing, violating position limits, fictitious trading, recordkeeping and reporting violations, failure to register, and failure to supervise. Some notable recent cases include:

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<sup>1</sup> Statement of J. Christopher Giancarlo, Acting Chairman, CFTC, before the U.S. Senate Committee on Agriculture, Nutrition, and Forestry (June 22, 2017), *available at* <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-25>.

- Allegations of engaging in wash trading on ICE Futures U.S., Inc., as a means of accomplishing “book squaring” needs.<sup>2</sup>
- Allegations that a trader engaged in spoofing of Eurodollar and U.S. Treasury futures to move the market in a favorable direction.<sup>3</sup>
- Allegations of engaging in wash trading to generate rebates.<sup>4</sup>
- Allegations of secretly using straw purchasers of live cattle futures contracts to violate position limits.<sup>5</sup>

The CFTC has been particularly active in bringing enforcement actions against individuals for fraud, misappropriation, and false statements, and has also brought a number of cases against individuals for illegal precious metal transactions. Enforcement actions against individuals have included civil money penalties ranging from \$200,000 to over \$2 million, as well as disgorgement, prohibitions from registration with the CFTC, and cease and desist orders. Meanwhile, CFTC Enforcement’s consent orders for market manipulation, wash trading, and spoofing against both individuals and companies have included civil money penalties in the millions, with one as high as \$85 million. Civil money penalties for reporting cases, while not as high as manipulation cases, have run in the hundreds of thousands of dollars, with one company agreeing to settle allegations for \$225,000. This enforcement activity demonstrates that the CFTC Enforcement intends to actively monitor the derivatives industry and will regularly pursue enforcement actions.

Finally, CFTC Enforcement continues to work cooperatively alongside other civil and criminal agencies, both domestic and foreign. In one high profile cooperative enforcement matter, the U.S. Department of Justice (“DOJ”) successfully prosecuted the first spoofing case, against trader Michael Coscia, alongside the CFTC’s civil settlement for the same conduct. That criminal conviction was recently upheld by the Seventh Circuit, which denied each of Coscia’s arguments in a total victory for the government.<sup>6</sup> The DOJ’s success will likely embolden it to bring more criminal cases alongside CFTC civil actions.

#### Clearer Cooperation Guidance and Precedent-Setting Non-Prosecution Agreements

One of the clearest statements from CFTC Enforcement and the new Director is an emphasis on, and an expectation of, cooperation from institutions and individuals who are the focus of an enforcement investigation. As Director McDonald recently stated, CFTC Enforcement is focused on “giving companies and individuals the incentive, the right incentives to comply with the law

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<sup>2</sup> *In re Copersucar Trading A.V.V.*, CFTC No. 17-22 (Aug. 15, 2017) available at <http://www.cftc.gov/idc/groups/public/@Irenforcementactions/documents/legalpleading/enfcopersucarorder081517.pdf>.

<sup>3</sup> *In re The Bank of Tokyo-Mitsubishi UFJ, Ltd.*, CFTC No. 17-21 (Aug. 7, 2017) available at <http://www.cftc.gov/idc/groups/public/@Irenforcementactions/documents/legalpleading/enftokyomitsubishiororder080717.pdf>.

<sup>4</sup> *In re Rosenthal Collins Capital Markets, LLC*, CFTC No. 17-17 (Jun. 29, 2017) available at <http://www.cftc.gov/idc/groups/public/@Irenforcementactions/documents/legalpleading/enfrosenthalorder062917.pdf>.

<sup>5</sup> *In re McVean Trading and Investments, LLC, et al.*, CFTC No. 17-15 (Jun. 21, 2017), available at <http://www.cftc.gov/idc/groups/public/@Irenforcementactions/documents/legalpleading/enfmcveanorder062117.pdf>.

<sup>6</sup> *United States v. Coscia*, No. 16-3017 (7th Cir. 2017), available at <http://media.ca7.uscourts.gov/cgi-bin/rssExec.pl?Submit=Display&Path=Y2017/D08-07/C:16-3017:J:Ripple:aut:T:fnOp:N:2006533:S:0>

while holding the people who violated the law accountable.”<sup>7</sup> To achieve that end, CFTC Enforcement has provided much clearer guidance on what cooperation means and how to obtain credit for such cooperation. Previously, guidance on cooperation amounted to a brief statement with a few modest bullet points and even shorter statements in settlements that merely noted an institution or individual’s cooperation with an investigation. This year, CFTC Enforcement put out a new statement on cooperation to replace the prior limited guidance.<sup>8</sup> The new guidelines flesh out what it means to be cooperative (or, alternatively, non-cooperative) in a much more fulsome manner. In evaluating cooperation, the guidance stated that CFTC Enforcement would consider:

- the value of the cooperation to the investigation and enforcement action;
- the value of the cooperation to the CFTC’s broader law enforcement interests;
- the culpability of the company or individual; and
- uncooperative conduct that offsets or limits credit that the company or individual would otherwise receive.

The key takeaway is that cooperation is measured both by how it assists CFTC Enforcement in a particular investigation, as well as how it assists CFTC Enforcement in achieving its investigatory goals. Further, recent settlements have provided more fulsome statements on the particular actions and conduct of firms or individuals in an investigation that lead to cooperation credit. For example, in a recent case, the CFTC noted that the company “self-reported the misconduct” and “proactively implemented large-scale remedial measures and process improvements to deter and detect similar misconduct.”<sup>9</sup> There is now a well-defined link between cooperation and the level of charge being brought, and the level of sanctions being imposed. Director McDonald recently stated, “We want to make it crystal clear to companies what we expect them to do in terms of self-reporting on the front end, but also what is fair for them to expect us to do on the back end.”<sup>10</sup> Cooperation can potentially result in much lower civil monetary penalties, and may also be the difference between a permanent ban from the derivatives industry, a temporary ban, or no ban at all. When issues arise that may result in an enforcement investigation, proactively implementing changes, such as with policies and

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<sup>7</sup> *CFTC Talks*, EP005: CFTC Director of Enforcement James McDonald (Aug. 25, 2017), available at [http://hwcdn.libsyn.com/p/2/2/1/221a3c555a7ecbd9/CFTC\\_Talks\\_Ep\\_5\\_Transcript.pdf?c\\_id=16566154&expiration=1503895103&hwt=d1c77e4c98f9dac2fe4b3e00abfd5839](http://hwcdn.libsyn.com/p/2/2/1/221a3c555a7ecbd9/CFTC_Talks_Ep_5_Transcript.pdf?c_id=16566154&expiration=1503895103&hwt=d1c77e4c98f9dac2fe4b3e00abfd5839).

<sup>8</sup> See *Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Individuals* (Jan. 19, 2017), available at <http://www.cftc.gov/idc/groups/public/@Irenforcementactions/documents/legalpleading/enf advisoryindividuals011917.pdf>; *Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Companies* (Jan. 19, 2017), available at <http://www.cftc.gov/idc/groups/public/@Irenforcementactions/documents/legalpleading/enf advisorycompanies011917.pdf>.

<sup>9</sup> *In re The Bank of Tokyo-Mitsubishi, UFJ Ltd.*, CFTC No. 17-21 (Aug. 7, 2017) available at <http://www.cftc.gov/idc/groups/public/@Irenforcementactions/documents/legalpleading/enftokiomitsubishior080717.pdf>.

<sup>10</sup> *CFTC Talks*, EP005: CFTC Director of Enforcement James McDonald (Aug. 25, 2017), available at [http://hwcdn.libsyn.com/p/2/2/1/221a3c555a7ecbd9/CFTC\\_Talks\\_Ep\\_5\\_Transcript.pdf?c\\_id=16566154&expiration=1503895103&hwt=d1c77e4c98f9dac2fe4b3e00abfd5839](http://hwcdn.libsyn.com/p/2/2/1/221a3c555a7ecbd9/CFTC_Talks_Ep_5_Transcript.pdf?c_id=16566154&expiration=1503895103&hwt=d1c77e4c98f9dac2fe4b3e00abfd5839).

procedures and training of employees, may assist in reducing the impact of an enforcement action.

CFTC Enforcement further emphasized cooperation and took it to the next level by entering into non-prosecution agreements (“NPA”) for the first time in CFTC history. Under the NPAs, individual traders were required to admit that they engaged in unlawful spoofing in exchange for the CFTC’s commitment to not bring any enforcement action against them arising from the investigation.<sup>11</sup> In the press release for this announcement, the CFTC emphasized the individuals’ “substantial cooperation, immediate willingness to accept responsibility for their misconduct, material assistance provided to the CFTC’s investigation of [the financial institution], and the absence of a history of prior misconduct.” CFTC Director of Enforcement James McDonald also commented that NPAs offer the CFTC “a powerful tool to reward extraordinary cooperation in the right cases.”<sup>12</sup> The CFTC’s use of NPAs could be seen as an extension of CFTC Enforcement’s cooperation advisories.

What remains to be seen is how far the CFTC is willing to extend its use of NPAs. For example, it is unclear if the CFTC would enter into an NPA with a company in exchange for cooperation in an investigation to hold rogue traders accountable. Both the SEC and DOJ frequently enter into NPAs with both individuals and companies. Thus, if the CFTC is looking to other regulators for direction in this area, we would expect the Commission to increase its use of NPAs with both individuals and companies.

## **II. The Transfer of the Market Surveillance Function and Concentration of Investigative Authority in CFTC Enforcement**

In March of this year, Chairman Giancarlo announced that the market surveillance function of the CFTC would be moved from the Division of Market Oversight (“DMO”) into CFTC Enforcement. The reorganization of the surveillance function is intended to enhance CFTC Enforcement’s ability to investigate and prosecute market-disrupting behavior—such as price manipulation, fraudulent schemes, and spoofing—in the futures and swaps markets. Chairman Giancarlo also made clear that DMO would retain a new “market intelligence branch,” which is tasked with “understand[ing], analyz[ing] and communicat[ing] current and emerging derivatives market dynamics, developments and trends.”<sup>13</sup> The market intelligence branch is intended to give the CFTC “better insight into the needs of participants in the futures and swaps we oversee.”<sup>14</sup>

The final rule implementing the transfer, which became effective on June 26, 2017, furthered Chairman Giancarlo’s original announcement by concentrating *all* investigative authority, including special call authority, in CFTC Enforcement. In particular, the final rule transfers investigative authority driven by traditional market surveillance of large traders and certain

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<sup>11</sup> The NPAs were announced after the CFTC’s initial press release regarding the enforcement action against the related financial institution and other more senior traders.

<sup>12</sup> *CFTC Enters into Non-Prosecution Agreements with Former Citigroup Global Markets Inc. Traders Jeremy Lao, Daniel Liao, and Shlomo Salant* (June 29, 2017), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7581-17>.

<sup>13</sup> See Remarks of Acting Chairman J. Christopher Giancarlo before the 42nd Annual International Futures Industry Conference in Boca Raton, FL, *CFTC: A New Direction Forward* (Mar. 15, 2017), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20>.

<sup>14</sup> <http://www.cftc.gov/PressRoom/PressReleases/pr7543-17>

commercial hedging activities to CFTC Enforcement.<sup>15</sup> In its cost-benefit analysis, the Commission indicated that it believes market participants will benefit from the final rule because the centralization of investigative authority will “foster increased efficiencies . . . under unified leadership.”<sup>16</sup> The centralization of investigative power will certainly promote more consistency, but it also greatly increases the authority of one division of the CFTC: CFTC Enforcement. For example, the special call power could increase the amount of information CFTC Enforcement is authorized obtain from market participants without obtaining a subpoena.<sup>17</sup> Because special calls will now come from CFTC Enforcement, they will now appear to carry a greater possibility of enforcement action.

### III. Updates on Commissioner Nominations

Since the former Chairman of the CFTC, Timothy Massad, left the Commission on February 17, 2017, and until August 3, 2017, when two new Commissioners were confirmed by the Senate, the CFTC had operated with only two commissioners—Chairman Giancarlo, a Republican appointee, and Sharon Bowen, a Democratic appointee. A consensus is required for the agency to promulgate rules, which has led to a slowdown in Commission rulemaking and actions. Indeed, the CFTC has not issued a final rule since January of this year. Commissioner Bowen has also recently indicated that she is ready to step down as a Commissioner, likely when her replacement is nominated.

On August 3, 2017, just before their summer recess, the Senate unanimously confirmed Giancarlo as Chairman—previously he had been serving in an Acting capacity. On that same day, Brian Quintenz, a Republican, and Rostin Benham, a Democrat, were confirmed as Commissioners, and on August 15, 2017, Quintenz was formally sworn in as Commissioner, bringing the Commission quotient up to three. Mr. Benham likely will be sworn in within the next few weeks. Once Congress resumes activities in September, we expect additional activity in the Senate that will allow the CFTC to operate with a full slate of Commissioners. Specifically, Dawn DeBerry Stump, a Republican, has been nominated as a Commissioner, and was unanimously passed out of the Senate Agricultural Committee, along with Mr. Quintenz and Mr. Benham. Ms. Stump’s confirmation vote before the full Senate will likely take place in conjunction with whomever is nominated to fill Commissioner Bowen’s Democratic vacated seat.

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<sup>15</sup> Specifically, DMO traditionally carried out investigations related to market surveillance activities pursuant to Part 19 (Reports by Bona Fide Hedgers), Part 20 (Large Trader Reporting for Physical Commodity Swaps), Part 21 (Special Calls), Part 140.74 (Delegation of authority to issue special calls for Series 03 Reports.), Part 140.97 (Delegation of authority regarding requests for classification of positions as bona fide hedging), and Part 150 (Limits on Positions).

<sup>16</sup> See 82 Fed. Reg. 28763 (June 26, 2017), available at <http://www.cftc.gov/idc/groups/public/@Irfederalregister/documents/file/2017-13243a.pdf>.

<sup>17</sup> In order to obtain subpoena authority CFTC Enforcement is required to obtain the approval of a majority of the Commissioners.

#### IV. Regulatory Agenda, Recent Initiatives, and Pending Rulemaking

##### Regulatory Agenda

As the new Commissioners move into place, Chairman Giancarlo will now be able to begin the implementation of his regulatory agenda, which will include<sup>18</sup>:

- **Swaps Reform:** Chairman Giancarlo has been a vocal critic of the CFTC's approach to regulating swaps, particularly he has said that current CFTC rules unnecessarily limit the execution methods available for swaps subject to the trading execution mandate (i.e., mandatory use of an order book or a request for quote sent to at least three market participants with an order book).
- **Cross-Border Harmonization:** Chairman Giancarlo has argued that that the CFTC's current cross-border approach, which emphasizes "identical, rule-by-rule substituted compliance analysis," is inconsistent with the approach agreed upon by the G-20, which urged a commitment to "consistent," rather than "identical," implementation.
- **FinTech Innovation:** Chairman Giancarlo has long advocated for FinTech innovation. He has long advocated for the potential benefits of technologies such as distributed ledger technology, which hold the promise of allowing market participants to better manage the complexities brought about by the Dodd-Frank Act. Chairman Giancarlo has argued that regulators must take a "do no harm approach" to FinTech innovations. He cited with approval the Innovation Hub created by the United Kingdom's Financial Conduct Authority.

##### Recent Initiatives

In addition to these proposed rules, the Commission announced two regulatory initiatives:

- **Project KISS:** In March 2017, Acting Chairman Giancarlo announced Project KISS, which stands for "Keep it Simple, Stupid." The objective of the initiative is to conduct a review of CFTC rules, regulations, and practices, and identify areas that the Commission can simplify and make less burdensome. In May 2017, the CFTC entered into the second phase of the project and requested public input for modernizing and simplifying the CFTC's rules. Market participants may submit input through the CFTC's website on a number of subject areas, including reporting, recordkeeping, clearing services, and the marketplace transaction of futures and swaps by September 30, 2017.<sup>19</sup>
- **LabCFTC:** On May 17, 2017, the CFTC launched a new FinTech initiative to "promot[e] responsible FinTech innovation to improve the quality, resiliency, and competitiveness of the markets the CFTC oversees." The initiative aims to accelerate the CFTC's engagement with the FinTech community and inform the CFTC's understanding of new technologies. Components of LabCFTC include "GuidePoint," which is a point of contact

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<sup>18</sup> The Chairman of the CFTC controls the agenda of the agency, meaning that the Chairman directs the Division staff and decides what proposed rules or enforcement actions are placed before the other Commissioners. Since the Chairman requires a majority of Commissioners to vote to approve certain actions, the other Commissioners are in a position to support or oppose certain agenda items. Of course, if the Chairman has a political majority, that provides a more supportive environment to advance the agenda.

<sup>19</sup> See *KISS Initiatives*, <https://comments.cftc.gov/KISS/KissInitiative.aspx>.

for FinTech innovators to engage with the CFTC, and “CFTC 2.0,” which is an initiative to “foster and help initiate the adoption of new technology . . . through collaboration with FinTech industry and CFTC market participants.”<sup>20</sup>

### Pending Rulemaking

Although the CFTC has not issued any final rules this year, it has issued four proposed rules and has extended the comment period for one proposed rule:

- Amendments to Recordkeeping Requirements: On January 19, 2017, the CFTC published a proposed rule that would “modernize and make technology-neutral the form and manner in which regulatory records must be kept, as well as rationalize the rule text for ease of understanding.” The comment period for this rule ended on March 20, 2017.<sup>21</sup>
- Amendments to Rules on Registration and Review of Exchange Disciplinary, Access Denial, and Other Adverse Actions: The CFTC also proposed a rule that would amend Parts 3 and 9 to integrate existing advisory guidance and update provisions applicable to designated contract markets (“DCMs”) and swap execution facilities (“SEFs”). The proposed rule would also require SEFs and DCMs to publish final disciplinary and access denial actions on their exchange websites. The comment period for this rule ended on March 27, 2017.<sup>22</sup>
- Amendments to Data Rules: If enacted, this proposed rule would amend Part 49 by, among other things, removing the “indemnification clause,” which requires authorities seeking swap data from swap data repositories (“SDRs”) to first indemnify the CFTC and each SDR from which the authority receives swap data. The requirement, which was repealed by Congress on December 3, 2015, was originally included in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The proposed rule would also permit certain regulators to access SDR swap data by entering into confidentiality arrangements with the Commission. The comment period for this rule ended on March 27, 2017.<sup>23</sup>
- Capital Requirements for Swap Dealers and Major Swap Participants: On March 16, 2017, the CFTC published an extension of the comment period for its proposed rule on

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<sup>20</sup> <http://www.cftc.gov/PressRoom/PressReleases/pr7558-17>

<sup>21</sup> See 82 Fed. Reg. 6356 (Jan. 19, 2017), available at <http://www.cftc.gov/idc/groups/public/@Ifederalregister/documents/file/2017-01148a.pdf>; *CFTC Unanimously Approves Proposal to Amend Recordkeeping Requirements* (Jan. 12, 2017, available at <http://www.cftc.gov/PressRoom/PressReleases/pr7512-17>). Over a dozen comments were filed by various market participants and industry associations, showing general support for the proposed amendments, suggesting some refinement of particular points and definitions, and requesting adequate implementation time for compliance with the new rule.

<sup>22</sup> See 82 Fed. Reg. 7738 (Jan. 23, 2017), available at <http://www.cftc.gov/idc/groups/public/@Ifederalregister/documents/file/2017-01232a.pdf>; *CFTC Unanimously Approves Proposals on Swaps Data and Other Amendments* (Jan. 13, 2017), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7513-17>.

<sup>23</sup> See 82 Fed. Reg. 8369 (Jan. 25, 2017), available at <http://www.cftc.gov/idc/groups/public/@Ifederalregister/documents/file/2017-01287a.pdf>; *Unanimously Approves Proposals on Swaps Data and Other Amendments* (Jan. 13, 2017), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7513-17>. Over two dozen comments were filed. There was particular concern that the rule would be unduly burdensome for non-financial entities that engage in swap dealing.

capital requirements. The proposed rule, which was announced on December 2, 2016, would establish minimum capital requirements for swap dealers (“SDs”) and major swap participants (“MSPs”). The proposed rule would also establish reporting, notification, and recordkeeping requirements for SDs and MSPs that are correlated to their capital requirements. The comment period for this proposed rule closed on May 15, 2017.<sup>24</sup>

- Chief Compliance Officer Duties and Annual Reports for Certain Registrants: On May 8, 2017, the CFTC published a proposed rule that would amend Part 3 to (1) define a “senior officer,” (2) clarify the duties of a Chief Compliance Officer (“CCO”) of a SD, MSP, or futures commission merchant, and (3) modify the requirements for the CCO annual report. The comment period for this proposed rule closed on July 7, 2017.<sup>25</sup>

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<sup>24</sup> See 82 Fed. Reg. 13971 (Mar. 16, 2017), available at <http://www.cftc.gov/idc/groups/public/@Irfederalregister/documents/file/2017-05277a.pdf>; CFTC Extends Comment Period on Proposed Capital Requirements of Swap Dealers and Major Swap Participants (Mar. 13, 2017), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7535-17>.

<sup>25</sup> See 82 Fed. Reg. 21330 (May 8, 2017), available at <http://www.cftc.gov/idc/groups/public/@Irfederalregister/documents/file/2017-09229a.pdf>; CFTC Proposes to Amend Rules Governing Chief Compliance Officer Duties and Annual Reports for Certain Registrants (May 3, 2017), available at <http://www.cftc.gov/PressRoom/PressReleases/pr7554-17>. Over a dozen comments were filed, many of which were generally supportive of the rule, particularly the CFTC’s efforts to harmonize its regulations with the Securities and Exchange Commission’s analogous requirements.