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Two sets of market enforcement actions

As the Commodity Futures Trading Commission embraces a model that encourages the self-reporting of trade practice violations by market participants directly to the commission, many questions arise as to how the new paradigm will affect the punitive impact on individuals and proprietary firms.

Where it was previously difficult to predict a standardized sanction rate for a particular rule violation in an environment that does not encourage self-reporting, it may be nearly impossible to forecast sanctions and their corollary monetary value in the new environment of self-reporting.

It may be too early to determine if the commission's year-old policy improves the stability of the marketplace and properly incentivizes traders to self-report rule violations, but the enforcement data suggests there may be some value in the commission's approach.

While the news may appear encouraging, market participants may be guessing how (and if) exchanges like those owned by CME Group Inc. will follow suit.

As the Wall Street Journal reported on Nov. 22, 2017, since the adoption of this self-reporting, there has been a significant reduction in enforcement cases prosecuted by the commission.

In fiscal year 2017, the commission brought 49 cases, down 28 percent from the previous year's 68. During that time, the commission collected a total of $413 million in fines, disgorgement and restitution. The previous year's figures amounted to $1.29 billion.

Despite the promising trend for traders as it relates to the federal regulator, the number of enforcement actions among CME's exchanges appears to remain consistent during 2016 and 2017, leaving some firms and traders guessing about the disparity between the underlying enforcement methodologies.

Our law firm — O'Mara, Gleason and O'Callaghan LLC — conducted an analysis of publicly available data based on CME's market regulation website, and the results show no signs of a reduction in enforcement actions brought across CME's four exchanges in either the number of cases or in the severity of penalties imposed.

Specifically, in 2016, there were a total of 128 individual enforcement actions among CME's four exchanges. Collectively, the Chicago Board of Trade, Chicago Mercantile Exchange, Commodity Exchange and New York Mercantile Exchange collected approximately $9.38 million in fines, disgorgement and restitution.

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However, the total number for that year is skewed slightly by a single NYMEX case involving the disgorgement of $2,812,216. In that matter, the panel found that the trader "repeatedly abused his trading discretion given to him by his employer for personal gain by intentionally trading his employer's account opposite two personal accounts owned by his wife."

By Trevor J. Orsinger

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Nonetheless, in 2016 the four exchanges collected $5,029,000 in fines, $4,301,984.80 in disgorgement and $53,787.50 in restitution.

Of the 128 cases, 29 were on CBOT, 33 on CME, 58 on NYMEX, and eight on COMEX.

In 2017, based on data collected up through Dec. 22, there were a total of 150 individual enforcement matters initiated against market participants. The exchange collected $5,617,000 in fines, $980,839.32 in disgorgement and $13,295 in restitution for a total of $6,611,134.32.

Of the 150 cases, 42 were on CBOT, 51 on CME, 35 on NYMEX and 22 on COMEX. That the number of cases prosecuted by CME between 2016 and 2017 increased is telling with regard to the rate of enforcement among the CME exchanges, especially considering the Commodity Futures Trading Commission's drastic reduction in prosecutions. More telling, however, is a closer examination of the fines, the core of the punitive basis for the exchange's market regulation function.

The total number of cases finalized by CME in 2017 increased by more than 17 percent from 2016. Additionally, the average price of the fines increased between 2016 and 2017. In considering only the fine paid by each respondent, the average value of each case was $35,464.84 in 2016. In 2017, that number increased nearly $2,000 to $37,446.67, more than a 5 percent increase from the previous year. (O'Mara, Gleason, and O'-Callaghan's analysis did not include the suspensions from trading on CME exchanges that sometimes accompany the monetary sanction for individual respondents.)

It remains to be seen whether the commission's and CME's market regulation department will reconcile the disparity between the rate of prosecutions among market participants and whether CME will adopt a similar self-reporting approach.

The commission promulgated its policy through a number of advisories; CME offers the opportunity to self-identify violations but has not offered guidance on its impact.

Absent clearer direction from the exchanges and considering that the number of commission prosecutions and amounts collected from respondents drastically shrunk between 2016 and 2017, it is likely CME will continue to prosecute cases at the same rate while increasing its sanctions.