

Meeting Minutes

Federal Reserve Bank of New York

33 Liberty Street

13th Floor

Thursday, May 2, 2019

8:30 a.m. – 10:00 a.m.

Members present: Syed Riaz Ali (by phone), Sarah Ashkenazi, James Brown, David Buchalter, Martha Burke (by phone), Maria Douvas-Orme, Chinedu Ezetah (by phone), Terence Filewych (by phone), Jill Hurwitz, Glade Jacobsen, Robert Klein, Matthew Lillvis (by phone), Nancy Rigby, Jeffrey Saxon, Lisa Shemie, David Trapani, James Wallin, Frank Weigand, and Bryan Woodard (by phone)

Federal Reserve Bank of New York (“FRBNY”) participants: Christina Getz, Michael Nelson, Thomas Noone, Janine Tramontana, Shawei Wang

Other participants: Jonathan Green (Arnold & Porter), Amelia Kaufman (Deutsche Bank, by phone), Greg Todd (Bank of America, by phone), Alex van Voorhees (Bank of America, by phone), Erik Walsh (Arnold & Porter)

“Spoofing” prosecutions

FMLG Chair Michael Nelson introduced Jonathan Green and Erik Walsh from the law firm Arnold & Porter. They continued discussions from prior meetings about trends in federal fraud prosecutions against traders, highlighting four cases: *United States v. Litvak*, *United States v. Thakkar*, *United States v. Flotron*, and *United States v. Vorley*. In *Litvak*, the Second Circuit twice vacated the conviction of a bond trader, more recently because the trial court admitted unduly prejudicial testimony from a customer that, in his personal opinion, the defendant was acting as a trusted agent instead of an arm’s length principal. The United States declined to try the defendant a third time. In *Thakkar*, federal prosecutors dropped charges against a software programmer following a trial that resulted in a hung jury. The programmer was indicted under the “anti-spoofing” provision of the Dodd-Frank Act, which prohibits “bidding or offering with the intent to cancel the bid or offer before execution.” 7 U.S.C. § 6c(a)(5)(C). In *Flotron*, a federal jury in Connecticut acquitted a precious metals trader of conspiracy to commit

“spoofing.” The defense in that case argued that it was impossible to determine criminal intent through a statistical analysis of cancelled trades, which are an ordinary feature of high-frequency trading. Finally, in *Vorley*, federal prosecutors charged two traders with wire fraud in connection with spoofing on a theory that the traders misrepresented supply and demand in the precious metals market. The U.S. Chamber of Commerce, the Securities Industry and Financial Markets Association, and other industry groups have appeared as amici curiae in support of the defendants’ motion to dismiss the indictment, arguing that the application of the wire fraud statute to these circumstances would deter legitimate trading activity. *Thakker*, *Flotron*, and *Vorley* are all part of a Department of Justice initiative called the “Futures Market Spoofing Takedown,” in which the Enforcement Division of the Commodity Futures Trading Commission also participated.

Members asked a variety of questions about similarities between these cases and two recent prosecutions involving FX traders: *United States v. Bogucki* and *United States v. Johnson*.

Japanese initial margin rules

Frank Weigand explained that the Financial Services Agency, Japan’s financial market and banking regulator, has proposed changes in law to allow margin to be netted against a trade when the firm is using pledged collateral—that is, a custody model as opposed to a title transfer. The change is designed to help Japanese firms meet the “phase five” initial margin deadline in September 2020. Members discussed similar problems in other bankruptcy regimes that presume a title transfer model.

Branches and subsidiaries

Robert Klein continued a discussion from a previous meeting on conflicting regulatory preferences for organizing the foreign operations of U.S. financial institutions as branches or subsidiaries. Members commented that the issue was not a prominent concern among regulators and was not a significant factor in day-to-day risk management. That said, organizing foreign operations through subsidiaries, as opposed to branches, has long-term implications for resolvability and regulatory oversight. Mr. Nelson advised that the FMLG consider ways to raise awareness of the long-term issues among regulators and central banks.

Compliance with qualified financial contract (“QFC”) stay rules

Bryan Woodard raised concerns about the ability of the industry to comply with QFC rules by July 1. The rules require U.S. Global Systemically Important Banks (“GSIBs”) and certain other entities to obtain consents from counterparties in certain QFCs to stay provisions of their trading agreements that may interfere with the orderly resolution of a GSIB. Members

discussed, among other issues, the difficulty in convincing smaller and foreign trading partners to consent; conflicting legal opinions on what types of contracts are QFCs; pockets of the market that are at heightened risk of disruption; and the possibility of regulatory relief. Several members also reported attempts to leverage requests for consents into broader renegotiations and bespoke, bilateral agreements.

LIBOR update

Maria Douvas-Orme and Jill Hurwitz summarized an April 2019 letter from the International Swaps and Derivatives Association (“ISDA”) to FRBNY President John Williams and Andrew Bailey, Chief Executive Officer of the United Kingdom’s Financial Conduct Authority about industry progress on the LIBOR transition. Ms. Douvas also briefed members on recent work by the Alternative Reference Rates Committee (“ARRC”), which is sponsored by the FRBNY, especially regarding fallback arrangements for cash products. Members discussed various legal concerns arising out of the LIBOR transition, including the need to amend certain existing contracts that an ISDA protocol would not cover.

ISDA novation protocol update

FMLG Treasurer Martha Burke reported that the Global Foreign Exchange Division of the Global Financial Markets Association was working with ISDA on potential revisions to the latter’s novation protocol. Discussions were still preliminary, and focused on clarifying the problems with broader adoption and use of the protocol and the operational risks arising out of manual novations.

Quadrilateral update

FMLG Secretary Thomas Noone reviewed plans for the upcoming Quadrilateral meeting.

Administrative matters

Ms. Burke gave a brief update on the group’s finances.

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