Securities Regulation Daily Wrap Up, ENFORCEMENT—CFTC cleans up in $5M wash sales settlement, (Jun. 30, 2017)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By Brad Rosen, J.D.

The CFTC simultaneously filed and settled charges against Rosenthal Collins Capital Markets, LLC, now known as DV Trading LLC (RCCM), of Chicago, Illinois, for engaging in illegal wash sales in order to generate rebates of exchange fees based upon increased trading volumes. According to the consent order, RCCM agreed to pay a $5 million civil monetary penalty and cease and desist from violating Section 4c(a) of the Commodity Exchange Act and Commission Regulation 1.38(a) (In the Matter of Rosenthal Collins Capital Markets LLC, June 29, 2017).

In a separate consent order, former RCCM trader Brandon Elsasser was found to have engaged in illegal wash sales and agreed to pay a $200,000 civil monetary penalty. He also agreed to cease and desist from violating the applicable CEA provision and commission regulation.

The consent order found that from early 2013 until July 2015, proprietary traders at RCCM engaged in three different wash trading strategies in order to generate rebates through the Eurodollar Pack and Bundle Market Maker Program offered by Chicago Mercantile Exchange, Inc. (CME). These rebates could offset exchange fees for any trading RCCM conducted in the CME eurodollar complex.

"Wash" trades are those in which no risk is assumed and where traders were trading with themselves, or each other, instead of with other parties. Wash trades are considered to be harmful because they "create illusory price movements in the market [and] may mislead market participants because they do not reflect the forces of supply and demand" as the CFTC noted in its order. Moreover, "[t]hey also are considered grave violations because they undermine confidence in the market mechanism that underlies price discovery."

RCM utilized three different strategies to effectuate the wash sales transactions and thereby generate the sought-after exchange fee rebates:

- **Strategy 1: direct self-trading.** RCCM designated one trader as the house rebate trader; he was instructed to generate certain quantities of rebates each month in the program in specific amounts that would allow RCCM to cover all of its Eurodollar transaction fees without regard to actual market conditions. The trader evaded RCCM's wash blocking system in order to trade against himself and generate rebates. He continued generating rebates using wash trades until his trading was detected and RCCM tightened its wash blocking system.
- **Strategy 2: scratch trading among RCCM traders.** Two RCCM traders began engaging in prolonged periods of scratch trading, that is, buying and selling opposite each other, in order to generate the rebates. They continued trading in that manner until the CME informed RCCM that it would exclude trades among RCCM traders from the rebate calculations.
- **Strategy 3: implied self-trading.** This strategy was conceived by Elsasser. Elsasser discovered he could trade against himself in rebate-eligible products and avoid detection using the exchange's implied matching engine to buy and sell contracts. The CME compliance department did not detect or investigate these transactions until they were brought to its attention by a regulatory inquiry. This strategy proved so effective that Elsasser generated rebates in excess of his group's Eurodollar trading, and he distributed the fee credits among other traders and the RCCM house account.

In total, RCCM earned rebates on approximately 300,000 Eurodollar contracts through more than 8,000 wash transactions while trading in the market maker program.

The orders are No. 17-17 and No. 17-18.

LitigationEnforcement: CFTCNews CommodityFutures ExchangesMarketRegulation FraudManipulation