

Key Takeaways: CFTC's FY 2021 Swap Dealers Enforcement Actions

December 7, 2021

In Fiscal Year 2021 (FY 2021), the Commodity Futures Trading Commission (CFTC) brought and settled five enforcement actions against swap dealers for alleged reporting, disclosures and supervision failures. Historically, the CFTC's swap dealer actions have focused on reporting requirements, and while FY 2021 was no different, this year saw an increased focus on external business conduct disclosures as well as significantly reduced penalties to reflect self-reporting, cooperation and remediation.

FY 2021 Swap Dealer Enforcement Actions

- *In re Credit Suisse* (No. 21-11, June 25, 2021)
 - Credit Suisse received a \$1.5 million penalty for purportedly failing to report approximately 14 percent of their overall reportable swaps' daily mid-market mark valuations (daily mark) to their swap data repository (SDR) between 2013 and 2018. Credit Suisse did not receive remediation, cooperation or self-disclosure credit.
- *In re Citibank, N.A. and Citigroup Global Markets Limited* (No. 21-15, Sep. 27, 2021)
 - Citi received a \$1 million penalty for its alleged failures between 2013 and 2017 related to (1) reporting Legal Entity Identifiers (LEIs) properly for tens of thousands of swaps; (2) satisfying no-action relief requirements related to LEI reporting for over one hundred thousand swaps; and (3) supervising their swap dealer activities diligently. The CFTC charged that Citi violated a cease and desist provision stemming from a 2017 CFTC enforcement action that involved similar LEI reporting errors but still reduced the penalty to reflect Citi's substantial cooperation and remediation.
- *In re Mizuho Capital Markets LLC* (No. 21-17, Sep. 27, 2021)
 - Mizuho received a \$1.5 million penalty for claimed failure to (1) engage in proper portfolio reconciliation with non-swap dealer counterparties; (2) disclose daily marks, and related methodology and assumptions, to counterparties eligible for the daily mark; (3) accurately and timely report to its SDR; and (4) maintain an adequate supervisory system. Mizuho's purported reporting and supervisory failures took place at various times between 2013 and 2021. The CFTC's recognition of Mizuho's self-disclosure, substantial cooperation and remediation resulted in a substantially reduced penalty.
- *In re Société Générale S.A.* (No. 21-36, Sep. 29, 2021)
 - SocGen received a \$1.5 million penalty for purportedly (1) failing to disclose daily marks to eligible counterparties; (2) reporting inaccurate daily marks to counterparties and inaccurate swap valuation data to its SDR; (3) failing to disclose pre-trade mid-market marks (PTMMM) to counterparties on certain

platforms; and (4) not maintaining an adequate supervisory system. SocGen's alleged reporting and supervisory failures took place at various times between 2013 and 2021. The CFTC significantly reduced the penalty to reflect SocGen's self-disclosure, substantial cooperation and remediation.

- *In re Cargill, Inc.* (No. 21-37, Sep. 30, 2021)
 - Cargill received a \$750,000 penalty for allegedly failing to include new swaps in its large trader reports (LTRs) for reportable positions as well as its Form 102S submissions from 2017 to 2019, submitting LTRs with incorrect values for several months in 2019, and failing to supervise its reporting obligations. The CFTC's recognition of Cargill's self-reporting and remediation resulted in a reduced penalty.

None of the above matters involved litigated decisions. Each of the above actions were resolved through a settlement by the respondent without admitting or denying any of the CFTC's findings or conclusions.

Key Takeaways

1. Self-Disclosure, Cooperation and Remediation Remain a Priority

Compared to FY 2020, the number of enforcement actions against swap dealers remained the same, with five total actions. However, the five FY 2020 actions resulted in nearly \$75 million in total penalties whereas FY 2021's enforcement actions resulted in only \$6.25 million in total penalties. The significant difference is attributable to the growing trend of self-reporting, cooperation and remediation. Of the five actions brought and settled in FY 2020, there were no actions that involved self-reporting and only one swap dealer received cooperation credit that resulted in a reduced penalty.

At the beginning of the last fiscal year, on October 29, 2020, the CFTC's Division of Enforcement issued a memorandum that articulated how self-reporting, cooperation and remediation could result in reduced monetary penalties. Specifically, the memorandum provided four scenarios:

- No self-reporting, cooperation or remediation results in no reduced penalty.
- No self-reporting, but cognizable cooperation and/or remediation that warrants recognition but results in no reduced penalty.
- No self-reporting, but substantial cooperation and/or remediation results in a reduced penalty.
- Self-reporting, substantial cooperation and remediation results in a significantly reduced penalty

This guidance seemed to help the CFTC and parties navigate the level of cooperation and the reduction in penalties this year. Compared to FY 2020, there was a significant difference in FY 2021: four of the five swap dealer enforcement actions involved reduced monetary penalties, three of which also involved self-reporting.

2. A New Focus on External Business Conduct Disclosures

FY 2021 continued the historical trend of swap dealer enforcement actions relating to purported violations of swap dealer reporting rules, with all five actions involving alleged reporting failures. Over the years, the CFTC has reiterated that reporting is at the heart of its market surveillance efforts. However, unlike years past, the CFTC also focused on external business conduct disclosures in FY 2021.

The three largest financial penalties — at \$1.5 million each — involved daily mark and PTMMM disclosures with alleged failures dating back to 2013 in all three cases. In prior years, the CFTC only brought charges related to PTMMM and daily mark disclosures on two occasions. First, the CFTC settled an action against Cargill on November 6, 2017, resulting in a \$10 million penalty; the second action was settled against The Bank of Nova Scotia on August 19, 2020, resulting in a record \$50 million penalty. In both instances, the large financial penalties reflected substantial alleged misconduct beyond a failure to meet the swap dealers' disclosure obligations.

The CFTC's heavy focus on these two counterparty disclosures of information reveals the agency's emphasis on ensuring swap dealer counterparties have accurate and up-to-date information so that they are well-informed both prior to execution and during the life of a swap. These business conduct standards require swap dealers to disclose certain information (such as material incentives, methods of calculation, and conflicts of interest) to counterparties in order to maintain fair and balanced transactions and overall market integrity.

3. Supervision Charges Likely Follow With Violations

In FY 2021, by bringing supervisory charges against four out of the five swap dealers, the CFTC continued to highlight the importance of having in place adequate compliance programs to prevent misconduct, quickly detecting misconduct when it occurs, and responding in a way that ensures that the same failures will not reoccur. The Commission has consistently brought supervisory charges in tandem with other swap dealer violations because it believes that the failure to maintain adequate supervisory systems and controls causes, or at least does not prevent, the underlying violation. The failure to supervise charges also are used to signal where swap dealer controls are purportedly lacking and where the swap dealer should focus compliance efforts moving forward.

The Commission remains particularly concerned with how long errors go undetected and whether the subject of the enforcement action should have learned of the purported error sooner. Evidence that the swap dealer knew or should have known of an alleged flaw may result in a scathing order and a more significant financial penalty.

Additionally, the CFTC pays close attention to failures it claims are reoccurring. During the last CFTC fiscal year, alleged recidivism played a substantial role in Citi's \$1 million penalty for reporting failures related to a single LEI error. This is the third time that Citi's swap dealer has been the subject of a CFTC enforcement action; one of the actions settled against Citi in 2017 specifically involved purportedly similar LEI reporting errors. In light of this history, the CFTC penalized Citi because it claimed the firm did not supervise its third-party vendor to ensure that the same LEI violations did not reoccur.

While a swap dealer's actions *after* detection of a reporting or other compliance failure may significantly reduce the ultimate penalty, it will not prevent a CFTC enforcement action. Adequate staffing and training of personnel; automated controls and processes to reduce human error; controls that are subject to regular testing; and specific policies and procedures that employees follow are preventative measures that swap dealers should take to avoid supervisory charges.

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12/7/21