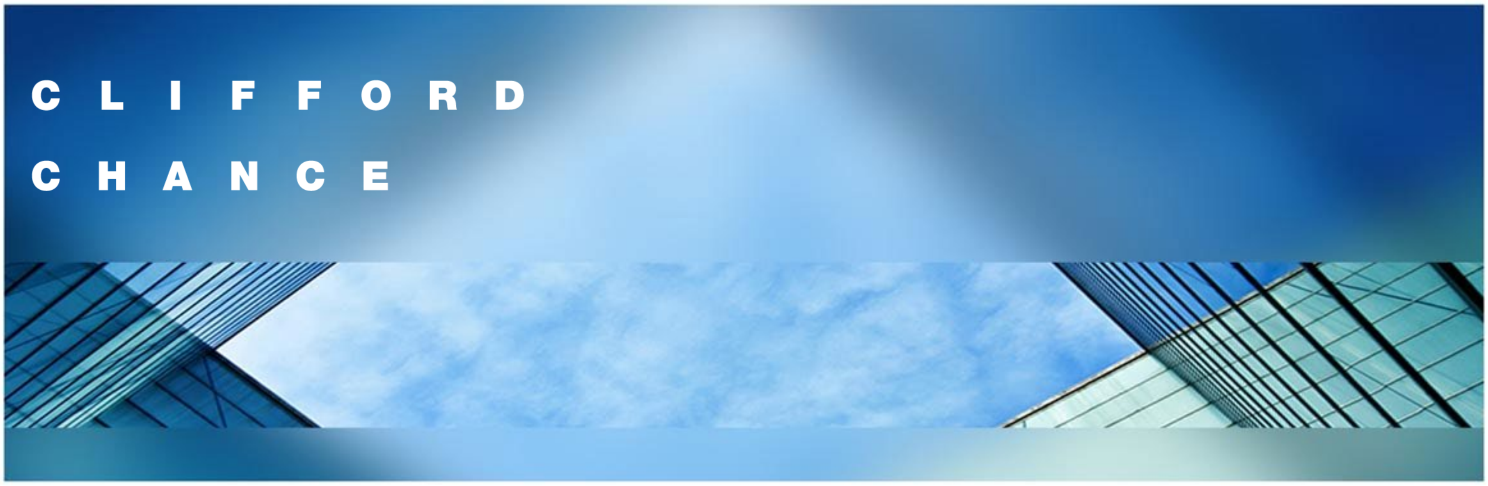

U.S. CFTC CHARGES TOKYO-BASED TRADER WITH SWAPS-RELATED MARKET MANIPULATION AND FALSE STATEMENTS TO INVESTIGATORS

On February 1, 2021, the Commodity Futures Trading Commission ("CFTC") charged a Tokyo-based swaps trader with manipulating U.S. dollar-based interest rate swap spreads. The complaint demonstrates the CFTC's focus on protecting the integrity of U.S. markets, including interest rate swap markets, from purposeful price manipulation, as well as the agency's increasingly sophisticated ability to reconstruct market conditions by analyzing large amounts of trading data. It is also indicative of the CFTC's continued willingness to assert jurisdiction over traders outside the U.S. whose trading affects U.S. markets, including U.S. price sources for instruments traded outside the U.S. Finally, the complaint underscores the major risks of making false statements to the CFTC, as well as the Commission's hostility toward the use of unrecorded and unmonitored communication platforms in connection with trading.

The alleged trading conduct, as well as alleged actions that the trader took to conceal communications evidence, relate to several matters covered in our topical guides and advisories concerning the CFTC's enforcement program. For further detail, please consult our ***Guide to United States, United Kingdom, and Hong Kong Derivatives and Commodities Market Enforcement Regimes***, and for those facing the prospect of a government inquiry, our guide to ***Responding to a U.S. Government Investigation in the Derivatives and Commodities Markets***, as well as our webinar ***Don't make it worse: responding properly to US/UK investigations***, or contact any of the individuals identified below.

CFTC Charges

The CFTC charged the trader with using a manipulative or deceptive device, in violation of Section 6(c)(1) of the Commodity Exchange Act ("CEA") and Rule 180.1(a), as well as attempted price manipulation in violation of Sections 6(c)(3)

Attorney Advertising: Prior results do not guarantee a similar outcome and 9(a)(2) of the CEA and Rule 180.2, by entering trades intended to push down the price of ten-year maturity U.S. dollar interest-rate swap spreads ("Ten-Year Swap Spreads") to the detriment of an unnamed Asia-based bond issuer who was entering into an interest rate swap with the trader's employer. In particular, the trader allegedly entered trades that would be reflected on the pricing screen of a U.S. swap execution facility ("SEF") broker firm, knowing that this pricing screen would be used to determine the price of the swap with the bond issuer.[1]

That the CFTC is bringing fraud charges in connection with a swap transaction occurring abroad demonstrates the CFTC's reliance on the Dodd-Frank Act's ("DFA") expansion of the CEA's anti-manipulation prohibitions to apply to swaps.[2] Under Section 2(i)(1) of the CEA, the DFA provisions pertaining to swaps apply to activities outside the U.S. only where the activities "have a direct and significant connection with activities in, or effect on, commerce of the United States."[3] In the CFTC's view, the CEA now applies overseas to swaps activity with a sufficient nexus to U.S. commerce (including where the parties to the swap transaction are outside the U.S.), and will consider the connection of swap activities to actions in U.S. commerce to determine whether an extraterritorial application of the swaps provisions is warranted.[4]

The trader was also charged with making false statements to the CFTC in violation of CEA Section 6(c)(2) for allegedly falsely stating that he had complied with a CFTC preservation request covering chat messages on unrecorded platforms such as WhatsApp, when in fact he had deleted conversations after receiving the preservation request, and falsely stating that his WhatsApp communications with other bank employees were only for social purposes.[5]

Trader's Alleged Conduct in Trading to Influence Swaps Pricing

The alleged scheme concerned an effort by the trader to benefit a Japanese affiliate of his employer with respect to the pricing of a U.S. dollar interest rate swap transaction between the Japanese affiliate and an unnamed Asian public financial institution (the "Bond Issuer Swap"). The CFTC alleged that the trader manipulated the U.S. dollar interest rate swap spreads published by a SEF broker firm in the U.S. upon which spread value the Bond Issuer Swap was priced.[6] The Bond Issuer Swap and the $1 billion ten-year U.S. dollar-denominated bond issuance that it related to (the "Bond Issuance") were priced during a February 3, 2015 pricing call by reference to a single pricing screen that the SEF broker firm used.[7] The trader allegedly knew that his employer's position in the Bond Issuer Swap would benefit if the SEF broker firm's pricing screen displayed lower prices

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1 Complaint, *Commodity Futures Trading Comm'n v. Gorman*, No. 21-cv-870 (S.D.N.Y.), ECF No. 1, Feb. 1, 2021 ("Complaint") at 27-29.
2 7 U.S.C. § 13(a)(2).
3 7 U.S.C. § 2(i)(1).
4 Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78. Fed. Reg. 45291, 45300 (July 26, 2013) (codified at 17 C.F.R. § 1). Congress has also introduced legislation that, if enacted, would extend the authority of the CFTC and U.S. Department of Justice to bring antifraud and anti-manipulation actions "to activities outside the United States where such activities, independently or in conjunction with activities in the United States, have or would have a reasonably foreseeable substantial effect within the United States." CFTC Reauthorization Act of 2019, H.R. 4895, Section 112, 116th Cong. (2019); see also our March 2020 article in the Futures and Derivatives Law Report, ***Extraterritorial Enforcement of the Commodities, Securities and Antitrust Laws: A Growing Confluence?***
5 Complaint at 29-30.
6 *Id*. at 1.
7 *Id*.

for Ten-Year Swap Spreads when pricing the Bond Issuance and the Bond Issuer Swap by reference to the spreads as reflected on the pricing screen.[8]

To carry out the scheme affecting the Bond Issuer Swap pricing, the trader allegedly executed trades through a broker who worked in the SEF broker firm's U.S. office, and traded in a manner designed to move the price of Ten-Year Swap Spreads downward on the SEF broker firm's pricing screen (opposite to the prevailing direction of the market at the time).[9] According to the complaint, the trader "almost never traded through U.S.-based brokers" of the SEF broker firm.[10] But in this instance, and as reflected in a text message that the trader had sent to a colleague, he sought to trade with a broker who could "move the screen the quickest," and indicated that he favored executing through the SEF firm's U.S.-based brokers rather than the SEF firm's U.K.-based brokers due to the former's control of the screen that would be used in pricing the Bond Issuer Swap.[11] The CFTC alleged that the price of Ten-Year Swap Spreads rose immediately after the trader ceased trading, and stayed higher for over 18 hours.[12] Because the allegedly-manipulated pricing in Ten-Year Swap Spreads was used to price the Bond Issuer Swap, the CFTC alleged that the international bank profited more (and the issuer less) than it otherwise would have but for the trades with the broker. This was because the Ten-Year Swap Spreads were used to calculate the amount of interest on top of the three-month U.S. dollar Libor rate that the bond issuer would pay to the bank, with lower spreads resulting in a higher interest rate payment to the bank.[13]

The complaint provides that, during the call on which the Bond Issuer Swap was being priced, the trader communicated with the New York-based head of the bank's Swaps Desk via unrecorded and unmonitored text messages on their personal cell phones. In the text messages, the trader and the desk head acknowledged there was buying interest in the Ten-Year Swap Spreads and that market prices were rising. The trader had indicated that he could trade in a manner that would cause spreads to fall to a lower level, but ahead of the pricing call the desk head had advised him not to engage in too much selling activity, given the robust buying interest that would prevent prices moving significantly downward.[14]

Nevertheless, the CFTC alleged, the trader continued trading during the pricing call by selling in the Ten-Year Swap Spreads at lower prices than he otherwise could have, for the purpose of moving the Ten-Year Swap Spreads downward.[15] These trades lost money for the bank, and the trades were executed at a worse price than the bank bought the Bond Issuer Swap when taking the SEF broker fees into account. However, the bank benefitted from the conduct because of the impact that the Ten-Year Swap Spreads had on pricing the Bond Issuer Swap.

8 *Id*. at 2.
9 *Id*. at 2-3.
10 *Id*.
11 *Id*. at 2, 9.
12 *Id*. at 3.
13 *Id*. at 8.
14 *Id*. at 10-11.
15 *Id*. at 11-17.

CFTC's Ability to Re-Create Market Conditions

The complaint's detailed accounting of how the trader traded in Ten-Year Swap Spreads, which includes insights concerning the scope of concurrent buying and selling interest and the effects of the relevant trades on price, is indicative of the CFTC's increased ability to review and process large amounts of trading data in support of its enforcement agenda. As recent settlement agreements have shown, the ability to collect, host, and analyze large amounts of trading data marks a significant advancement in the CFTC's enforcement toolkit, by which the CFTC is able to identify more comprehensively and charge improper trading activities in comparison to past investigations.

Communication Platforms and Preservation

The CFTC alleged that the trader sought to cover up his conduct by deleting communications, including those on WhatsApp, after the CFTC sent him a document preservation request.[16] The trader is also alleged to have lied to the CFTC about properly complying with the preservation request through a letter from his counsel to the CFTC and testimony to the Commission, as well as the nature of the content of his WhatsApp communications with bank employees when he stated that they were "entirely social" and not relevant to the CFTC's investigation.[17] As the false-statement charge underscores, a lack of candor in response to a CFTC subpoena or document request can constitute a separate violation of the CEA. Further, a failure to preserve, or worse, actions taken to delete, relevant communication records can have potentially dire consequences for the investigative target, including the potential for attributing an adverse inference regarding the content of the destroyed materials at trial.

[16] *Id*. at 22.
[17] *Id*. at 26.

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