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Key Issues for a Trade Conduct Policy

Preface: In our work advising financial industry clients navigating an increasingly enforcement focused regulatory environment, our discussions frequently center around one theme: “*What trading and markets issues are regulators looking at and how do we convey those to our trading team?*” To that end, one of the most valuable resources that an in-house legal and compliance team can offer their front office “clients” is a robust and clear trade conduct policy, along with periodic training to reinforce it. The goal is not for the trading team to become experts in the nuance of securities and commodities laws. Rather, an effective trade conduct policy is one that provides traders and their support teams with *practical knowledge and examples* to use to *spot issues in real time* and that also prompts and encourages traders to *escalate questions and uncertainties for legal and compliance support* sooner rather than later.

With that background in mind, we assemble here our list of *key issues to address in a trade conduct policy* (and we include an appendix of illustrative cases / enforcement actions). We assume a target audience that is a multi-asset and multi-strategy global trading team at a firm that might trade commodities, derivatives, securities, digital assets, or other institutionally traded asset classes. We also presume a target audience that is trading both on exchanges and in over the counter markets and that is executing electronically (through manual and algorithmic orders) and through voice.

Any and all are welcome to use or refer to this issues list. However, if seeking to adopt a new or modify an existing trade conduct policy based on this list, please consult with counsel in order to ensure that: (1) any final version is appropriately tailored to and calibrated for the needs, risks, and regulatory status of the actual business and entity to which it would apply, (2) the governance processes of the relevant entity or entities have been followed in order to make the policy effective and in force, and (3) the policy is reviewed and updated, periodically, based on new or evolving regulatory guidance and developments.

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Trade Conduct Policy Issues List:

I. Trade Practice Issues

A. Manipulation and Attempted Manipulation

1. Market Power Manipulation
2. Fraud Based Manipulation
3. Examples:
 - a) Trading to cause (or attempting to cause) an artificial price
 - b) Corners and squeezes
 - c) Trading in the spot market to benefit a related financial position.
 - d) Trading around reference prices, pricing benchmarks and indices, and price setting windows to benefit a related position
 - e) Uneconomic trading (intentionally selling or buying at non bona fide prices, at a loss)
 - f) Using a manipulative scheme or device
4. Fraudulent or Deceptive Statements, Misstatements, and Omissions
 - a) False reports
 - b) Inappropriate or untruthful communications with benchmark setting organizations
 - c) Selective trade and price reporting designed to impact reported price benchmarks or reference prices

B. Disruptive Trading

1. Disorderly Trading
 - a) Intentional or reckless disregard for the orderly execution of transactions during the closing period, during a pricing window, or generally
 - b) Recklessness is an act or omission that “departs so far from the standards of ordinary care that it is very difficult to believe the actor was not aware of what he or she was doing”
2. Spoofing
 - a) Bidding or offering with the intent to cancel the bid or offer before execution
 - b) Layering
 - c) Spamming (*e.g.*, sending multiple orders or messages in order to delay or limit the functioning of either an exchange or the ability of others to use the exchange)
 - d) Using self-match prevention or other compliance tools in a manner that may constitute spoofing

C. Wash Trading and Noncompetitive Trading

1. Entering into, or purporting to enter into, transactions to give the appearance that purchases and sales have been made, without incurring market risk or changing the trader's market position
2. Trading directly or indirectly against oneself
3. Trading without the intent to take on a bona fide market risk, price risk, or a position
4. Impermissible test trades (*e.g.*, open and closing a position, quickly, in a live market, in order to test systems)
5. Abuse of market maker or other similar incentive programs by wash trading to generate volume (*e.g.*, trading against oneself to earn fee discounts and rebates or equity rewards)
6. Failing to appropriately use self-match prevention technology

D. Coordinated Trading / Anti-Competitive Conduct

1. Agreements not to trade
2. Dividing up a market with a competitor
3. Coordinated manipulative trading

E. Technology Assisted Trading

1. Guidance on use of artificial intelligence (AI) and other similar predictive analytics tools
2. Electronic and algorithmic trading
 - a) System safeguards, pre-trade risk checks
 - b) Use of kill switches
 - c) Monitoring programs
 - d) Processes for design, testing, and deployment into production environments
 - e) Compliance with jurisdictional presence requirements or prohibitions

II. Fraud and the Use of Information

A. Traditional 10b-5 “insider trading”

B. Fraud based misappropriation of information

C. Applicable to securities, commodities, and derivatives trading

- D. Paying bribes, kickbacks, or other similar benefits to obtain information
- E. Failing to follow appropriate diligence and onboarding process for information vendors, research vendors, and similar “field” agents and consultants or “expert networks”
- F. Access to and understanding the content of alternative data sources
- G. Handling and use of counterparty information

III. Corruption, Sanctions, Money Laundering

- A. Anti-Bribery and Anti-Corruption policies; FCPA guidance and training
- B. Gifts and Entertainment policy
- C. Sanctions policy
- D. Anti-Money Laundering policy
- E. Know Your Customer / Know Your Counterparty requirements
- F. Monitoring

IV. Communications and Messaging

- A. Careful and professional communications at all times
- B. Avoid inappropriate language, exaggerations, and statements that can be taken out of context
- C. Permissible and impermissible use of electronic communications tools; compliance with firm policies; guidance regarding inappropriate use of off-channel communications or use of communications platforms or mechanisms where communications are not monitored and retained as regulations require
- D. False statements
- E. Misstatements and omissions

- F. Guidance on communications and interactions with market participants; acceptable and unacceptable “market color” conversations
 - G. Guidance on communications and interactions with governmental and other public officials
- V. Exchange Specific Rules**
- A. Position Limits
 - B. Aggregation
 - C. Exchange for related positions (EFRPs)
 - D. Block Trades
 - E. Cross Trades
 - F. Connectivity and Technology Requirements (*e.g.*, CME Tag 50 requirement)
- VI. Entity Level Issues**
- A. Monitoring and surveillance
 - B. Supervision requirements; failure to supervise
 - C. Recordkeeping and reporting
 - D. Conflicts of interests
 - 1. Proprietary trading team versus sales team
 - 2. Information barriers
 - 3. Use of customer / counterparty information
 - 4. Appropriate disclosures to customers / counterparties, when relevant
 - E. Registrations
 - 1. Entity status registrations (*i.e.*, swap dealer, major swap participant, futures commission merchant, introducing broker, commodity trading advisor, commodity pool operator, floor trader, security based swap dealer, security based major swap participant, broker dealer, investment adviser, investment company)

2. Employee status and registrations (*i.e.*, licensing and associated person registrations)
3. Statutory disqualifications

F. Privacy policy compliance

G. Periodic compliance trainings

H. Compliance management process to address complaints and infractions

I. Whistleblower policy

VII. Instruction to Escalate Issues to Legal and/or Compliance

A. Include appropriate internal contact information

B. Reminder that compliance is the responsibility of supervisors, employees and agents - not just legal and compliance departments

Appendix of Illustrative Cases and Settlements

Buying an illiquid digital asset to push up reference prices for a related swap. See, e.g., *CFTC v. Eisenberg (2023)*, [LINK](#), where the CFTC alleges that a trader opened a swap position in an illiquid digital asset and then bought large quantities of the same digital asset in the spot market, pushing up the spot price on marketplaces that were used as reference prices for the swap. The swaps then did increase in value, based on the inflated price references, and the trader used that purported increase in value as collateral to take a non-recourse loan from the same marketplace where the swap position was held. As prices of the relevant digital asset crashed back to reality, the swap position went down in value, and the trader kept the loan proceeds. The trader is charged by both the CFTC and the DOJ.

Trading rate swaps to impact reference pricing for a rate swap being written in connection with a bond offering. In May 2023, the CFTC entered into a settlement with HSBC ([LINK](#)) alleging that traders engaged in and attempted to engage in manipulative and deceptive trading in interest rate swaps, basis swaps, and swap spreads in connection with interest rate swaps that HSBC entered into with bond issuers (issuer swaps). The scheme went as follows: The issuer swaps were priced in part based on prices displayed on pricing screens controlled by interdealer broker firms; HSBC traders intentionally traded at the broker firms controlling the relevant screens during telephonic pricing calls in which the bond issuances, and the related issuer swaps, were priced, and HSBC traders structured their trading intentionally to move prices for the relevant swaps on these screens. This activity was designed to increase the profitability of issuer swaps for HSBC to the detriment of HSBC's counterparties.

Manipulating physical benchmark pricing to increase value of trading positions. In May 2022, the CFTC entered into a settlement with multiple Glencore entities ([LINK](#)) for manipulation and corruption. The \$1.186 billion settlement included charges that traders sought to manipulate or attempt to manipulate U.S. price-assessment benchmarks relating to physical fuel oil products, and related futures and swaps, in order to benefit Glencore's trading positions. The charges also allege the payment of kickbacks and bribes to employees and agents of state owned entities (SOEs) in exchange for improper preferential treatment and access to trades with the SOEs. Glencore also settled with the DOJ and the U.K. Serious Frauds office.

Trading outsized volumes during a "bid-week" pricing window to benefit related swaps positions. In December 2014, the CFTC entered into a settlement with Total Gas and Power North America ([LINK](#)) on these facts: during bid-weeks for several months, traders attempted to manipulate monthly index settlement prices of natural gas at four hubs through their physical fixed-price trading. The settling entity (TGPNA) was one of the largest players in the fixed-price market during these periods, with their trading accounting for a substantial percentage of the total market by volume at the relevant hubs, even though TGPNA had no material customer

business, assets, or transportation at the hubs. This fixed-price trading attempted to favorably affect the monthly index settlement prices to benefit their related financial swap positions.

Selling a large volume of credit default swaps in a short period of time constituted a manipulative device. “[A]cting on behalf of JPMorgan, the [t]raders' activities on February 29, 2012 constituted a manipulative device in connection with swaps because they sold enormous volumes of the [credit default swap] in a very short period of time at month-end.” *CFTC v. JPMorgan (i.e., the London Whale settlement; October 2013)*. ([LINK](#))

Spoofing and splitting orders to avoid detection. In a November 2019 settlement with Tower Research Capital LLC ([LINK](#)), the CFTC described these facts: Traders placed one or more orders that they wanted to get filled (genuine orders) on one side of the market, typically consisting of passive orders whose quantities are only partially visible to other market participants; and, on the opposite side of the market, placed one or more orders that the traders intended to cancel before execution (spoon orders), typically consisting of fully-visible passive orders for a larger total quantity. Generally, after receiving a full or partial fill on the genuine orders, the traders then canceled the spoon orders. In placing the spoon orders, the traders often used an order splitter to enter several smaller, randomly-sized orders in an attempt to obscure their scheme from other market participants. The traders engaged in this scheme to induce other market participants to trade against their genuine orders—by intentionally sending a false signal to the market that they wanted to buy or sell the number of contracts specified in the spoon orders and creating a false impression of supply or demand—so that the genuine orders would fill sooner, at better prices, or in larger quantities than they otherwise would.

Spoofing. In a September 2020 settlement with JP Morgan ([LINK](#)), the CFTC observed that the traders intentionally sent false signals of supply or demand designed to deceive market participants into executing against other orders they wanted filled. The CFTC also brought failure to supervise charges. JP Morgan also entered into settlements with the DOJ and the SEC on this matter.

Failure to appropriately address disruptive trading in compliance programs. In a March 2023 settlement with BBL Commodities ([LINK](#)), the CFTC observed that BBL's policies and procedures did not specifically address potentially disruptive trading, and BBL lacked written policies or procedures for the detection and deterrence of disruptive trading by its employees or directing the implementation of the firm's trading strategies in such a manner as to avoid disruptive trading. Nor did BBL's written policies and procedures provide any guidance to BBL staff with respect to assessing the potential disruptive impact of BBL's orders; assessing liquidity prior to placing orders; describing appropriate or inappropriate trading during settlement periods; or mitigating the potential disruptive impact of BBL's orders.

Wash trading in futures during the pre-open period. In a June 2019 Settlement with Eagle Market Makers ([LINK](#)), the CFTC observed that certain traders, entered bids and offers of similar quantities in the same futures contract for Eagle’s proprietary trading accounts which were intended to and did in fact offset each other upon execution. “By this conduct, the Order concludes, Eagle intended to and did negate market risk or price competition and engaged in wash sales that were noncompetitive transactions.”

Wash trading as noncompetitive trading. In a September 2015 settlement with Cargill de México SA De CV ([LINK](#)), the CFTC observed that Cargill de México engaged in wash sales and unlawful non-competitive transactions in certain agricultural futures products. Before orders for these trades were entered on an exchange, Cargill de México employees, either acting alone or with another employee, entered equal and opposite transactions in the same futures contract for another account that was also owned by Cargill de México, and matched the product, quantity, price, and timing of those orders and trades. The CFTC imposed compliance training requirements, a report on updated policies and procedures, and the use of self match prevention technology.

Bribes and kickbacks; misappropriation of information. In a December 2020 settlement with Vitol Inc. ([LINK](#)), and a December 2023 settlement with Freepoint Commodities ([LINK](#)), the CFTC brought allegations relating to bribes and kickbacks paid to employees and agents of state owned entities in exchange for confidential information regarding trades and access to trading opportunities. In the Freepoint settlement, the CFTC emphasized the charges around the misappropriation of material non-public information. Vitol and Freepoint also had DOJ settlements that included FCPA charges.

Insider trading and expert networks. In February 2011, the SEC charged a New York-based hedge fund and four hedge fund portfolio managers and analysts who illegally traded on confidential information obtained from technology company employees moonlighting as expert network consultants ([LINK](#)). The SEC also charged the moonlighting employees for passing along company confidential information ([LINK](#)).

Alternative data seller charged with securities fraud. In September 2021, the SEC charged App Annie and its founder with securities fraud after it used non-aggregated and non-anonymized mobile app data to alter its model-generated estimates to make them more valuable to sell to trading firms ([LINK](#)).

Unapproved communication and messaging methods. In September 2022, the CFTC ordered eleven financial institutions to pay over \$710 million for recordkeeping and supervision failures for widespread use of unapproved communication methods ([LINK](#)). In August 2022, the SEC settled a similar action ([LINK](#)).

Failure to supervise charges for a broker based on customer activity. In September 2022, the CFTC charged ADM Investor Services Inc., a registered futures commission merchant, for supervisory failures based on these facts: (1) ADMIS' account review policies and procedures were inadequate because they failed to provide adequate guidance regarding account changes requests submitted by individual brokers, and (2) ADMIS failed to perform its supervisory duties diligently because it failed to detect repeated incidents in which brokers employed by ADMIS or ADMIS' introducing brokers executed improper or fictitious trade transfer requests that violated the CEA and CFTC regulations. Through the transfers in question, which collectively persisted for several years, the brokers executed trades and then submitted improper or fictitious trade transfer requests to allocate winning trades to preferred customers or to accounts that they controlled or managed, while allocating losing trades to other accounts they controlled or managed.