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The CFTC Announces New Enforcement Advisory—Penalties, Monitors, and Admissions

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On October 17, 2023, the Commodity Futures Trading Commission's ("CFTC" or "Commission") Division of Enforcement ("DOE") released its latest enforcement advisory, providing guidance to CFTC staff on resolution of an enforcement action. Specifically, the advisory provides guidance for:

- Assessing whether a civil monetary **penalty** ("penalty") is an adequate deterrent, particularly in cases involving recidivist respondents;
- Determining whether to impose a corporate compliance **monitor** or consultant, and what their duties should be; and
- Deciding whether **admissions** should be required based on the facts and circumstances of certain enforcement actions.

As always, recommendations on the resolution of enforcement matters is a discretionary function of DOE and involves a case-by-case analysis of the associated facts and circumstances. This guidance, however, provides important insights into how market participants and others can anticipate DOE approaching proposed enforcement resolutions.

Penalties

The advisory emphasizes that the goal of the new penalty policy is to ensure both general and specific deterrence. According to DOE, "[I]f penalties are not sufficiently high, entities may choose to continue to behave unlawfully, viewing penalties as a cost of doing business; and individuals may view the potential rewards of misconduct as outweighing the potential risks." According to DOE, higher penalties empower compliance professionals operating within covered entities and motivate senior management to invest in compliance.

Cases involving recidivism—i.e., repeated violations of the law by the same respondent in current and prior CFTC actions—are underscored in the new advisory. A person or entity will be considered as recidivist based on an evaluation of a range of factors, including:

- whether the prior and current Commission actions involve the same or similar kinds of violations and whether the violations resulted from the same root cause or involve the same general subject matter;

- the length of time that occurred between offenses, with more recent conduct resulting in a more likely determination of recidivism;
- the involvement of overlapping management;
- whether the new misconduct is pervasive—*de minimis* misconduct that is identified and remediated quickly is less likely to be determined to constitute recidivism; and
- the robustness and effectiveness of the post-resolution remediation and the demonstrated commitment to addressing prior misconduct and minimizing the recurrence risk.

DOE considers recidivism to be an aggravating factor that can increase the penalty amount imposed in a resolution and "will heavily factor recidivism when determining appropriate and effective deterrence." It also will consider recidivism when evaluating any cooperation credit. The new advisory states that entities determined to be recidivist will not only be subject to escalating penalties, but also that "the Division will be inclined to recommend that a Monitor or Consultant be imposed."

Monitors and Consultants

The CFTC anticipates that Monitors, which can be costly and intrusive to companies, will be imposed in cases where significant and/or pervasive compliance and control failures indicate a lack of sufficient commitment to effective compliance. Consultants may be recommended in cases with less severe conduct and where the entity needs the assistance of a neutral third party to advise on remediation.

DOE will need to approve Monitors and their responsibilities, which "will" include: (1) testing the sufficiency of policies, procedures, and controls to prevent future similar misconduct; (2) preparing specific recommendations for issues identified through testing; and (3) testing the sufficiency of the enhancements made to policies, procedures, and controls based on the Monitor's recommendations and their effectiveness over time.

An approved Monitor will provide reports to the DOE on the remediation plan and recommendations as well as status and progress of its implementation. At the termination of the Monitorship, the Monitor and the entity will be required to certify the entity's completion of the remediation plan.

Unlike Monitors, Consultants do not need to be approved by the CFTC, but they will be responsible for advising the entity regarding the implementation of remediation following misconduct.

Admissions

Recent CFTC resolutions have included admissions,[1] demonstrating as the new advisory states, "[R]espondents should no longer assume that no-admit, no-deny resolutions are the default." In her October 17, 2023 statement, Commissioner Goldsmith Romero stated that she "applaud[s] the Enforcement Division's decision to end the routine use of neither-admit-nor-deny settlements. Using neither admit-nor-deny settlements relieves defendants of the consequences of breaking the law (which is not the government's role), and does not serve the enforcement goals of accountability, justice, and deterrence."

In the latest guidance, the CFTC outlines factors the DOE will consider when assessing the appropriateness of admissions. Factors that weigh in favor of admission include whether:

- there is a parallel criminal resolution where the respondent admits to the underlying misconduct;
- the investigation conclusively establishes misconduct;
- a respondent seeks cooperation credit. An admission of wrongdoing may be considered when assessing the extent of a respondent's cooperation; and
- whether the offense is a strict liability offense, and there is no need to assess the respondent's state of mind.

Cases where there is a realistic risk of criminal exposure arising uniquely from admitting the misconduct weigh against admissions. Additionally, in cases where there is a legitimate factual dispute where the CFTC is persuaded there is significant litigation risk establishing the fact at trial, it counsels against admissions to that fact.

It is one thing to require admissions where a parallel criminal action has resulted in a plea or similar admission. It is another matter entirely to require it in a civil settlement. The Securities and Exchange Commission ("SEC") has been down this road previously, prohibiting the respondent agreeing to settle SEC claims from disputing (directly or indirectly) the SEC's allegations, and at times requiring admissions. Some judges have criticized the SEC's policy as contrary to First Amendment rights,[2] and the SEC has used admissions sparingly. We will have to see if the CFTC policy draws similar challenges and if the CFTC uses admissions sparingly or liberally.

Department of Justice Corporate Enforcement and Voluntary Self-Disclosure Policy

The CFTC's latest guidance appears to be an attempt to align with some of the key points in the Department of Justice's ("DOJ") February 22, 2023 Corporate Enforcement and Voluntary Self-Disclosure Policy.[3] Specifically, both policies emphasize full cooperation and timely and appropriate remediation. Both also focus on recidivism and weigh it heavily in determining the appropriate penalty and whether to impose a monitor. The CFTC also seems to be following the DOJ's lead in requiring monitors and admissions in egregious cases. The DOJ indicates that a Monitor is appropriate unless a company has, "at the time of resolution, demonstrated that it has implemented and tested an effective compliance program and remediated the root cause of the misconduct." The CFTC similarly anticipates appointing a Monitor in cases with significant and pervasive misconduct indicating a lack of commitment to compliance and remediation on the part of the respondent, including recidivism. In other words, the appointment of a Monitor should be limited to "cases of a broken culture of compliance," i.e., a recidivist.

Implications of the CFTC Advisory

CFTC Chairman Behnam stated, "[I]t is our duty to ensure that every enforcement action aims to elevate compliance and optimize deterrence." It remains to be seen if this new guidance will achieve these goals. For example, the criminal law concept of recidivism assumes a more prominent role in this latest guidance and, according to the guidance, "will [be] heavily factor[ed]" in determining recommended penalties. But recidivism is a malleable concept and some violations are less significant than others. The CFTC states that *de minimis* conduct identified and remediated in a timely and appropriate fashion is less likely to be determined to constitute recidivism, but past CFTC settlements have found even *de minimis* violations may support a failure to supervise charge. And undue focus on general deterrence,

rather than specific deterrence based on the facts and conduct at issue, should not be used to justify a broader penalty on one person or entity based on the unrelated conduct of others or the industry.

Another concern posed by this new guidance is its decided shift in favor of the appointment of Monitors or Consultants. Although Monitors may be a necessary and effective solution for some matters, particularly those involving a parallel criminal action, a distinction should be made between registrants and non-registrants in non-criminal matters. CFTC registrants already are subject to frequent examinations and oversight. As such, it will be important for the CFTC to carefully evaluate exactly what situations necessitate a Monitor and the role of Monitors in remediating registrant misconduct.

Experienced counsel can help market participants and others enhance existing compliance programs, remediate following misconduct, and protect themselves from the risks posed by increasing penalties and a growing emphasis from the CFTC and DOJ on deterrence through enforcement.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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[1] *See, e.g.*, CFTC Orders Three Financial Institutions to Pay Over $50 Million for Swap Reporting Failures and Other Violations, CFTC Release No. 8801-23 (Sept. 29, 2023); CFTC Orders Four Financial Institutions to Pay Total of $260 Million for Recordkeeping and Supervision Failures for Widespread Use of Unapproved Communication Methods, CFTC Release No. 8762-23 (Aug. 8, 2023).

[2] *SEC v. Moraes*, https://www.corporatedefensedisputes.com/wp-content/uploads/sites/52/2022/10/SEC-v.-Moraes-S.D.N.Y.-Oct.-28-2022.pdf. ("By preventing defendants from publicly defending themselves, or even criticizing the SEC's handling of the case (thereby 'creating the impression' that the Commission sanctioned them without basis), the Provision denies the public the opportunity to scrutinize the government's enforcement practices.")

[3] *See also* https://www.paulhastings.com/insights/client-alerts/safe-harbor-in-the-coming-enforcement-storm-doj-announces-new-m-and-a-policy.