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An Illusory Promise or Real Change? Transition at CFTC Brings Hope for Dodd-Frank Act Revisions

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Over the past five years, the Commodity Futures Trading Commission (CFTC) has settled 20 enforcement actions against financial institutions for violations of various Dodd-Frank Act regulatory requirements (*i.e.*, rules other than prohibitions on fraud, manipulation and spoofing). The resulting civil monetary penalties — for actions involving record keeping, know-your-customer, diligent supervision, swap data reporting, real-time price reporting and daily swap position reporting — exceed $45 million. Notably, almost half of these cases settled in 2019, indicating an acceleration of the trend in the last 12 months.

This uptick has occurred despite recent efforts to reduce regulatory obligations in the space. The Trump administration has sought, through executive order, to alleviate burdens in the over-the-counter (OTC) derivatives market, and the CFTC's 2017 "Project KISS" was intended to make the agency's rules, regulations and practices simpler, less burdensome and less costly. However, the strict liability standard and highly technical rules stemming from extensive regulatory requirements implemented in 2012 have created a difficult landscape within which market participants operate.

The trend also comes at a time of transition at the CFTC. In July 2019, a new chairman took the reins of the agency and has since appointed new directors for three of the agency's four operating divisions. Recent proposals from the new Division of Swap Dealer and Intermediary Oversight (DSIO) are a potentially promising indication that progress lies ahead. DSIO Director Joshua Sterling has voiced some welcome messages, supporting streamlining data use, limiting one-off no-action letter relief in favor of broadly applicable guidance and evaluating potential amendments to existing rules. At the same time, Director Sterling stated in remarks before the D.C. Bar in September 2019 that he is "strengthening [DSIO's] relationship with the Division of Enforcement with a more focused approach to referrals … ."

Background

New Year's Eve 2012 marked the beginning of the implementation of the Wall Street Transparency and Accountability Act of 2010, better known as Title VII of the Dodd-Frank Act. In the two years leading to the December 31, 2012, compliance date, the CFTC proposed and adopted nearly 40 comprehensive regulations comprising more than 150 new rules and scores of additional requirements. More than 3,600 pages were added to the Federal Register. The pace of rule-writing was unprecedented for the agency.

The rapid adoption of rules left little doubt that the CFTC would need to make future adjustments. Prior to 2012, the OTC swap market had been unregulated, opaque and dominated by customized transactions. Commissioner Jill Sommers highlighted some of the early challenges in her opening remarks at a 2011 CFTC open meeting: "There was often insufficient time to fully consider the implications of all aspects of some proposals, particularly when we were getting revisions the night before a vote, and sometimes the morning of a vote. [As a result,] we have issued a number of proposals in which at least three Commissioners have voiced concerns regarding the possibility of unintended consequences."

The extent of these unintended consequences is difficult to quantify, but one indicator is the dramatic increase

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in CFTC staff no-action letters issued between 2012 and 2014. The agency did not have the time or resources to revise each rule, as more and more issues were identified in the run-up to the initial compliance date. Instead, as a stop-gap approach to plug many of the holes in the new and complex regulatory regime, the CFTC leaned on the no-action process, in which the staff issues a nonbinding notice that it will not recommend an enforcement action for failure to comply under specific circumstances. From 2012 to 2014, the staff issued 327 no-action letters, up from just nine in 2011. The relief in the no-action letters was often time-limited, sometimes for as little as a few months. Many of these had to be renewed perpetually. Others expired, yet the problems with the rules remained unresolved. This patchwork of no-action letters remains in place today, and the CFTC has done little to incorporate the staff's relief into its regulations.

Good Faith Compliance

In response to concerns from market participants during this timeframe, the CFTC often issued temporary relief. For example, on the Friday before Christmas 2012 — just 10 days before the compliance date — the CFTC adopted a time-limited exemptive order for cross-border swap activities through the first half of 2013. The order's preamble included what was thought by the industry to be the Commission's statement of a policy to refrain from bringing enforcement actions for technical noncompliance with Title VII swap rules when market participants attempted in good faith to comply.

The late Commissioner Bart Chilton touted the 2012 exemptive order and highlighted its language describing the Commission's policy to permit market participants to "avoid a Dodd-Frank compliance-related enforcement action by working to comply [with the new rules] reasonably and in good faith." Republican and Democratic Commissioners alike reiterated their commitment in congressional oversight hearings to the principle of "good faith compliance" as a basis for the CFTC to forgo enforcement action during the initial period of unprecedented implementation. Nevertheless, to date 80% of the Commission's enforcement actions for Dodd-Frank regulatory rule violations cite conduct from 2013.

Notably, most regulatory requirements under the Dodd-Frank Act do not require intent as an element of a violation. In other words, the Title VII Dodd-Frank regulatory regime essentially imposes strict liability. Market participants not surprisingly question whether this is the right fit for a previously unregulated market that recently became subject to numerous new and complex regulatory requirements.

Looking Ahead

Market participants have been waiting for the better part of a decade to see substantive steps taken to address many of the challenges and issues that resulted from the rushed implementation of Title VII. With the recent additions of a number of new senior staff and a new chairman, the Commission has a fresh opportunity to make significant reforms in this area.

The DSIO/Enforcement connection will be an area to watch closely. On one hand, the new Commission and staff have an opportunity to make meaningful improvements to the regulatory framework. On the other, increased referrals from DSIO to Enforcement may well simply contribute to the upward trend in enforcement actions for regulatory violations on a strict liability basis and provide very little in the way of meaningful regulatory reform.