COMMODITY FUTURES TRADING COMMISSION

CFTC TALKS

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with

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MR. BUSCH: Hey it’s Andy here. Before we get to the show, I just wanted to let you know if you want to hear more podcasts, you can go to our website, cftc.gov and click on the podcast button. Or you can find us on iTunes by searching for CFTC Talks on your podcast app. By the way, we’re on Stitcher, iHeart Radio, Spotify, pretty much wherever you’re listening to a podcast we’re probably on the thing. You can always find us there and do the same thing. Just hit subscribe if you want to get it every week.

Now one more thing, you can send a suggestion via email by using podcasts@cftc.gov. Now you can already leave comments on many of the outlets the show appears on but we thought we’d make it easier for you to connect to the show. If you have time, drop us a line, drop us an idea or a comment, we’d love to hear from you. Okay on to the show.

Welcome to CFTC Talks. I’m your host Andy Busch, Chief Market Intelligence Officer for the CFTC. As always, please remember there is an important
All right, well this week we’re going to continue into the realm of the non-virtual currency world. Last week we talked about the major currencies like U.S. dollar and Euro and what was driving their values. Now this week, we want to discuss similar products that are influenced by the U.S. dollar and that is precious metals. However, we’re going to take a little bit of a different tact. Instead of trying to understand what their values are or what is driving their values, we’re going to discuss how the CFTC looks at these markets from a fraud, manipulation and enforcement of the CEA or Commodity Exchange Act lens. And that means we’re going to need someone who does this on a daily basis to review what is happening in this space. Fortunately, we just happen to have such a person. Many of the listeners of this show are familiar with him. CFTC’s Director of the Division of Enforcement, Jamie McDonald. Jamie, welcome back to CFTC Talks.
MR. MCDONALD: Thanks Andy it’s great to be here with you.

MR. BUSCH: Well Jamie, you were one of our very first guests on our show back last year and I encourage listeners to go back and take a listen to it and check it out, it was great. But before we dive into the precious metals, Jamie how about an update on what you and the Division of Enforcement have been doing since that podcast. I know you’ve been really busy.

MR. MCDONALD: Yeah we have been busy. We’ve been hard at work investigating and prosecuting misconduct in the commodity markets including some substantial cases involving precious metals which we’ll talk about today. We’ve been working hard, in particular, to identify instances of fraud and manipulation and to hold bad actors accountable. Just to give you one measure of the work we’ve done over the past year, we’re just a little more than halfway into this fiscal year but we’ve already filed almost as many cases involving manipulative conduct as the
Commission has filed in any prior year. I expect we’re going to have many more yet to come this year so hopefully that’s something we’ll be able to talk about later.

MR. BUSCH: Wow you’re making me look like a slacker here. I hope my boss doesn’t listen to this. I think that’s great because it is such an important role and it’s really important to make sure these markets are fair, that they’re operating in the most efficient manner and obviously this is a key component of it.

I also wanted to ask you because last year on the show we talked about, because you had a lot of interest in self-reporting with market participants. I just wanted to follow up with you to see how that was going.

MR. MCDONALD: Right. So when I was on the program about six months ago, we were just starting to roll out our self-reporting and cooperation program. The basic idea is that we’re trying to provide incentives for market participants to self-report
misconduct when they see it, including by identifying the individuals who were involved in the misconduct. And then provide them incentives to cooperate with our investigation and fix the problem going forward.

The goal of the program is to increase the information that comes into the division about misconduct in our markets and to learn about it at an early stage so that we can hold not just the company responsible but also the individuals. And we do that by trying to provide the company real incentives to self-report at an early stage as soon as they learn about the misconduct. And we do that by offering substantial discounts in terms of the civil monetary penalty that the company may otherwise incur had they not self-reported, cooperated and remediated the wrongdoing. We’re just about six months into that program. It’s too early to draw any firm conclusions but the early returns look good. We’re seeing a change in the behavior of market participants and we’ve already been able to bring cases against individuals that we otherwise might not have been able to bring
but for the companies self-reporting and cooperation. So I hope to have more to report on this soon.

MR. BUSCH: Wow, that’s great. I’m glad to hear that that’s working out. We’ll have you back on to give us a full year update because I know that’s something that has been important. I’m glad to hear that there is progress being made on it. Let’s get into the precious metals, that’s what everybody came here for. Let me start with the basics. Just as a reminder for everybody out there, the CFTC’s mission is to foster open, transparent, competitive and financially sound markets. By working to avoid systemic risks, the Commission aims to protect market users and their funds, consumers in the public from fraud, manipulation and abusive practices related to derivatives and other products that are subject to the Commodity Exchange Act. Now Jamie, that’s pretty broad but it doesn’t cover everything does it?

MR. MCDONALD: That’s right. So our role here in the Division of Enforcement flows from the Commission’s more general mission. Our role is to
protect the public and preserve market integrity by
detecting, investigating and prosecuting misconduct in
the commodity markets. It is important to remember
though that although the Commission’s mission is broad
and the role that the Division of Enforcement plays
within that mission is an important one, it doesn’t
cover every potential type of wrongdoing. But our
role does have a number of different components.

So in the Division of Enforcement, we have
the market surveillance unit and that’s a unit of
staff that’s dedicated to surveilling our commodity
markets. That includes the precious metal markets and
they do that to identify misconduct in those markets.
It also includes which you might traditionally think
of as enforcement activity. Like investigating the
leads that we get about misconduct and bringing
enforcement actions when we identify the wrongdoing.
We have certain areas that have been traditional areas
of focus within the Division of Enforcement or for
market surveillance and one of those is the market for
precious metals, which includes gold, silver,
platinum, and palladium.

MR. BUSCH: Well, the CFTC, I guess because I did a little bit of research on it but the CFTC has a long history of looking into precious metals for fraud, manipulation and other illegal activities. Can you give us a brief history of where this thing started?

MR. MCDONALD: Sure. So just to take a step back for a minute. I talked about some of the ways that we in enforcement get information about wrongdoing. One I talked about earlier is company self-reporting. Another I just mentioned is work from our market surveillance unit. But there are a number of other ways that we get information that might lead to an enforcement investigation or an action and that includes information that we get from customer complaints and from whistleblowers.

We’ve been receiving customer complaints about precious metals trading since at least the 1980’s. We’ve received more complaints about misconduct in the precious metals market than with
respect to any other commodity. We take these customer complaints seriously. So we’ve been investigating misconduct in the precious metals market at least since the 1980’s. So that is customer complaints on the one hand.

We also get information about misconduct in the precious metals market from our whistleblower office. Our whistleblower office was established in 2010 by Dodd Frank. This is since 2010 when it was established, served as another valuable source of information for the division and for the Commission. Under the whistleblower program, if a whistleblower has original information that leads to successful enforcement action resulting in monetary sanctions of a million dollars or more, the whistleblower could be eligible for a monetary award of between 10 and 30 percent of the ultimate monetary reward that was collected.

These awards can be incredibly significant. The largest issued by the CFTC to date is $10 million. And I expect we’re going to be in a position to issue
even larger awards in the near future. I would be remiss if I didn’t say for all the listeners out there, you can get more information about our whistleblower office or to file a complaint by going to the website whistleblower.gov.

MR. BUSCH: Nice. I think what is interesting is too often people look at that pejoratively but I think if you’re really a fan of the markets and you want these things to work efficiently and fairly for everybody, that’s a great service to have and it is important in aiding your group with looking at wrongdoing. Walk us through the process of how that works. What does your division do when it receives a complaint?

MR. MCDONALD: Right. What we do depends on a few different things. The first is the level of specificity if it’s included in the complaint and the type of information that is included in the complaint. Sometimes the complaint is sufficiently specific that we can pick it up and run with it. If that’s the case, then that’s what we do. But a lot of times, the
complaint points us in a general direction but we still need more information. In those cases, we’ll either reach out to the complainant directly or conduct our own analysis to try to determine if there was, in fact, some sort of fraud or manipulation in one of the precious metals market.

A lot of this work is done by the market surveillance unit. A lot of times where we’ve got a complaint where we require more information, we’re doing both of those things. Somebody is reaching out to the complainant to get more information and at the same time, we’re conducting our own analysis to try to corroborate or confirm the information that was provided by the customer in the complaint.

Once the surveillance staff has done the analysis and gathered the necessary information, surveillance then will refer the matter to an enforcement team. The enforcement team continues the investigation and, if appropriate, brings and enforcement action. The first thing when we’re thinking about how to deal with a complaint turns on
the amount of specificity or the type of information that is included in the complaint.

But the second way that how we deal with a complaint may differ. It relates to the type of misconduct that is reported in the complaint. We’re talking today mostly about fraud and manipulation cases. Let’s talk about fraud cases first. The Commission has aggressively pursued fraud actions in the precious metals context. When we’re dealing with a fraud complaint, we work to try to identify the victims, the potential perpetrators and then a large part of the work focuses on finding and trying to track the money, the proceeds of the fraud. If we’re able to find the fraud early enough, we can go into court, get an emergency asset freeze to ensure that money is still there or we can still find the money to compensate the victims.

When it comes to manipulation cases, our analysis is just a little bit different. One thing in particular that we’ve emphasized recently is the data analytics component of our manipulation analysis. When
we’re looking at manipulation and precious metals trading it is not enough, generally, for us just to have a customer complaint or a tip, that’s a starting point. But to determine that actual misconduct happened, we usually need to be able to tell the story with market data in addition to the customer complaint. That’s been a deep focus of ours recently.

MR. BUSCH: Yeah and the technology is so key for that right. I mean, because everything is traded electronically now so the deep dive and the resources that you need to be able to monitor that are critical.

MR. MCDONALD: That’s right. The technology and the expertise that we have on staff and that we’re continuing to develop. But there is another component of it as well which is coordination with our other law enforcement partners. If I could give you one set of examples here, just looking back at the last year. We have worked closely with the Department of Justice and with the Federal Bureau of Investigation to make sure that we had access to all of the data, all of the
technology and all of the expertise that we need in order to evaluate allegations of manipulative misconduct in these markets.

And just in the last year, we have filed seven cases involving manipulative conduct in the precious metals markets. That includes charges of manipulative conduct and spoofing against three banks in which the Commission imposed more than $45 million in penalties. We also charged four individuals with manipulative conduct and also with spoofing and in a parallel proceeding, the Department of Justice charged these same individuals criminally. This marked the largest parallel action that the CFTC has ever done with the criminal authorities and it marked the largest criminal prosecution in connection with the commodities markets in the history of DOJ.

Now those cases were done in the precious metals markets and they were made in part, based on sophisticated data analysis which revealed the manipulative conduct and the charges which all came in the past year. And the fact that they were brought in
parallel with the criminal charges brought by our criminal counterparts, I think should serve as an indication of just how seriously we view misconduct in this area.

MR. BUSCH: So you mentioned the FBI and the DOJ. Who else do you work with? I mean there is probably quite a few agencies that you work with on these types of cases.

MR. MCDONALD: Right. We are constantly working to develop our relationships with our fellow law enforcement partners. This includes not just the ones that I think our audience would expect like the SEC or like the FTC but we’re also working to develop our relationships with the state authorities. Because a lot of times, the customer complaints will go into the state securities and commodities regulator or the state attorney general. Particularly where we’re dealing with national and international markets, it is becoming increasingly important that we’re able to consolidate the data, consolidate the complaints and we’re able to make sure that we’re not just looking at
one piece of the puzzle. But to the extent that there are other regulators out there who also have some insight into what is happening. We want to make sure we have the benefit of that information as well.

MR. BUSCH: Well you mentioned obviously when people call in with tips and helping out on that side. But not all the tips you get are worthwhile right. So maybe what are some of the common mistakes that complainants make about manipulation or that they don’t understand.

MR. MCDONALD: I wouldn’t necessarily call them mistakes but I do think it is important to remember that customer complaints are just one piece of the analysis. They can be an important piece for sure but they’re just one piece.

One example is that we often see customer complaints where there are significant price moves in the precious metals markets. Or when customers lose substantial amounts of money or when the markets react in a way that certain individuals or a group of individuals didn’t anticipate. It is understandable
that from the customers perspective when something like this happened, they may suspect that there was some sort of wrongdoing involved. We investigate the complaints diligently and we take them seriously. They sometimes serve as the source for some of our most significant enforcement cases.

But the complaint itself isn’t going to be enough for us to bring an enforcement action for manipulation. Price moves or customer losses alone aren’t going to be enough for us to make a manipulation case. Our job is to take a clear eye view of the facts and to look at all the evidence and to look at all the data. In particular, we need to do a deep dive into the data to figure out whether that data is showing a pattern that is consistent with manipulation.

MR. BUSCH: So it is basically, these are starting points to take a look at and to start to dive into and figure out if there has been some wrongdoing and I think that makes perfect sense. Speaking of starting, you actually mentioned that you take all of
this very seriously which I think is obviously really good. Actually, the Agency has taken quite a few steps to publicly address a lot of these issues. Ladies and gentlemen, you can look all of these up if you want, you can Google them or whatever. I think they’re all up on our website at some point but it might be easier to Google them.

There was the 2004 Division of Market Oversight Michael Gorham letter to silver investors. There was the 2008 CFTC report on large short trader activity in the silver futures market. There was a 2010 Commission public hearing to examine futures and options trading in the metal markets. And then there was the 2013 public announcement at the end of a multiyear silver investigation into the silver markets. Which I think is really unusual that you just announce the end of an investigation. Instead of bringing any charges, you just said there was nothing here that you could see. I guess the question I have for you, Jamie, is what did the CFTC and the Division of Enforcement learn from all of these?
MR. MCDONALD: I think one thing that we learned is the importance of communicating with the public on these issues. As I said earlier, it is certainly understandable that when folks lose money in our markets, that might lead them to make complaints about suspected wrongdoing.

But one thing the Commission has been clear about is that enforcement cannot serve as a one size fits all solution to every customer complaint in the market. Enforcement forms part of our customer protection efforts to be sure but so does our customer education and outreach program and so do the other avenues that the Commission has like your podcast, Andy. To communicate with market participants and with customers and to ensure that they understand the risks associated with particular types of trading activity.

I think one thing that we’ve learned is the importance of communicating with the public and that communication goes both ways. We get complaints from the public. We often will communicate back to those
same complainants to ensure that we have access to all the information that we need. But it’s also communication from us to the public to make sure that the customers themselves continue to remain vigilant, to ensure that they fully understand the markets and the products that they’re investing in and to ensure that they understand and are comfortable with the risk associated with particular trading activity.

Even when we’re talking about the type of significant enforcement actions that we’ve had over the past year, unprecedented penalties against major banks and unprecedented civil and criminal charges against traders at those banks, those enforcement actions can’t, by themselves, prevent customer losses or ensure that risk to customer trading positions won’t ultimately become a reality in certain instances. That’s why they’re called risks is because there is a chance they may come to fruition.

So customers need to be particularly diligent to ensure that they’re trading in a responsible way while only taking on appropriate
risks. That’s part of what our customer education program is about. And the public statements that you just mentioned, I think they’re also designed to get that same message across.

MR. BUSCH: Those are great points. Well just to wrap this up, from big picture point of view here, Jamie, what can you say about the current state of the precious metal markets?

MR. MCDONALD: So in the Division of Enforcement, we don’t make predictions about where the market is going nor are we making broad statements about the market generally. We look backwards to try to identify misconduct. But what I can say about the market from the enforcement standpoint is that we are working very hard to ensure that if there is wrongdoing in any of our markets, including in the precious metals markets and especially in the precious metals markets, that we’re ready to stop it and that we are on the beat to hold the bad actors accountable. We’re doing this in a number of ways that I think are areas of particular emphasis recently which includes
some of the things that we’ve talked about like our use of data analytics and like our coordination with other agencies.

I think we’re starting to see some of the fruits of those efforts. Like I said, some of the enforcement actions that I talked about just a few minutes ago were brought in close coordination with our law enforcement partners. My view as a former federal prosecutor is that when you are thinking about deterring misconduct as much as we do, the threat of a criminal prosecution in the appropriate case is one way to ensure that you can achieve optimal deterrents. So coordination with other agencies and the data analytics. Those cases, same thing that we brought with our fellow law enforcement agencies, were built in part around some of this new sophisticated data analytics that we’re doing.

I think the current state of the market, we’re on the beat, we’re working hard and we’re employing new techniques and relationships to make sure that we are as active as we possibly can be in
this market.

MR. BUSCH: CFTC Director of Division of Enforcement, Jamie McDonald. Thanks again for coming on the show.

MR. MCDONALD: Thank you, Andy.

MR. BUSCH: All right, that’s a wrap for the show this week. We’ll be back next week with another guest on our quest to learn about the markets we watch. I’m Andy Busch, thanks for listening, this has been CFTC Talks.

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