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# CFTC's Civil Monetary Penalty Guidance: A Perspective from a Former CFTC Regulator

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Futures and Derivatives; Commodity Futures Trading Commission (CFTC)

On May 20th the U.S. Commodities Futures Trading Commission (the "CFTC" or the "Commission") Division of Enforcement (the "Division") announced new guidance for Division staff to consider when recommending civil monetary penalties in an enforcement action (the "CMP Guidance" or the "Guidance").[1] CFTC Enforcement Director Jamie McDonald explained that the Guidance serves two purposes.

> On a big picture level, this penalty guidance reflects our view that the ultimate goal of our enforcement program is to deter misconduct…. But for enforcement actions to deter, the potential wrongdoer must have some sense of how certain types of misconduct will be punished. For companies to build effective compliance programs, they must understand how enforcement authorities would view certain categories of conduct. For business executives to cultivate a true culture of compliance, they must be able to explain to their employees how enforcement bodies would separate right from wrong, and the expected consequences for any wrongdoing. All of this requires clear statements about how and why enforcement authorities punish.[2]

Upon its release, the Guidance was quickly met with questions from members of industry, namely, what does it mean in practice? As a former CFTC regulator who brought dozens of cases over my 13 year career in the Division of Enforcement, I can say that determining a civil monetary penalty in a proposed CFTC enforcement action is a mixture of both art and science.[3]

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[1] Memorandum from James M. McDonald, Director, Division of Enforcement, to Division of Enforcement Staff, Civil Monetary Penalty Guidance (May 20, 2020), available at https://www.cftc.gov/media/3896/EnfPenaltyGuidance052020/download.

[2] Remarks of CFTC Director of Enforcement James McDonald at Futures Industry Association Fireside Chat, Commodity Futures Trading Commission Public Statements and Remarks (May 28, 2020), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/opamcdonald6.

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This new CMP Guidance provides an explanation into the "art" of the Division's decision-making process, namely the qualitative factors that are regularly taken into account when finalizing a penalty. But what is missing from this Guidance is the "science" behind the numbers, or the quantitative factors. How the Division "counts the conduct" to come up with a penalty range is a critical first step that occurs before these qualitative factors are applied. Understanding the possible penalty range is as important as understanding what factors can impact that range.

In terms of answering the starting question: what does this Guidance mean in practice?, understanding both the CMP Guidance factors, *i.e.*, the art of the process, and the elusive quantitative factors, or the science of the numbers, provides key advocacy opportunities for companies and individuals engaged with the Enforcement division. For those currently in front of the Division of Enforcement, the CMP Guidance provides a precise roadmap for advocacy in that the listed factors in the Guidance can be leveraged into productive settlement discussions with the Division. For those companies not currently in front of the Division, the CMP Guidance provides a similar roadmap on how to structure systems and controls to potentially limit and manage future exposure to CFTC enforcement action.

Utilizing my perspective and experience as a former CFTC regulator, the following explains the background and reason for the CMP Guidance; deciphers the Guidance factors and how they can be used when negotiating a settlement or reviewing internal systems and controls; and examines the missing piece of the equation – the quantitative component in the Division's penalty decision-making process and how this piece can be filled in by understanding how to interpret and distinguish precedent CFTC enforcement cases.

## I. Background and Reason for the Guidance: What it Signals for the Industry

The CMP Guidance is emblematic of the Division's recent efforts to provide greater transparency around its enforcement program, including the Division publishing its Enforcement Manual for the first time.[4] The Guidance builds upon original guidelines related to civil monetary penalties published by the agency in 1994,[5] as well as three more recent CFTC advisories on

Attorney, she was responsible for investigating and prosecuting alleged violations of federal laws dealing with commodities, futures, options, swaps, and other derivatives. She negotiated and settled numerous matters, including the LIBOR settlements with international financial institutions, which imposed penalties totaling over $2.8 billion. These settlements are the largest ever brought by the CFTC.

[4] *See* "CFTC Division of Enforcement Issues First Public Enforcement Manual," Commodity Futures Trading Commission press release (Washington, D.C., May 8, 2019), available at https://www.cftc.gov/PressRoom/PressReleases/7925-19. In a statement connected to the publication of the Enforcement Manual, Director McDonald noted, "The decision to create and publish the Enforcement Manual was rooted in the common sense notion that our policies and procedures should be readily accessible to those affected by them." http://cftc.gov/PressRoom/SpeechesTestimony/opamcdonald3. The CFTC's publication of its Enforcement Manual came years after the publication of similar documents by the Securities and Exchange Commission ("SEC"), which published its Enforcement Manual on October 6, 2008, and the Department of Justice's ("DOJ") Justice Manual, formerly called the United States' Attorney Manual, has been published and regularly updated since 1953.

[5] CFTC Policy Statement Relating to the Commission's Authority To Impose Civil Money Penalties, (1994 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 26,265 (Nov. 1, 1994).

cooperation and self-reporting.[6] The CMP Guidance and these advisories should be read not as separate and distinct documents, but as policies that operate in conjunction with each other.

None of these documents announces anything new; together they simply communicate practices that the Division regularly employs in its investigations and settlements when evaluating potential mitigating or aggravating factors in a proposed settlement.[7] Instead, these advisories should be read as clear statements from the Division emphasizing the CFTC's *expectation* that cooperation will be given, a self-report of violations will be made, and remediation will occur in an enforcement investigation. These Advisories also offer, in return for significant cooperation, early self-reporting, and full remediation, the promise of a "substantial reduction" in the penalties assessed.[8] Since the publication of these Advisories, the CFTC's enforcement orders have included detailed paragraphs that describe the level and quality of cooperation received, whether a self-report occurred, what remediation has been undertaken, and whether any of these impacted the ultimate penalties assessed.

Further, by publishing the CMP Guidance and including it in the Enforcement Manual, like the Advisories before it, the Guidance becomes an official part of the Enforcement program and underscores the expectation that current and future staffers will employ these factors in determining an appropriate penalty. Again, the factors discussed in this document are not revolutionary, but they do commit the CFTC to a process for reaching settlement decisions.

Additionally, when meeting with Enforcement leadership, such as the Director or the Deputy Directors, staff will be expected to address these factors to justify any settlement recommendations. In turn, companies and individuals can leverage the Guidance when meeting with Division staff and leadership to effectively advocate negotiating positions by both

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[6] *See* The Cooperation Factors in Enforcement Division Sanction Recommendations for Individuals and Companies published in January, 2017 (Jan. 19, 2017), available at http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisorycompanies011917.pdf; the Updated Advisory on Self-Reporting and Full Cooperation published in September, 2017 (Sept. 25, 2017), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisoryselfreporting0917.pdf; and the Advisory on Self Reporting and Cooperation for CEA Violations Involving Foreign Corrupt Practices published in March, 2019, available at https://www.cftc.gov/sites/default/files/2019-03/enfadvisoryselfreporting030619.pdf (collectively, the "Advisories").

[7] *See* Memorandum from James M. McDonald, Director, Division of Enforcement, to Division of Enforcement Staff, Civil Monetary Penalty Guidance (May 20, 2020), available at https://www.cftc.gov/media/3896/EnfPenaltyGuidance052020/download. In the preamble to the Guidance, the Division Director noted, "The factors below generally reflect the existing practice within the Division, which has been refined over time as a result of changes to relevant legal authorities and precedents, as well as lessons learned from the Commission's enforcement actions."

[8] *See* September 2017 Self-Reporting Advisory at 2 ("Specifically, if a company or individual self-reports, fully cooperates, and remediates, the Division will recommend that the Commission consider a substantial reduction from the otherwise applicable civil monetary penalty.").

anticipating arguments staff will have made to leadership on the Guidance factors and preparing responses to address such arguments.

Division Director McDonald supported this approach to advocacy when he stated that "the [G]uidance should streamline any discussions we have with defense counsel and market participants about penalties. To the extent you are preparing for discussions with staff about penalties, your preparations should focus on the factors laid out in the guidance."[9]

Companies can use the roadmap provided by the CMP Guidance to clearly articulate how they have cooperated, the expediency of their self-reporting, and the extent of their remediation to achieve a potentially substantial reduction in the eventual penalty assessed. For those considering internal controls, this presents an opportunity to build systems that incentivize self-reporting and prompt remediation, which will be important if facing an enforcement action down the road.

## II. The Factors in the CMP Guidance: A Roadmap to Settlement and an Effective Compliance Program

The CMP Guidance lays out a number of factors that the Division will consider when crafting a penalty. Each of these factors provides not only insight into what the Division deems important for settlement purposes but also what it suggests is needed within a company's policies, procedures, and controls to ensure compliance with CFTC regulations and prevent violations.

**The Gravity of the Violation.** The Guidance indicates that the gravity of the relevant violation(s) is a primary factor in determining a civil monetary penalty amount, largely because this factor goes directly into how the conduct is assessed. This factor will determine whether the starting penalty range is on the high or low end of possible penalty ranges. The Guidance states that gravity is determined by evaluating the following:

- Nature and scope of the violations, including:
  - the number, duration, type and degree of the violations;
  - the level of involvement, meaning if the company or individual acted in concert with others;
  - if efforts were made to conceal the violations;
  - whether the violations resulted in harm to victims and the number and type of victims.[10]

In negotiating a settlement, companies first need to understand the nature of the alleged violation, as it is one of the key factors driving the penalty demanded by the Division. There is a substantial difference in the seriousness of market disruptive behavior, like manipulation, which directly impacts the markets and market participants, as compared to regulatory violations, such

[9] Remarks of CFTC Director of Enforcement James McDonald at Futures Industry Association Fireside Chat, Commodity Futures Trading Commission Public Statements and Remarks (May 28, 2020), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/opamcdonald6.

[10] CMP Guidance at 3.

as recordkeeping and reporting, which have little or an indirect impact on the market. This difference is also codified in the penalty amounts associated with each in the Commodity Exchange Act ("CEA").[11]

The gravity of the violation analysis undertaken by the Division will also consider whether the company's systems and controls were sufficient, either to timely catch the wrongdoing or to prevent widespread regulatory failures. Companies can speak to this factor by emphasizing the limited nature of a violation, its isolation within the company (as opposed to a systemic failure), awareness or lack-thereof by senior management, and lack of impact on the markets or victims.

- Whether the misconduct was intentional or willful.[12]

The statutes in the CEA that involve specific intent, such as price manipulation, fraudulent manipulation, and spoofing, are the more serious violations because they are most disruptive to the markets. Further, intentional or willful misconduct also draws a greater penalty assessment because the Division views this behavior as blatantly disregarding agency rules and regulations.

- Consequences flowing from the violations, including:
  - harm to victims and market participants;
  - benefit reaped by the respondent; and
  - impact on market integrity, customer protection, or the mission of the CFTC.[13]

Here the Division again emphasizes the potential harm to the markets and to individuals as these go to the core of the agency's mission: to ensure the integrity of markets and protect consumers. This is why manipulation has such a higher penalty amount than non-manipulation cases.[14] Effective advocacy before the Division on these points can provide necessary context for understanding the conduct's impact on markets and individuals and frame that conduct appropriately.

**Mitigating and Aggravating Circumstances.** The Guidance acknowledges that the Commission has typically considered mitigating and aggravating circumstances when determining the appropriate civil monetary penalty. It is within these factors that market participants have the most control, and later, in front of the Division, the most opportunity for advocacy, as they govern what steps are taken before a violation occurs and what steps are taken once a violation happens and is discovered. These factors echo the points laid out in the

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[11] *See* 7 U.S.C. 9, 13a, and 13a-1, which define the amount that can be charged for each violation of the CEA, whether in an administrative action through the Commission or an injunctive action in federal court. These statutes set different dollar amounts for manipulation and non-manipulation offenses.

[12] CMP Guidance at 3.

[13] *Id*.

[14] *See* 7 U.S.C. 9, 13a, and 13a-1; a single manipulation violation can garner a penalty of up to $1,212,866, based on inflation-adjusted numbers. For additional discussion, *see infra*, Section IV.

Advisories which emphasize cooperation and self-reporting. The Division breaks out the mitigating and aggravating factors as follows:

- Post-violation conduct – which can be mitigating, "such as attempts to cure, return of victim funds," or aggravating, "such as concealment or obstruction of an ongoing investigation;"[15]
- Whether the misconduct was self-reported and the extent of the cooperation and remediation provided (here the Guidance specifically references the prior Advisories);
- Timeliness of remediation;
- Existence and effectiveness of the company's compliance program;
- Prior misconduct, such as whether the company or individual is a recidivist;
- Pervasiveness of misconduct within the organization, including the "responsibility" of management; and
- Nature of any disciplinary action taken with respect those engaged in misconduct.[16]

The Division takes the time to list out these factors in detail because it believes each of these factors are demonstrative of a compliant market participant. No matter the violation, the Division will first ask, "what were the systems and controls in place? Did they work as designed or did they fail?" There is often the view that if a violation occurred, a company's systems and controls failed in some way. Of course, the truth is much more complex and nuanced. But a company must be able to speak to each of these factors and demonstrate a robust compliance system to ensure these factors mitigate the penalty amount. Addressing these factors will be the heart of any settlement presentation to the Division and a successful presentation can result in material penalty reductions. Several published orders in the past year have described that a company's ability to demonstrate cooperation, self-reporting, and full remediation, including (and, in some cases, especially) disciplinary action, resulted in a substantial reduction in the ultimate penalty assessed.[17] The Division just does not quantify how much of a reduction.

On the other hand, the listed aggravating factors also speak to the effectiveness of a company's compliance program. For example, the notation on the responsibility of management goes to the compliance concept of "tone from the top." The Division is increasingly placing an emphasis on the role management has to play with compliance and in instilling a culture of compliance. As such, the Division is looking for cases to bring against leadership, even Board leadership, where it can be shown that leadership had an active role in the conduct or were negligent in

[15] CMP Guidance at 3-4.

[16] *Id.*

[17] *See e.g.*, https://www.cftc.gov/PressRoom/PressReleases/8033-19 (Oct. 1, 2019) (announcing settlements with six institutions for various reporting violations and noting for each settlement whether the penalties assessed were substantially reduced due to the cooperation, self-reporting, and remediation provided by the institutions).

oversight.[18] In addition, repeat conduct, or recidivism, is particularly significant to the Division. A company or individual who has had several investigations (even if they do not result in an action) and actions brought against them will be looked at more closely and given less credit, unless they can prove that going forward there will be significant changes in compliance systems and controls and full remediation for any past violations. Although Enforcement investigations are backward-looking, the Division is also focused on how a company or individual intends to comply going forward. Credit will be given for changes that show a willingness to build and implement fulsome policies and procedures and convey a culture of compliance, as noted above.

**Other Considerations.** The final category appears to be a catchall but contains key factors that are increasingly important to the CFTC. Division staff will also consider the following, in assessing the appropriate civil monetary penalty:

- The total mix of remedies and monetary relief to be imposed, including the remedies and relief to be imposed in parallel cases.

This is the Division's recognition that the agency is consistently working in parallel with another regulatory or law enforcement agency, whether it be the DOJ, the SEC, prudential regulators like the Office of the Comptroller of the Currency or Federal Reserve Board, self-regulatory agencies ("SROs") such as exchanges or the National Futures Association, state regulators such as Attorneys General offices, or foreign regulators, such as the U.K. Financial Conduct Authority or Japan's Financial Services Agency. The parallel nature of enforcement is a concept that has always existed – the CFTC oversees and enforces markets and market participants with global footprints and as such its jurisdiction will overlap with a variety of regulators – but this emphasis is growing.[19] This factor also recognizes that there is no need for the CFTC to pile on with penalties when bringing an action against a company in parallel with other regulators.[20] Effective advocates can use this as another negotiating tool.

- Monetary and non-monetary relief in analogous cases

In all cases, the Division will seek consistency by placing a proposed settlement within the larger context of precedent cases. The Division will seek to slot cases among others with similar violations and fact patterns and use the factors contained in this Guidance to determine whether a company's penalty should be similar to those who received significantly higher monetary penalties or be lower due to its particular mitigating factors. However there is a lack of transparency in this process as the analysis comparing the weighting of the penalty factors

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[18] *See* https://www.cftc.gov/sites/default/files/2018-10/enfmichaelleibowitzorder092818.pdf (Sept. 28, 2018).

[19] *See e.g.*, https://www.cftc.gov/PressRoom/PressReleases/7884-19 (Mar. 6, 2019) (The CFTC's announcement on its Advisory on Self Reporting and Cooperation for CEA Violations Involving Foreign Corrupt Practice is supported by a statement from the DOJ's Assistant Attorney General for the Criminal Division.)

[20] *See* https://www.cftc.gov/PressRoom/PressReleases/8035-19 (Oct. 2, 2019) (noting that the civil monetary penalties assessed against two institutions are offset by the amounts paid to the New York Attorney General's Office in a parallel matter).

within each case is not made public. A company or individual should examine potentially analogous cases and prepare to address them in a settlement meeting with the Division but will be at a significant information disadvantage compared to the CFTC.[21] Often counsel with experience with the Division can help to identify distinguishing factors within the cases to best frame the arguments to be made.

- Conservation of Commission resources, including timely settlement.[22]

The Commission is keenly aware that investigations can take a long time, tying up finite Division resources. In some instances, when the conduct is identified, and where outside counsel has conducted a complete investigation, there can be a path to a quick resolution without the need for a protracted and duplicative agency investigation. Whether this will translate into a reduced penalty is unclear. Nevertheless, shortcutting an agency investigation through a fulsome internal investigation can still potentially save a company from spending millions of dollars in responding to the CFTC's investigation.

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Taken separately, these factors can seem overwhelming or confusing, but they are tools that can be used to successfully negotiate a lower civil monetary penalty. While only the Division may know how they weigh each factor in this Guidance, specifically addressing each of these factors in settlement discussions will allow companies to shape how the Division views those factors and ultimately alter the final picture to their benefit.

## III. The Missing Piece: Quantifying the Settlement

As noted above, the CMP Guidance provides some insight into how the Division first arrives at its penalty numbers, by determining the scope and gravity of the offense. Before there ever is a determination on how the Guidance's mitigating and aggravating factors will impact the fine assessed, the staff has to determine an initial penalty range based on the number of violations involved, as the CEA allows fines to be assessed per "each violation."[23] This is always the starting point, and how the violations are counted can vary based on the type of conduct involved and the violation being considered. For example, if the CFTC were to bring an action under 7 U.S.C. § 9 against a company for attempted manipulation of a commodity benchmark by submitting false transaction information, the Division could count each reported transaction as a violation. Or the Division could decide to count as one violation each day in which there is a false transaction reported. Each of these options result in vastly different starting numbers.

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[21] *See* discussion infra, Section IV.

[22] CMP Guidance at 4.

[23] 7 U.S.C. 9, 13a and 13a-1, which provide specific dollar amounts that can be charged for each alleged violation of the CEA. The CFTC has long-used the number of the violations as a basis for the calculation of their civil monetary penalties. Both the "gravity of the violation" and the "other considerations" factors were included in the CFTC's 1994 guidance. *See* CFTC Policy Statement Relating to the Commission's Authority To Impose Civil Money Penalties, (1994 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶ 26,265 (Nov. 1, 1994).

Without specific guidelines around this process, exactly how a penalty range is developed is left up to the determination of each individual enforcement team.

One way the CFTC could have been helpful in this Guidance or, if not there, then in future orders, is to provide quantitative percentages demonstrating how a company's cooperation, self-reporting, and/or remediation reduced the assessed penalty, e.g., a statement that a company's cooperation, self-reporting, and remediation resulted in a fine that was X% less than it would have been. This would provide the "science" behind the penalty assessments that the industry is missing today.

The Director of Enforcement has explained that the vagueness in this process allows for flexibility, which the CFTC needs to respond to each unique market and the particular situation of each target of an enforcement action. Further the Director believes that market participants will find this flexibility beneficial.[24] This may be true as it provides an opening for subjects of an enforcement proceeding to present their unique circumstances and distinguish themselves from enforcement precedents.

Companies facing the CFTC should first appropriately frame the gravity of the alleged offense, as noted above, in order to begin the settlement discussion within a reasonable range of penalty amounts.[25] Once targets of an enforcement action have crafted their position on the gravity of an offense, they then can focus on the mitigating circumstances present. Often this includes distinguishing themselves from enforcement precedents. But an analysis of precedent cases is complicated by the fact that the penalty numbers in published cases have already had the mitigating and aggravating factors from the CMP Guidance applied, thus giving a final, and not a starting, penalty. This final penalty must be unraveled to understand the impact of any cooperation, self-reporting, or remediation had on the final penalty assessed.

Enforcement precedent is still useful in preparing for settlement negotiations, as it gives some points from which a company can compare and distinguish itself, to achieve a like or better penalty result. But in no way does it put the company or individual on equal footing with the Division. Effective advocacy around the gravity of the offense, mitigating and aggravating factors, and distinguishing facts from CFTC precedent will still go a long way to having productive settlement discussions, despite this opacity on the science behind the Division's numbers.

## IV. Conclusion

The CMP Guidance was the CFTC Division of Enforcement's attempt to provide greater clarity around its decision-making process in determining civil monetary penalties. But, the document only goes so far as to present the qualitative factors contained in that analysis. Nevertheless, it is still a useful roadmap into Enforcement Division thinking and, with experienced counsel who understands the agency and how to interpret CFTC precedent, market participants can fill in the

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[24] *See* Remarks of CFTC Director of Enforcement James McDonald at Futures Industry Association Fireside Chat, Commodity Futures Trading Commission Public Statements and Remarks (May 28, 2020) available at https://www.cftc.gov/PressRoom/SpeechesTestimony/opamcdonald6.

[25] *See* Section II, Gravity of the Conduct.

missing piece, the quantitative factor. Then, a company or individual will be armed to have productive, substantive negotiations where they are on the same page, or at least in the same chapter, as the Division when it comes to settlement discussions. Additionally, market participants can use the CMP Guidance to be proactive and examine their systems and controls to ensure they have policies and procedures in place to demonstrate a robust culture of compliance and ensure that if things go wrong, they can be detected quickly and remediated swiftly. In this case, being forewarned by this Guidance is as close as possible to being forearmed.

The Futures and Derivatives team at Covington, with its deep experience and expertise with the CFTC and the markets it oversees, can be a valuable advocate for clients facing an enforcement action, and can assist clients in examining and tailoring internal policies, procedures, and training programs to ensure implementation of effective compliance systems and controls.

If you have any questions concerning the material discussed in this client alert, please contact the members of our Futures & Derivatives practice below.


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