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CFTC Exercises Disruptive Trading Authority for the First Time

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Bob Pease served as team leader and one of the authors of the CFTC Disruptive Trading Interpretive Guidance and Policy Statement that put into place the spoofing rule.

By order dated July 22, 2013, the Commodity Futures Trading Commission (CFTC or Commission) settled charges against Panther Energy Trading LLC and its principal Michael Coscia for engaging in the disruptive trading practice known as "spoofing." The CFTC charged that Panther and Coscia used a computer algorithm that was designed to illegally place and quickly cancel bids and offers in futures contracts. The CFTC ordered Panther and Coscia to pay civil penalties of $1.4 million and to disgorge an additional $1.4 million in illegal profits. Coscia was also given a one year ban on trading in any CFTC regulated markets. This case is significant because it is the first action the CFTC has brought using its new Dodd-Frank disruptive trading authority.

Panther and Coscia used a computer algorithm that was designed to place a small order which was then followed with several large buy orders. The large orders were intended to give the market the impression that there was buy side pressure. The small order would then be executed at the manipulated price and Panther's algorithm would then immediately cancel the large orders. These transactions occurred in milliseconds. Panther and Coscia profited on the executions of the small orders many times over the time period under review. The order stated that "although Coscia and Panther wanted to give the impression of buy-side interest, they entered the large buy orders with the intent that they be cancelled before these orders were actually executed."

Under Dodd-Frank, the CFTC was given new authorities to police disruptions to the markets. One of these provisions is known as spoofing, defined as bidding or offering with the intent to cancel the bid or offer before execution. This new tool enables the CFTC to bring an action without having to bring a more difficult anti-manipulation case or prove manipulative intent. This case also demonstrates that the CFTC will be examining and policing algorithmic trading programs with particular emphasis on high frequency trading (HFT). HFT trading comprises a significant percentage of trading in both the futures and equity markets. The CFTC Technology and Advisory Committee, chaired by Commissioner O'Malia, has held public meetings on this topic and the Commission has promised to issue a concept release addressing risk controls for algorithmic trading. This case will increase the pressure on trading firms to have more pre-trade risk controls in place to prevent trading with the intent to cancel before execution.

While this case only directly impacts traders using algorithms, it indicates the aggressive posture that the CFTC is taking in enforcement matters. We expect that the CFTC will bring more cases under its new disruptive trading authority particularly under the spoofing provisions. Commissioner Chilton has been quoted many times urging the Commission to police the "cheetahs" using high speed algorithms to disrupt markets. We also expect the CFTC to use all of the tools in its tool box including its new Dodd Frank anti-manipulation authority to pursue violations in exchanged traded futures & options, swaps and physical commodities. As the agency starts to move beyond Dodd Frank rulemaking, it will have more resources to focus on this area. We will continue to follow this issue and provide updates as necessary.