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Bridging the Week: December 11 – 15 and December 18, 2017 (ICOs; Financed Spot Virtual Currencies; Investment of Customer Funds; Wash Sales) [VIDEO]

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Last week, the Securities and Exchange Commission said it had no appetite to classify as a non-security a digital token issued to support an iPhone food app, while the SEC chairman issued a personal statement cautioning generally about initial digital coin offerings. Separately, the Commodity Futures Trading Commission issued proposed interpretive guidance to clarify when financed offers and sales of virtual currencies to retail clients would be subject to regulatory requirements that ordinarily apply to all futures contracts. As a result, the following matters are covered in this week's edition of *Bridging the Week*:

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Bridging the Week

Financial Institutions & Banking
Securities & SEC
All Federal

- Non-Registered Cryptocurrency Based on Munchee Food App Fails to Satisfy SEC's Appetite for Non-Security (includes **Legal Weeds** and **Compliance Weeds**);
- CFTC Proposes Interpretation to Make Clear: Retail Client + Virtual Currency Transaction + Financing + No Actual Delivery by 28 Days + No Registration = Trouble (includes **Legal Weeds**);
- ICE Clearing Entities Seek Exemption From CFTC Prohibition Against Investing Customer Funds in Certain Non-US Sovereign Debt (includes **My View**);
- Trader Sanctioned by CME for Wash Sales to Generate Credits Under Exchange Incentive Program (includes **Compliance Weeds**);
- No Suspense Anymore – CME Group Clarifies Suspense Account Requirements in New Guidance (includes **Compliance Weeds**); and more.

This is the last regularly scheduled edition of *Bridging the Week* for 2017. The next regularly scheduled edition will be January 8, 2018. Happy holidays and may peace reign!

Briefly:

- **Non-Registered Cryptocurrency Based on Munchee Food App Fails to Satisfy SEC's Appetite for Non-Security**: The Securities and Exchange Commission filed and simultaneously resolved an enforcement proceeding against Munchee Inc., for conducting an initial digital coin offering constituting the unregistered offer or sale of securities. Munchee agreed to cease and desist from its violations to settle this matter. It was not required to pay any fine. The company voluntary returned all funds it had received from token purchasers – US $60,000.

On the same day the SEC issued its Munchee order, SEC Chairman Jay Clayton released a personal statement addressing cryptocurrencies and ICOs (click here to access). Although acknowledging that some cryptocurrencies may not be securities, he cautioned "market participants against promoting or touting the offer and sale of

digital coins or tokens without first determining whether securities laws apply to those actions." Solely labeling a token a utility token or currency is not sufficient, he said. Generally, Mr. Clayton noted, "[t]okens and offerings that incorporate features and marketing efforts that emphasize the potential for profits based on the entrepreneurial or managerial efforts of others continue to contain the hallmarks of a security under U.S. law."

Munchee had developed an iPhone application for persons to review restaurants. Beginning in October 2017, it offered and sold digital tokens – known as MUNs – to be issued on a blockchain to raise US $15 million to fund further development of the app. According to the SEC, Munchee claimed in its promotional efforts that MUN tokens would rise in value as a result of the firm's managerial efforts, and that MUN tokens would be traded on secondary markets. Holders of MUN tokens would not receive any income or dividends from Munchee. Although Munchee described utility benefits of possessing MUNs in promotional materials and other marketing efforts, (e.g., the more MUNs a person held, the more MUNs it would receive for writing restaurant reviews), the principal benefit of holding MUNs was the potential for appreciation of their value through Munchee's entrepreneurial efforts. As a result, concluded the SEC, MUN tokens were securities and Munchee's offer and sale of MUN tokens without filing a registration statement with it (absent a bona fide exemption) was illegal.

According to the SEC, "[d]etermining whether a transaction involves a security does not turn on labeling – such as characterizing an ICO as involving a 'utility token' – but instead requires an assessment of 'the economic realities underlying a transaction'."

In his statement, Mr. Clayton also cautioned broker-dealers and other market participants who authorize their customers to transact in cryptocurrencies to ensure that such activities do not undermine their anti-money laundering and know-your-customer obligations. Mr. Clayton indicated that his statement was his own, and did not reflect the views of any other commissioner or the SEC.

On the same day Mr. Clayton issued his statement, Commodity Futures Trading Commission Chairman J. Christopher Giancarlo issued a parallel statement commending Mr. Clayton's writing and reminding market participants that, "the relatively nascent underlying cash markets and exchanges for bitcoin remain largely unregulated markets over which the CFTC has limited statutory authority." (Click here to access Mr. Giancarlo's statement.)

UK Regulator Publishes Input on Distributed Ledger Technology and ICO Guidance

The UK Financial Conduct Authority published responses to its April 2017 discussion paper on distributed ledger technology. (Click here for a copy of the FCA's feedback summary; click here for further background in the article "Financial Conduct Authority Seeks Comments on Proposed Distributed Ledger Technology Regulation" in the April 16, 2017 edition of *Bridging the Week*.)

Generally, persons responding expressed support for FCA's "technology-neutral" approach to regulation and welcomed FCA's "open and proactive approach to new technology," including its Sandbox and RegTech initiatives. Respondents believed current FCA rules were sufficient to accommodate applications of new technologies, including the use of DLT by regulated entities.

Respondents also agreed with FCA that issues regarding ICOs must be considered on a case-by-case basis. As part of its feedback publication, FCA included a specific annex setting forth regulatory considerations for ICOs, including that digital tokens issued as part of ICOs could be securities, and that persons issuing or selling securities must comply with relevant regulatory requirements.

Legal Weeds: Last July, the SEC published a Report of Investigation concluding that digital tokens issued by an entity for the purpose of raising funds for projects – even if using distributed ledger or blockchain technology – may be securities under federal law. If so, such securities must be registered with the Commission or eligible for an exemption from registration requirements. Moreover, the SEC concluded that any person offering trading facilities like an exchange for digital tokens that are securities must be registered as a national securities exchange or be exempt from such registration requirement.

The SEC's Report followed an investigation by the SEC's Division of Enforcement which concluded that digital tokens offered and sold during April and May 2016 by DAO, an unincorporated virtual organization created by Slock.it UG, a German corporation, were securities subject to the SEC's registration requirements.

(Click here for background in the article "SEC Declines to Prosecute Issuer of Digital Tokens That It Deems Securities Not Issue in Accordance With US Securities Laws" in the July 26, 2017 edition of *Between Bridges*.)

There is nothing in the Munchee order or Mr. Clayton's statement that is fundamentally inapposite to guidance given in the SEC's DAO Report. However, these two new writing make it clear that marketing a digital token as a utility token and untethering a token from the earnings of a company are not sufficient to make the token a non-

security. A cryptocurrency will still be regarded as a security if its holders purchase the token with the expectation that it will rise in value principally based on the managerial efforts of others.

Indeed, Munchee considered application of the DAO standards to its ICO. However the firm incorrectly concluded that, since MUN digital tokens were "utility tokens," their issuance in an ICO did not "pose a significant risk of implicating federal securities laws." Unfortunately for Munchee, the SEC considered the substance of the firm's tokens, not their form.

Compliance Weeds: In his statement, Mr. Clayton sounded an ominous warning to advisors in the ICO space. Given that the determination of whether a particular cryptocurrency is a security depends on the facts and circumstances, Mr. Clayton indicated (in bold) that, "**[o]n this and other points where the application of expertise and judgment is expected, I believe that the gatekeepers and others, including securities lawyers, accountants and consultants, need to focus on their responsibilities**."

The highlighting of this sentence in bold should not be dismissed lightly. Although a personal statement, Mr. Clayton is clearly indicating that, in connection with each ICO, advisors must assess whether a relevant token is a security. In considering this, advisers must evaluate what would be the principal motivation for someone to purchase the cryptocurrency – is the token to be a medium of exchange like a fiat currency (and thus a virtual currency and not a security)? Is the token inextricably tied to use of the underlying project (and potentially a utility token not subject to securities law requirements)? Or is the token principally a vehicle to profit from the underlying project (and thus, likely a security)?

In analyzing whether a cryptocurrency is a utility token or a security, Mr. Clayton provided two examples: a digital token that represents an interest in a book-of-the-month club and permits holders to receive future publications is likely not a security. However, a digital token is likely a security if it will help fund the development of a publishing house to sign-up authors and publish books with all infrastructure to be developed in the future and the holder expects to realize appreciation in the value of his/her tokens through their resale. According to Mr. Clayton, "[i]t is especially troubling when the promoters of [ICOs] emphasize the secondary market trading potential of these tokens."

This seems like a bright line test. However, the challenge for brokers and traders transacting in cryptocurrencies is determining when cryptocurrencies that might have been born principally as a security begin functioning mostly, if at all, as a virtual currency.

- **CFTC Proposes Interpretation to Make Clear: Retail Client + Virtual Currency Transaction + Financing + No Actual Delivery by 28 Days + No Registration = Trouble**: The Commodity Futures Trading Commission issued a Proposed Interpretation that would formally require actual delivery of a virtual currency to a retail client within 28 days to avoid Commission registration requirements by persons selling and either financing or arranging financing of the virtual currency.

Although the CFTC does not typically regulate spot transactions involving retail clients, retail commodity transactions on a leveraged or margined basis, or financed by the offeror, the counterparty or a person acting in concert with such persons on a similar basis may implicate certain Commission requirements – namely registration requirements by the offeror and a requirement that the products be traded on or subject to the rules of a designated (e.g., licensed) contract market. (Clickhere to access 7 USC §2(c)(2)(D)(i).) The key is whether actual delivery of the commodity has occurred within 28 days of the transaction. If yes, CFTC registration and other requirements are not implicated. If no, CFTC registration and other requirements are implicated.

In its Proposed Guidance, the CFTC said that, consistent with prior guidance involving retail transactions of tangible commodities (click here to access), it will consider "actual delivery" of a virtual currency to have occurred when a customer can take "possession and control" of all of the cryptocurrency and use it freely no later than 28 days from the date of the initial transaction and can do so unencumbered. This would require neither the offeror nor seller, or any person acting in concert with such persons, retaining any interest or control in the virtual currency after 28 days from the date of the transaction.

Among other situations, the CFTC noted that actually delivery of a virtual currency will occur within 28 days of an initial transaction when there is a record of a sale of the relevant virtual currency, including any financed portion, on the relevant blockchain, from the seller's blockchain wallet to the buyer's blockchain wallet, or if the transaction occurred on a matching platform, from the offeror's blockchain wallet to the purchaser's blockchain wallet – provided the purchaser's wallet is "not affiliated with or controlled by the counterparty seller or third party offeror in any manner."

Actual delivery will not have occurred cautioned the CFTC when, within 28 days, virtual currency sold to a retail client is rolled, offset against, netted out, or settled in cash or virtual currency between a buyer and the offeror or counterparty seller or any person acting in concert with either such person.

The CFTC will accept comments on its Proposed Guidance for 90 days after its publication in the *Federal Register*.

Another Day, New CFTC-Overseen Bitcoin Contracts

CME Bitcoin cash-settled futures contracts began trading last night, as of today's trade date. Initially CME Bitcoin futures will require an initial margin of 47 percent of contract value for speculators, and 43 percent for hedgers (click here for details). Unlike CBOE cash-settled Bitcoin futures where the unit of trading is one Bitcoin, the unit of trading for CME Group Bitcoin futures contracts is five Bitcoin. The initial listings will be for January, February, March and June 2018. (Click here for details; click here for a general overview of the CME and CBOE's Bitcoin futures contracts in the article "Three CFTC-Regulated Exchanges Self-Certify Bitcoin Derivatives Contracts" in the December 3, 2017 edition of Bridging the Week.)

In its first night of trading, the January 2018 CME Bitcoin futures contract opened at US $20,650/Bitcoin (click here for details).

Nadex self-certified its Weekly Variable Payout ("Spread") Bitcoin contract on December 14 for initial trading on December 18 (click here to access). Nadex's contract will be based on the Tera Bitcoin Price Index – an index comprising prices from nine worldwide spot exchanges trading Bitcoin. This product, which principally will be marketed to retail clients, requires full collateralization by traders and caps persons' potential gains or losses. (Click here for further details in the article "First Cash-Settled Bitcoin Futures Contract Begins Trading on CFTC-Overseen Exchange; Industry Organization Bemoans Self-Certification Process" in the December 10, 2017 edition of *Bridging the Week*.)

Bitcoin and Other Cryptocurrencies Allegedly Used for Terrorist Financing

The US Attorney's Office for the Eastern District of New York oversaw the issuance of an indictment against Zoobia Shahnaz for purportedly purchasing Bitcoin and other cryptocurrencies to help finance the Islamic State of Iraq and al-Sham ("ISIS"). The five-count indictment was filed in a federal court in Brooklyn, NY (click here for a copy of the indictment).

According to the indictment, Ms. Shahnaz obtained a loan from a financial institution for $22,500 under false pretenses, and fraudulently used over a dozen credit cards to purchase Bitcoin and other cryptocurrencies valued in excess of US $65,000. Ms. Shahnaz then allegedly engaged in a number of transactions to launder and transmit over US $150,000 to various shelf entities in Pakistan, China and Turkey, and attempted to leave the United States and travel to Syria.

Ms. Shahnaz, if convicted, could be subject to up to 30 years imprisonment for bank fraud and 20 years on each count of money laundering.

Korea-based Crypto-Exchange Fined by Korean Regulator

Korean media reported that Bithumb, Korea's largest cryptocurrency exchange, was sanctioned Korean Won 58.5 million (approximately US $54,000) for failing to protect personal private information of account holders. Bithumb apparently sustained a hacking attack in April that resulted in 31,506 IDs and passwords of users being stolen. (Click here for details from a sample article by *THE CHOSUNILBO Business*.

Legal Weeds: The CFTC has previously filed and settled an enforcement action against a Bitcoin platform that purportedly dealt with retail clients and facilitated financing where actual delivery did not occur within 28 days.

In June 2016, BFXNA Inc., doing business as Bitfinex, agreed to settle charges brought by the Commission alleging that, from approximately April 2013 through at least February 2016, it engaged in prohibited, off-exchange commodity transactions with retail clients and failed to register as a futures commission merchant, as required. According to the CFTC, during the relevant time period, Bitfinex "operated an online platform for exchange and trading cryptocurrencies, mainly Bitcoins." The CFTC said that Bitfinex's platform allowed retail participants to borrow funds to purchase Bitcoins from other platform users. However, financed Bitcoins purchased were not delivered to purchasers within 28 days as required for retail clients under applicable law. (Click here for details in the article "Bitcoin Exchange Sanctioned by CFTC for Not Being Registered" in the June 5, 2016 edition of *Bridging the Week*.)

Bitfinex is one of the nine component exchanges whose prices are utilized by the Tera Bitcoin Price Index (click herefor details). Bitfinex currently does not conduct business with US individual persons. (Click here for details – see paragraph 3.)

The CFTC has brought numerous enforcement actions against firms, claiming that they sold precious metals to retail clients on financing without actual delivery occurring within 28 days.

Most recently, Monex Deposit Company and two affiliated companies (collectively, "Monex"), and Louis Cabrini and Michael Cabrini, the firms' principals, were charged in a civil complaint by the CFTC with fraud and engaging in illegal precious metals transactions with retail clients. The complaint was filed in a federal court in Illinois, and the case was subsequently transferred to California.

According to the CFTC's complaint, from July 16, 2011, through March 31, 2017, Monex offered leveraged precious metals trading to retail clients through its "Atlas" trading program. Through this program, retail clients purchased and sold precious metals; paid only a portion of the purchase price; and either borrowed the difference (for purchases) or borrowed the metal (for sales). Clients were subject to margin calls if the value of their account equity declined below a certain level (determined in Monex's discretion), and forced liquidation, if the value of their account value fell to 7 percent.

The CFTC charged that these leveraged purchase and sales to retail clients constituted prohibited off-exchange futures contracts, and that Monex operated as a futures commission merchant without required registration in facilitating these transactions.

(Click here for details regarding the CFTC's enforcement action against Monex in the article "Retail Metals Dealer and Principals Sued by CFTC for Illegal Transactions and Fraud" in the September 10, 2017 edition of *Bridging the Week*.)

- **ICE Clearing Entities Seek Exemption From CFTC Prohibition Against Investing Customer Funds in Certain Non-US Sovereign Debt**: The Commodity Futures Trading Commission proposed an order authorizing three ICE derivatives clearing organizations to invest customer funds in certain euro-denominated sovereign debt instruments issued by France and Germany. The three ICE entities are ICE Clear Credit LLC, ICE Clear US, Inc., and ICE Clear Europe Limited.

The proposed order would also permit the three ICE DCOs to engage in repurchase transactions in the relevant French and German sovereign debt.

Prior to the collapse of MF Global in 2011, such investments were permitted by CFTC rule. However, in 2013, the CFTC amended the relevant rule to prohibit investment of customer funds in non-US sovereign debt. (Click here to access CFTC Rule 1.25(a).)

Under the proposed Order, the CFTC would impose a number of conditions on the ICE DCOs' investment of customer funds in French and German sovereign debt instruments. Among other things, such debt could only be purchased with customers' euro cash; the two-year credit default spread of the issuing sovereign must be 45 basis points or less at the time of the transaction; and the dollar-weighted average of the time-to-maturity portfolio in each type of approved sovereign debt could not exceed 60 days. Counterparties to ICE DCO entities must be a permitted depository under applicable CFTC rules (click here to access CFTC Rule 1.49(d)(3)) or in another jurisdiction that has adopted the euro as its national currency, or a securities dealer located in a money center country (click here to access CFTC Rule 1.49(a)(1)) that is regulated by a national financial regulator such as the UK Prudential Regulation Authority or Financial Conduct Authority.

The CFTC will accept public comment on its proposed order for the ICE DCOs for 30 days after its publication in the*Federal Register*.

My View: I have always regarded the CFTC's prohibition on futures commission merchants and DCOs investing in the qualified sovereign debt of non-US countries as an over-reaction to the collapse of MF Global and an unwise imposition of currency basis risk on such entities. Currently, if clients deposit euros with an FCM or DCO, the entity must first convert such currency to US dollars in order to purchase approved USD-denominated obligations. What the CFTC is proposing for the ICE DCOs is sensible, and includes more than adequate protections for customers. However, this expansion of investment authority should not be restricted to the ICE DCOs. It should be expanded to all DCOs as well as to all FCMs, and be considered for other non-US sovereign debt – as generally recommended by both FIA and CME Group in their Project Kiss submissions to the CFTC in October. (Click here for background in the article "Derivatives Industry Wishes Upon a CFTC KISS Star and Hopes Dreams Come True" in October 8, 2017 edition of *Bridging the Week*.)

- **Trader Sanctioned by CME for Wash Sales to Generate Credits Under Exchange Incentive Program**: The Chicago Mercantile Exchange brought and settled a disciplinary action against Brandon Elasser for purportedly engaging in wash sales to earn trading-fee credits for his employer under a CME-administered incentive program. According to CME, Mr. Elasser placed matching buy and sell orders on Globex in Eurodollar futures for the same beneficial owner with the expectation the trades would match between June 2014 and July 2015. Mr. Elasser agreed to pay a fine of US $40,000 to resolve the CME's disciplinary action and agreed to a 20-business day all CME Group trading access ban. Mr. Elasser previously settled charges by the Commodity Futures Trading Commission related to this incident by

agreeing to pay a fine of US $200,000. (Click here for a copy of the relevant CFTC Order.)

Separately, two individuals resolved disciplinary actions alleging disruptive trading practices filed by CME Group exchanges. In one, Michael ten Hacken agreed to pay a fine of US $20,000 and submit to a 15-business day all CME Group trading access prohibition for purportedly entering and cancelling orders in Oats and Rice futures contracts on Globex during the pre-open period for the purpose of assessing market depth and not for executing orders. The Chicago Board of Trade claimed these transactions – which occurred on "multiple occasions" from January 3, 2016, through January 27, 2017 – caused "fluctuations in the publicly displayed Indicative Opening Price." Additionally, Mark Palmer consented to pay a US $12,500 fine and a two-month all CME Group trading access prohibition to resolve charges that, from July 1, 2014, through September 4, 2015, he entered bids, offers and modifications on Globex in the pre-open period at prices through existing bids and offers. CME claimed these messages were not entered to achieve executions and also caused fluctuations in the publicly displayed Indicative Opening Price.

Finally, Phillip L. Martin agreed to pay a fine of US $20,000 and incur a 15-day all CME Group trading access prohibition for allegedly engaging in "numerous" wash sales from February 1, 2016, to October 12, 2016, to move positions from one to another or between accounts he owned. Mr. Martin accomplished this by purportedly entering matching buy and sell orders on Globex that he expected would match.

Compliance Weeds: As I have written previously, although much attention has been focused on the CFTC's and exchanges' prohibition against spoofing (e.g., placing an order without the intent at the time of order placement for the order to be executed), market participants must be equally cognizant of exchanges' prohibition against persons entering or causing the entry of order messages with the intent to disrupt or with reckless disregard for the consequences of such messages on the orderly trading of the market. (Click here to access CME Group Rule 575.D. and here for ICE Futures U.S. Rule 4.02(l)(1)(C) and (D).) Exchanges have used these prohibitions to prosecute traders for:

- purportedly misusing user-defined spreads (click here to access the article "CME Group Resolves Two Disciplinary Actions Alleging Market Disruption" in the October 1, 2017 edition of *Bridging the Week*);
- trading in an alleged disruptive fashion at a contract's termination (click here to access the article "Two Firms Settle With CME Group Exchanges for Not Supervising Employees Who Allegedly Engaged in Disruptive Trading Practices" in the September 10, 2017 edition of *Bridging the Week*); and
- supposedly testing the liquidity of a market (click here to access the article "CME Group Exchanges Charge One Trader With Impermissibly Entering Orders to Test Gold Market Latency and Another With Failure to Timely Complete Delivery" in the June 4, 2017 edition of *Bridging the Week*).

CME Group has also brought a disciplinary action against a non-US brokerage entity for liquidating customers' orders following non-payment of margin calls without considering the impact of the liquidation on market prices. (Click here to access the article "CME Group Settles Disciplinary Action Alleging That Automatic Liquidation of Under-Margined Customers' Positions by Non-US Futures Broker Constituted Disruptive Trading" in the March 20, 2017 edition of *Between Bridges*.)

- **No Suspense Anymore – CME Group Clarifies Suspense Account Requirements in New Guidance**: CME Group published a new Market Regulation Advisory Notice governing the use of so-called "suspense accounts" used to submit orders into its Globex trade matching system and the requirements for the proper documentation of such orders.

Suspense accounts are typically used when orders for multiple customers are placed at one time without identifying the specific customers associated with the transaction. The customers are identified after-the-fact.

Officially, CME Group will authorize five circumstances where a suspense account may be used:

- orders entered by or on behalf of a so-called "Eligible Account Manager" with written discretion over the customers' accounts. (EAMs include a Commodity Futures Trading Commission-registered commodity trading advisor or a Securities and Exchange Commission-registered investment adviser, among other persons; click here for a full list of EAMs in CFTC Rule 1.35(b)(5)(i));
- not held or "DRT" (disregard the tape) orders that are bunched for multiple customers subject to a written predetermined allocation methodology;
- orders subject to a written predetermined allocation methodology;
- multiple bunched market-maker orders subject to request for cross functionality to meet a single customer order; and

- orders entered by Execution Operations subject to *de minimis* usage.

Each of these circumstances is subject to express enumerated requirements. Moreover, no person may enter customer orders into a suspense account that is also used for personal or proprietary orders except for a commodity trading advisor that has permission of its customers.

Subject to CFTC review, CME Group's new MRAN will be effective October 1, 2018.

Compliance Weeds: Typically, upon receipt, futures commission merchants, introducing brokers and members of contract markets must immediately prepare a record that identifies the specific customer placing an order and the time the order is received, among other information, if the order cannot immediately be entered into an exchange's trade matching engine. (Click here to access CFTC Rule 1.35(b)(1).)

However, an exception to this requirement exists for qualified bunched orders. Among other things, the person placing the order for post-execution allocation must have been granted written discretion by the customer and the order placer must be an EAM. Allocations must be made as soon as practicable after an entire transaction is executed; allocations must be fair and equitable; and the allocation methodology must be sufficiently objective to allow for independent verification of the fairness of the methodology by regulators and outside auditors. Certain recordkeeping requirements also apply. (Click here for further background in Interpretive Guidance by the National Futures Association.)

The CME Group's new MRAN endeavors to comport the CFTC's requirements with the practical aspects of order placement into Globex.

More briefly:

- **Compensation for Trading Advice Solely Incidental to Business of FCMs, SDs or IBs Does Not Implicate CTA Registration Requirements**: The Commodity Futures Trading Commission issued an interpretive guidance indicating that receipt of separate compensation by a futures commission merchant, an introducing broker or a swap dealer in connection with commodity trading advice that was "solely incidental" to the FCM's, IB's or SD's principal business would not require such entity to register as a commodity trading advisor. Although the CFTC's interpretive guidance was issued in response to specific requirements of European Union-based investment managers to unbundle payments for investment research under the Markets in Financial Investment Directive II, the CFTC made clear that its guidance was not limited to payments received from EU-based managers.

- **FINRA Settles With Broker-Dealer for US $1.1 Million Fine for TRACE Reporting and Supervision Breakdowns**: Deutsche Bank Securities Inc. agreed to pay a fine of US $ 1.1 million to the Financial Industry Regulatory Authority to resolve charges that, from 2014 to 2016, the firm failed to fully comply with its trade reporting obligations for secondary market transactions in eligible fixed income securities under its Trade Reporting and Compliance Engine requirements. FINRA also claimed that Deutsche Bank's supervisory system was inadequate regarding its TRACE obligations during the relevant time. Deutsche Bank also agreed to undertake corrective actions to avoid future issues and to identify all persons, including current titles, responsible for ensuring compliance with TRACE reporting requirements. Identified persons must include relevant senior management, business and compliance personnel.

- **CFTC Seeks Comments on CME's Direct Funding Participant Proposal**: The Commodity Futures Trading Commission sought public comment on a proposal by the Chicago Mercantile Exchange to permit certain qualified entities guaranteed by a futures commission merchant-registered clearing member (termed "direct funding participants") to clear trades directly, without becoming full clearing members themselves. The objective of the CME's proposal is to insulate a DFP from the risk of pro rata loss allocation in the case of the insolvency of an FCM clearing member where the DFP might otherwise hold its account. An FCM clearing member guaranteeing a DFP would be responsible for all financial obligations of the DFP; however, it would only have to set aside 4 percent of a DFP's performance bond requirements as capital, as opposed to 8 percent if it carried the account directly (instead, the DFP would have to post 104 percent of ordinary performance bond requirements). The CFTC will accept comments through January 12, 2018. (Click here for additional details regarding CME's proposal in the article "One More Time – CME Group Resubmits Direct Funding Participant Proposal to CFTC" in the April 23, 2017 edition of *Bridging the Week*.)

- **HK SFC Bans Trader for 18 Months for Attempting to Hide FX Spot Trade Execution Error**: The Hong Kong Securities and Futures Commission banned Abbie Yip Ka Ying, a former trader with BNP Paribas in HK, from the industry for 18 months for attempting to hide an erroneous foreign exchange spot trade. According to SFC, Ms. Ying made the erroneous trade on June 24, 2015, and took affirmative steps to conceal her loss of US $58,000 by requesting a trader split the loss over two days; manually re-booking

the loss in the wrong portfolio; not reflecting the loss in the required daily reports; failing to advise her supervisor regarding the loss; and misleading her supervisor when asked.

- **Eurex Withdraws Availability of Formerly Broad-Based Non-US Stock Index Futures Contract to US Persons**: Eurex announced that, as of January 8, 2018, its MSCI Sound Africa Index futures contract would no longer be available for direct access by US-based Eurex participants and investors. This contract was formally certified as a broad-based non-US stock index futures contract eligible for US persons on February 4, 2014 (click here for details). In August 2013, Eurex was subject to a public rebuke by the Securities and Exchange Commission for not monitoring its contracts sufficiently, when its EURO STOXX Banks Index futures contract morphed from a non-US broad-based stock index futures contract solely under the oversight of the Commodity Futures Trading Commission, to a non-US futures contract based on a narrow-based stock index – a so-called "security futures contract" – under the jurisdiction of the SEC and CFTC. (Clickhere for details.) Different requirements apply when a contract is considered a security futures contract as opposed to an ordinary futures contract. (Click here for general background.)