




U.S. COMMODITY FUTURES TRADING COMMISSION

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Office of the
Inspector General

February 11, 2015

TO: Timothy G. Massad, Chairman
Commissioner Mark P. Wetjen
Commissioner Sharon Y. Bowen
Commissioner J. Christopher Giancarlo

FROM: A. Roy Lavik 
Inspector General

SUBJECT: Investigation into an Allegation of Illegal Trading by an Employee of the
Commodity Futures Trading Commission

Attached is a new report of investigation from my Office. It is brief and self-explanatory, and resolves in favor of the employee. We are happy to provide further information about this investigation at your request and convenience.

I am very pleased with the level of cooperation received from the Office of Data and Technology and all witnesses in connection with this investigation. I appreciate your continuing support of this Office.

Attachment

**Investigation into an Allegation of Illegal Trading by an Employee of the
Commodity Futures Trading Commission**

**Prepared by the
Office of the Inspector General
Commodity Futures Trading Commission**

February 11, 2015

Background, Scope, and Methodology

On November 3, 2014, house counsel for a registered Retail Foreign Exchange Dealer (RFED) contacted the Division of Enforcement (DOE) and said a CFTC employee was attempting to open a forex trading account in violation of CFTC's regulations. The RFED counsel also disclosed that this would be the CFTC employee's second account, and that the employee had also opened a forex trading account with the RFED in July 2012. DOE notified the Office of General Counsel (OGC) and OGC, in turn, contacted our Office.

On November 4, 2014, we researched the CFTC employee in question. We requested and received all Office of Government Ethics (OGE) financial forms filed by the CFTC employee during the relevant period. An OGC attorney tasked with ethics issues provided his recollections of this employee and voluntarily produced relevant email. We spoke with house counsel for the RFED. We informed DOE and OGC that we intended to investigate.

On November 5, 2014, we spoke with an Assistant U.S. Attorney (AUSA) in the District of Columbia. We also briefed the CFTC General Counsel on this matter. On advice of the AUSA, we interviewed the target CFTC employee. During the interview, the employee volunteered to close the forex account, cancel the pending application for a forex account, permit us to image his or her work PC and to access the forex account online, and to voluntarily provide relevant email exchanged between the employee and OGC. Later the CFTC employee authorized the release of documents directly from the RFED.

On November 6 we sought assistance from the CFTC Office of Data and Technology (ODT) to obtain imaging services. ODT imaged the target employee's computer the next day and later presented OIG with a list of web pages viewed by the target employee. On November 7, the employee logged into his or her forex account and OIG personnel downloaded all daily, monthly, and yearly trade statements, and viewed all messages. We later sought targeted records directly from the RFED.

In order to complete our investigation, we interviewed 11 individuals. We reviewed trading records, searched over 41,000 items on the employee's computer, and reviewed numerous websites visited by the employee during the relevant period. Based on our investigation, we conclude the employee traded in accord with the advice he received from OGC, did not trade using proprietary trade data maintained by CFTC, and did not violate the personal use policy for CFTC employees (for CFTC computers and equipment). We made no referral to US Department of Justice (US DoJ) and we recommend that no action be taken against this employee.

Facts

The CFTC employee at the center of this investigation (“the employee”) is an attorney who began working for the Commission in 2011. The employee generally has worked drafting regulations and Rule Enforcement Reviews¹ since that time.

After working at the CFTC for less than a year, the employee inquired with OGC whether it was permissible for CFTC employees to trade forex.² There were multiple phone conversations regarding this inquiry, and multiple emails. The employee wrote:

I had a quick follow-up question regarding our call on the trading policy a couple weeks ago. My understanding is that it's permissible for us to trade the E-mini, since it's based on the S&P 500, and that it's also permissible to trade ForEx. Could I ask you to please confirm this by email, so I have a copy for my records? Thanks very much for your assistance.

The OGC attorney responded:

Let's talk more about this but it is permissible to trade E-Minis, S&P 500, and ForEx pursuant to our current ethics regulations. Let's meet for an hour and chat about this so I can learn more for possibly amending the ethics regulations in the near future. Anytime in the mornings is ok with me.

Both the OGC attorney and the employee recall additional phone conversations discussing the employee's questions. Days later, the employee sought additional advice:

I had one more follow-up question, which might also be relevant to you as you consider any upgrades to the policy. You mention in your email below that it's permissible for employees to trade ForEx. Just to confirm my understanding:

- *It is permissible for employees to trade ForEx on the over-the-counter spot market, since no futures or options are involved*
- *but it would not be permissible for employees to trade ForEx futures, such as the ForEx futures contracts listed on the CME*

Could you please confirm if my understanding is correct?

OGC responded again:

¹ CFTC's Rule Enforcement Reviews can be found here: <http://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/dcmruleenf>.

² The employee was not an eligible contract participant. See, 7 USC § 1a(18).

Pursuant to the current ethics regs., if you mean by over the counter spot-market - cash to buy currencies - then it is likely permissible barring any conflict of interest appearance problems that we might assess by reviewing the transaction and who is the employee-buyer. It is not permissible for employees to trade ForEX futures. I'd also have to double check Dodd-Frank³ to see if there were any restrictions added in this area.

There was one final email from the employee:

That's correct that I'm referring to over the counter, spot-market purchases of currencies (e.g. EUR/USD). ...[I] don't have access to any market information involving currencies, so hopefully there would not be any appearance of a conflict of interest.

Five days later, the employee opened a forex account with a CFTC-registered RFED. The employee disclosed his or her employment at CFTC on the account opening form. For the first six months that the account was open, the employee made cash deposits and did not trade.

The employee traded forex on 18 days during two months in 2013.⁴ All trading was in GBP/USD currency pairs; most but not all positions were closed out the same day, the rest were subject to two-day settlement.⁵ The employee additionally traded forex during seven months in 2014; the employee traded on three to 13 days each month in which trading took place. During this second period of trading all positions were closed out the same day and all trading was in EUR/USD currency pairs.

In late October 2014 the employee applied for an additional forex account with the same RFED, again disclosing his or her employment with CFTC on the account opening form. An employee of the RFED noticed the account applicant was a CFTC employee, and took steps resulting in this investigation. After being interviewed by a representative of the OIG, the employee immediately closed the forex account and cancelled the pending application.

³ Dodd-Frank Wall Street Reform and Consumer Protection Act, P.L. 111-203, 124 Stat. 1376 (2010).

⁴ CFTC has publicly warned: "The Forex market is volatile and carries substantial risks. It is not the place to put any money that you cannot afford to lose, such as retirement funds, as you can lose most or all it very quickly." CFTC Fraud Advisories – Foreign Currency Trading (Forex) Fraud, located at: http://www.cftc.gov/ConsumerProtection/FraudAwarenessPrevention/CFTCFraudAdvisories/fraudadv_forex.

⁵ CFTC states: "The most actively traded currency pairs are the Euro/U.S. Dollar, U.S. Dollar/Japanese Yen, and British Pound Sterling/U.S. Dollar." CFTC Release PR7056-14 ("CFTC Orders Five Banks to Pay over \$1.4 Billion in Penalties for Attempted Manipulation of Foreign Exchange Benchmark Rates") (available here: <http://www.cftc.gov/PressRoom/PressReleases/pr7056-14>).

Analysis, Conclusion and Recommendation

An OGC attorney charged with ethics-related responsibilities advised a CFTC employee that it is permissible to trade forex. We believe the employee and the OGC attorney are in substantial agreement on the substance of the advice given.⁶ We believe the employee reasonably interpreted the OGC's advice as authorizing the trading that took place in 2013 and 2014.

The OGC attorney delivered the advice in an informal manner, by phone and by email. The OGC attorney left things somewhat hanging, stating that it is permissible to trade forex but noting there would be a need to "double check Dodd-Frank to see if there were any restrictions added in this area." The informal nature of the advice does not change the outcome here.

OGE regulations require Ethics advice to be documented "when appropriate,"⁷ and OGE "strongly encourages" documenting ethics advice given to employees;⁸ however, ethics advice is valid and protects the employee even if it is not given in writing.⁹ The significance of an opinion from an ethics official (written or verbal) is stated in the OGE regulations:

Disciplinary action for violating [the Standards of Ethical Conduct] or any supplemental agency regulations will not be taken against an employee who has engaged in conduct in good faith reliance upon the advice of an agency ethics official, provided that the employee, in seeking such advice, has made full disclosure of all relevant circumstances.¹⁰

However, advice from an agency ethics official, in and of itself, may not provide a defense to a criminal violation of the Commodity Exchange Act.¹¹ Trading in prohibited investments by Commissioners and CFTC employees is a felony:

It shall be a felony punishable by a fine of not more than \$500,000 or imprisonment for not more than five years, or both, together with the costs of prosecution, for any Commissioner of the Commission or any employee or agent thereof, to participate, directly or indirectly, in any transaction in commodity

⁶ The OGC attorney and the employee separately volunteered that the employee was advised (verbally) that forex accounts need not be reported on the OGE Form 450 (personal financial disclosure).

⁷ "One element of an agency ethics program is that the Designated Agency Ethics Official 'shall ensure that ... [r]ecords are kept, when appropriate, on advice rendered.' 5 C.F.R. § 2638.203(b)(8)." New GAO Report; Documenting Ethics Advice, DO-08-025 (Aug. 26, 2008) (available here: <http://www.oge.gov/displaytemplates/modelsub.aspx?id=2147483902>).

⁸ *Id.*

⁹ Documenting Ethics Advice, US Office of Government Ethics, DO-05-019 (Nov 17, 2005) (available here: <http://www.oge.gov/DisplayTemplates/ModelSub.aspx?id=2207>).

¹⁰ 5 C.F.R. § 2635.107(b).

¹¹ The OGE regulations state (5 C.F.R. § 2635.107(b)):

Where the employee's conduct violates a criminal statute, reliance on the advice of an agency ethics official cannot ensure that the employee will not be prosecuted under that statute. However, good faith reliance on the advice of an agency ethics official is a factor that may be taken into account by the Department of Justice in the selection of cases for prosecution. Disclosures made by an employee to an agency ethics official are not protected by an attorney-client privilege.

futures or any transaction of the character of or which is commonly known to the trade as an “option”, “privilege”, “indemnity”, “bid”, “offer”, “put”, “call”, “advance guaranty”, or “decline guaranty”, or any transaction for the delivery of any commodity under a standardized contract commonly known to the trade as a margin account, margin contract, leverage account, or leverage contract, or under any contract, account, arrangement, scheme, or device that the Commission determines serves the same function or functions as such a standardized contract, or is marketed or managed in substantially the same manner as such a standardized contract, or for any such person to participate, directly or indirectly, in any investment transaction in an actual commodity if nonpublic information is used in the investment transaction, if the investment transaction is prohibited by rule or regulation of the Commission, or if the investment transaction is effected by means of any instrument regulated by the Commission. The foregoing prohibitions shall not apply to any transaction or class of transactions that the Commission, by rule or regulation, has determined would not be contrary to the public interest or otherwise inconsistent with the purposes of this subsection.¹²

Congress has criminalized a broad class of trading by CFTC employees, but reserved to the Commission the authority to both add to the list of prohibited investments and to permit trading as the Commission “has determined would not be contrary to the public interest or otherwise inconsistent with the purposes of this subsection.”

While the OGC attorney intended to amend the advice given if further research warranted it (“I’d also have to double check Dodd-Frank to see if there were any restrictions added in this area”), all agree that the 2012 advice was never amended.

After the advice was given, the Commission in October 2012 amended the Employee Standards of Conduct to prohibit Commissioners and Commission employees from participating, directly or indirectly, “in retail forex transactions, as that term is defined in § 5.1(m) of this chapter.”¹³ Section 5.1(m) of the Commission Regulations¹⁴ in turn cross-references §§ 2(c)(2)(B) and (C) of the Commodity Exchange Act.¹⁵

Prior to the rule amendment, we believe it would have been more than logical to interpret the existing rule and statute to prohibit retail forex investment by Commissioners and CFTC employees under the broad prohibitions stated in the statute and rule. However, the preamble to the October 2012 proposed rule amendment stated:

¹² 7 U.S.C. § 13(c).

¹³ 17 CFR § 140.735-2.

¹⁴ 17 CFR § 5.1(m)(defines “retail forex transaction” as “any account, agreement, contract or transaction described in section 2(c)(2)(B) or 2(c)(2)(C) of the Act. A retail forex transaction does not include an account, agreement, contract or transaction in foreign currency that is a contract of sale of a commodity for future delivery (or an option thereon) that is executed, traded on or otherwise subject to the rules of a contract market designated pursuant to section 5(a) of the Act.”)

¹⁵ 7 U.S.C. § 2(c)(2)(C)(i)(II)(bb)(AA) (“Subclause I of this clause shall not apply to... a contract of sale that . . . results in actual delivery within 2 days.” Subclause I, in turn, authorizes the Commission to regulate forex trading by non-eligible contract participants (i.e., retail forex)).

The Commission proposes adding swaps to those agreements, contracts or transactions Commission staff may not trade. The Commission would like to take this opportunity to also add retail forex transactions, as that term is defined in regulation 5.1(m), to this list.¹⁶

The Commission did not state it was clarifying an existing prohibition; it stated it was adding forex to the list of prohibited investments for CFTC employees. It therefore appears the Commission previously interpreted the Commodity Exchange Act and regulations to permit CFTC employees to trade retail forex, consistent with the advice the employee received. In this scenario, forex became a prohibited investment only in October 2012.

Had the OGC attorney notified the employee in October 2012 regarding the change in regulation, we believe the employee would have ceased trading. We are somewhat loathe to place on the employee the burden of keeping abreast of the regulatory landscape in this instance because the Employee Code of Conduct on the CFTCnet for CFTC employees was not updated for more than two years after the 2012 amendment.¹⁷

In any event, at the outset the Assistant U.S. Attorney we consulted stated that there would be no interest in prosecuting an employee for trading forex consistent with permission received from the Agency, unless the employee used CFTC confidential or proprietary information to trade. We have examined the employee's work computer and internet browsing history, and we found no evidence that the employee used CFTC proprietary or confidential information to trade. The employee had no direct access to TSS or ISS.¹⁸ There is no allegation or indication that others accessed TSS or ISS on his or her behalf. Instead, the employee purchased trade data directly from the RFED, and used the purchased data to implement trade strategies.

While there is no indication that the employee traded using CFTC proprietary or confidential data, the employee did store account opening and account closing forms on a work pc, some account statements, and trading notes. The employee obtained these documents exclusively through personal email, simply forwarding attachments from a personal email address to work email. We found no communications with the RFED originating from or addressed to the employee's work email account. In addition, the employee sporadically accessed the forex account online from his or her work pc. There is no indication that the employee traded from a work pc.

¹⁶ 76 FR 33066, *33075 (June 7, 2011). The final rule was issued on October 16, 2012. 77 FR 66288 (Nov 2, 2012).

¹⁷ As of November 5, 2014, the Employee Standards of Conduct had not yet been updated on CFTCnet to display amended § 140.735. On November 7, 2014, we asked the OGC to update the instructions, and the appropriate revisions were completed on January 21, 2015.

¹⁸ TSS and ISS are databases maintained at CFTC to facilitate market surveillance. "Broadly speaking, TSS captures transaction-level details of trade data, while ISS facilitates the storage, analysis, and mining of large trader data from a position perspective." 78 FR 69178 (Nov. 18, 2013).

The level of usage of the work pc by the employee for forex-related material does not indicate a violation of the CFTC's personal use policy.¹⁹ In fact, despite performing searches targeted to find materials relating to personal forex trading, we found on this employee's computer more than twice as many personal items pertaining to non-forex matters, with the vast majority of items on the work pc pertaining to official work activity. Likewise, the employee's internet browsing history showed far more visits to non-work websites that were not related to forex trading, with the bulk of internet sites visited being work-related.

We conclude that the employee did not engage in any intentional misconduct. We have made no referral to DoJ. We recommend that the Agency refrain from any adverse action against this employee. We recommend that Commissioners and employees seek guidance from OGC whenever there is any question regarding the legality of an investment, and document all advice received.

¹⁹ A link to the current CFTC Personal Use Policy may be found here:
<http://cftcnet/Commission/About/Communications/Pages/LimitedUsePolicy.aspx>.

Appendix: Related Matters

During our fieldwork for this investigation, four matters came to our attention upon which we would like to remark.

1) We learned on November 5, 2014, that the CFTCnet internal employee webpage titled “Standards of Conduct” was not current, even though the Commission amended the standards of conduct to prohibit forex trading by Commission employees in October 2012. We verbally asked staff in OGC on November 7, 2014, and periodically thereafter, to update the page. The “Standards of Conduct” were not updated until January 21, 2015. Given that a CFTC employee was under investigation for improper forex trading, we do not understand the delay here in notifying the rest of CFTC.

2) Documentation of OGC’s ethics advice to the employee consists solely of email initiated by the employee. We presume that, had the employee not documented the advice, OGC would have. We recommend that CFTC periodically advise employees that they are encouraged to retain documentation of all ethics advice they receive.

3) We note that the CFTC employee was not only told that it was permissible to trade forex, but also that it is permissible for CFTC employees to trade “E-Minis” and “S&P 500,” without qualification. We recommend that OGC ethics officials evaluate CFTC employee investments in light of the felony statute and take care to not, through the use of casual language or through the failure to qualify common investment terms, authorize trading that violates the felony prohibition.

4) The CFTC employee occasionally forwarded forex account statements and forex notes to his or her work email. We noticed that the automated email alert employees receive regarding potentially dangerous email only asks the employee to “indicate” two things prior to release of the email:

- 1) Do you know this sender? Yes/No
- 2) Were you expecting this email? Yes/No

Here, the CFTC employee truthfully answered both questions in the affirmative as the email was from a known sender (the employee) and was expected (the employee sent it). We recommend that employees also be asked to state whether the email is work related.