

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of:)

JSC VTB Bank and VTB Capital PLC,)

Respondents.)

) CFTC Docket No. 16-27
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4:07 pm, Sep 19, 2016

**ORDER INSTITUTING PROCEEDINGS PURSUANT TO
SECTIONS 6(c) AND 6(d) OF THE COMMODITY EXCHANGE ACT, MAKING
FINDINGS AND IMPOSING REMEDIAL SANCTIONS**

I.

The Commodity Futures Trading Commission (“Commission”) has reason to believe that between December 2010 and June 2013 (the “Relevant Period”), JSC VTB Bank (“VTB”) and VTB Capital PLC (“VTB Capital”) (collectively, “Respondents”) violated Section 4c(a)(1) and (2) of the Commodity Exchange Act (“Act”), 7 U.S.C. § 6c(a)(1) and (2) (2012), and Commission Regulation (“Regulation”) 1.38(a), 17 C.F.R. §1.38(a) (2015). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted to determine whether Respondents engaged in the violations set forth herein and to determine whether any order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of an administrative proceeding, Respondents have submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Without admitting or denying any of the findings or conclusions herein, Respondents consent to the entry of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions (“Order”) and acknowledge service of this Order.¹

¹ Respondents consent to the entry of this Order and to the use of these findings in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party; provided, however, that Respondents do not consent to the use of the Offer, or the findings or conclusions in this Order consented to in the Offer, as the sole basis for any other proceeding brought by the Commission, other than in a proceeding in bankruptcy or to enforce the terms of this Order. Nor do Respondents consent to the use of the Offer or this Order, or the

III.

The Commission finds the following:

A. SUMMARY

During the Relevant Period, VTB and its subsidiary VTB Capital executed over 100 block trades in Russian Ruble/U.S. Dollar futures contracts (“RUB/USD contracts”) on the Chicago Mercantile Exchange (“CME”), with a notional value of approximately \$36 billion. These trades were non-arms-length, risk-free, and solely intended to transfer cross-currency risk from VTB to VTB Capital to allow the risk to be hedged in the over-the-counter (“OTC”) swaps market, which VTB could not do, but VTB Capital could. Through the transactions with its subsidiary, VTB obtained more favorable prices than it would have otherwise obtained if it had to deal with other financial institutions. For these reasons, Respondents’ block trades in RUB/USD contracts constituted fictitious sales and caused prices to be reported to or recorded by the CME that were not true and bona fide prices in violation of Section 4c(a)(1) and (2) of the Act. By failing to obtain fair and reasonable prices in light of the circumstances of the markets and the parties to the block trades, the transactions also were not in compliance with the applicable exchange requirements and thus constituted unlawful noncompetitive trades in violation of Regulation 1.38(a).

In accepting VTB and VTB Capital’s Offer, the Commission recognizes Respondents’ significant cooperation during the investigation of this matter.

B. RESPONDENTS

JSC VTB Bank (VTB): VTB is headquartered in St. Petersburg, Russia and has offices and subsidiaries around the world. VTB is the second largest banking institution domiciled in the Russian Federation. VTB has never been registered with the Commission in any capacity.

VTB Capital PLC (VTB Capital): VTB Capital is a U.K.-incorporated bank. It is 94% owned by a holding corporation that is 100% owned by VTB. It is regulated by the Financial Conduct Authority and the Prudential Regulatory Authority in the United Kingdom. VTB Capital has never been registered with the Commission in any capacity. VTB Capital’s financial results are consolidated with VTB.

C. FACTS

1. **The RUB/USD Contract**

The RUB/USD contract trades through Globex on the CME. Each contract represents 2,500,000 Russian Rubles (“Rubles”). RUB/USD contracts are cash-settled in U.S. dollar denominations according to CME settlement rules. The CME has approved block trades in the RUB/USD contract in minimum block sizes of 50 contracts. The RUB/USD contract is active, but because of the time difference and long periods of illiquidity, trading is predominantly done

findings or conclusions in this Order consented to in the Offer, by any other party in any other proceeding.

off-exchange through block trades which are allowable by CME Rule 526 as long as executed in accordance with exchange requirements. Throughout the Relevant Period, Respondents' RUB/USD positions often comprised a significant portion of the total RUB/USD open interest.

2. VTB's Need to Transfer Risk Via Block Trades

VTB operates as a bank within the Russian Federation. In the course of its normal operations, VTB frequently enters into loans with its customers that are denominated in Rubles. VTB and its customers then often enter into swaps that provide the customers' funds in USD. This exposes VTB to cross-currency risk between the Ruble and USD, which VTB desires to hedge. Due to uncertainty in Russian bankruptcy laws, significant capital requirements would be imposed on any international banks entering into OTC cross-currency swaps with VTB. As such, any interested swap counterparties would require significant premiums from VTB to enter into such swaps. Consequently, VTB looked to its U.K.-domiciled subsidiary, VTB Capital, to assist in hedging its cross-currency risk.

As with other banks, VTB Capital cannot enter into significant OTC cross-currency swaps with VTB because VTB Capital would quickly exceed its U.K. capital-at-risk regulatory limits. So, instead, VTB Capital and VTB entered into large block RUB/USD trades, clearing them through the CME. These block trades effectively transferred the cross-currency risk from VTB to VTB Capital. VTB Capital then offset the transferred cross-currency risk by entering into OTC cross-currency swaps with various international banks; thus, the actual hedge of VTB's cross-currency risk was VTB Capital's OTC swaps. During the Relevant Period, VTB and VTB Capital entered into more than 100 equal and offsetting RUB/USD contracts block trades cleared through the CME. These block trades had a total notional value of approximately \$36 billion.

3. Respondents' Block Trades Were Noncompetitively Priced and Designed to Avoid Market Risk

VTB Capital describes itself as a foreign currency "market maker" or "broker" for VTB. During the Relevant Period, VTB contacted VTB Capital when VTB sought to enter into a RUB/USD block trade. VTB Capital would quote a price for the block trade that was typically the mid-point between the current bid-ask spread of OTC RUB/USD swaps. VTB typically accepted the price, and the block trade was entered and cleared via a broker.

VTB, however, did not seek to price the block trades with other counterparties. VTB believed doing so would be unfruitful because block prices from the open market (through trades with other financial institutions) would not have been as favorable to VTB as the prices offered by its subsidiary, VTB Capital. Further, in this relatively illiquid market, VTB believed that pricing inquiries alone would likely impact market prices unfavorably for VTB.

The block trades were entered to transfer cross-currency risk from VTB to VTB Capital in order to enable VTB Capital to hedge the risk, which VTB was unable to do. The block trades, by design, did not create any market risk to the combined VTB entities because, ultimately, any financial gains and losses from these trades were consolidated on VTB's books.

IV.

LEGAL DISCUSSION

A. Respondents Violated Section 4c(a)(1) and (2) of the Act

Respondents' RUB/USD block trades constituted unlawful fictitious sales and caused prices to be reported or recorded that were not true and bona fide prices. Section 4c(a)(1) and (2) of the Act makes it unlawful "for any person to offer to enter into, enter into, or confirm the execution of a transaction that is . . . a fictitious sale" or that "is used to cause any price to be reported, registered, or recorded that is not a true and bona fide price."

A central purpose of the Act is to "insure fair practice and honest dealing on the commodity exchanges . . ." *Amend Grain Futures Act*, H.R. Rep. No. 1637, 73d Cong., 2d Sess., at 1 (1934). As recognized in the seminal case of *In re Goldwurm*,

The language [of Section 4c of the Act] could hardly be broader and, together with the other prohibitions in this section and other parts of the [A]ct, evinces an intention to outlaw insofar as possible all schemes of trading that are artificial and are not the result of arms-length trading on the basis of supply and demand factors and trading opinion of these factors.

7 Agric. Dec. 265, at 275 (Apr. 21, 1948) (emphasis omitted).

As the Commission has recognized, "the statutory language and legislative history evince a Congressional intent to ban all trading techniques that involve fictitious transactions." *In re Thomas Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194, at 45,742 (CFTC Dec. 10, 1997). Although "fictitious sales" is not specifically defined in the Act, "the central characteristic of the general category of fictitious sales is the use of trading techniques that give the appearance of submitting trades to the open market while negating the risk or price competition incident to such a market." *In re Harold Collins*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,982 at 31,902 (CFTC Apr. 4, 1986), *rev'd on other grounds sub nom. Stoller v. CFTC*, 834 F.2d 262 (2d Cir. 1987). "[P]rice competition or market risk is negated when it is reduced to a level that has no practical impact on the transaction at issue." *In re Gimbel*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,213, fn. 7 (CFTC Apr. 14, 1988). Even when noncompetitive trading of futures contracts is allowed by exchange rules, failure to follow those rules results in such trading being fictitious in violation of Section 4c(a) of the Act. See *In re Emil Vojtek*, 22 Agric. Dec. 778 (determining that futures contracts traded off-exchange were not valid "changer trades" permitted by the exchange and therefore constituted fictitious trades in violation of Section 4c of the Act).²

Respondents' RUB/USD block trades were fictitious sales under the Act. Respondents designed the block trades to accomplish through the use of the futures market that which was not otherwise possible for VTB to accomplish in the swaps market. Through the block trades, VTB was able to transfer its cross-currency risk to VTB Capital which could then hedge the risk in the swaps market. VTB obtained pricing from VTB Capital for these transactions that was more

² In order to establish a violation of Section 4c(a) of the Act, the Commission must also demonstrate that a person knowingly participated in transactions initiated with intent to avoid a bona fide market position. *In re Harold Collins*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 31,903.

favorable than it admittedly could have obtained from third-parties in the futures market. With this structure, Respondents, as intended, negated market risk and avoided price competition. Accordingly, Respondents' block trades were "fictitious from the standpoint of reality and substance" and in violation of Section 4c(a)(1) and (2)(A) of the Act. *In re Goldwurm*, 7 Agric. Dec. 265, 275 (providing that cotton futures trades entered for purpose of accomplishing income tax reporting goals were "fictitious from the standpoint of reality and substance"). Further, Respondents' trades caused prices to be reported to or recorded by the CME that were not true and bona fide prices in violation of Section 4c(a)(2)(B) of the Act. *See In re Morgan Stanley & Co.*, [2012 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 32,218 (CFTC June 5, 2012) (settlement order) (finding violation of Section 4c(a) where unlawfully executed exchanges for related positions caused non-bona fide prices to be reported or recorded).

B. Respondents Violated Regulation 1.38(a)

Regulation 1.38(a) requires all purchases and sales of commodity futures be executed "openly and competitively." "The purpose of this requirement is to ensure that all trades are executed at competitive prices and that all trades are directed into a centralized marketplace to participate in the competitive determination of the price of futures contracts." *In re Absa Bank, Ltd.*, [2014-2015 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 33,269 at 76,422 (CFTC Sept. 25, 2014). An exception exists for non-competitive trades that are executed in accordance with the rules of the exchange. *See* 17 C.F.R. § 1.38(a).

Block trades entered under specific conditions are allowed under CME rules and are an example of such permitted noncompetitive trades. Among other requirements, CME Rule 526 requires all block trades to be transacted at prices that are "fair and reasonable" in light of, among other things, "the circumstances of the markets or the parties to the block trade." Block trades executed on the CME that fail to comply with these requirements violate Regulation 1.38(a). *See In re Morgan Stanley & Co.*, [2012 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 32,218 (finding that exchanges for related positions conducted in violation of exchange rules were unlawful noncompetitive trades under Regulation 1.38(a)).

The prices utilized by Respondents for the RUB/USD block trades were not fair or reasonable because they did not take into account the circumstances of the markets or the parties to the trade. In fact, Respondents admitted that VTB did not seek price quotes from unrelated third parties because such prices would not be as favorable as those offered by VTB Capital and that merely seeking a price could cause unfavorable pricing to VTB. Accordingly, Respondents' RUB/USD block trades did not comply with CME block trade requirements and thus were unlawful non-competitive trades in violation of Regulation 1.38(a).

V.

FINDINGS OF VIOLATION

Based on the foregoing, the Commission finds that, during the Relevant Period, VTB and VTB Capital violated Section 4c(a)(1) and (2) of the Act and Regulation 1.38(a).

VI.

OFFER OF SETTLEMENT

Respondents have submitted the Offer in which they, without admitting or denying the findings and conclusions herein:

- A. Acknowledge receipt of service of this Order;
- B. Admit the jurisdiction of the Commission with respect to all matters set forth in this Order and for any action or proceeding brought or authorized by the Commission based on violation of or enforcement of this Order;
- C. Waive:
 - 1. the filing and service of a complaint and notice of hearing;
 - 2. a hearing;
 - 3. all post-hearing procedures;
 - 4. judicial review by any court;
 - 5. any and all objections to the participation by any member of the Commission's staff in the Commission's consideration of the Offer;
 - 6. any and all claims that they may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (2012), and 28 U.S.C. § 2412 (2012), and/or the rules promulgated by the Commission in conformity therewith, Part 148 of the Regulations, 17 C.F.R. §§ 148.1-30 (2015), relating to, or arising from, this proceeding;
 - 7. any and all claims that they may possess under the Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, §§ 201-253, 110 Stat. 847, 857-868 (1996), as amended by Pub. L. No. 110-28, § 8302, 121 Stat. 112, 204-205 (2007), relating to, or arising from, this proceeding; and
 - 8. any claims of Double Jeopardy based on the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief;
- D. Stipulate that the record basis on which this Order is entered shall consist solely of the findings contained in this Order to which Respondents have consented in the Offer;
- E. Consent, solely on the basis of the Offer, to the Commission's entry of this Order that:
 - 1. makes findings by the Commission that Respondents violated Section 4c(a)(1) and (2) of the Act and Regulation 1.38(a);

2. orders Respondents to cease and desist from violating Section 4c(a)(1) and (2) and Regulation 1.38(a);
3. orders Respondents to pay a civil monetary penalty in the amount of \$5,000,000, plus post-judgment interest, for which Respondents are jointly and severally liable;
4. orders Respondents and their successors and assigns to comply with the conditions and undertakings consented to in the Offer and as set forth in Part VII of this Order.

Upon consideration, the Commission has determined to accept the Offer.

VII.

ORDER

Accordingly, IT IS HEREBY ORDERED THAT:

- A. Respondents shall cease and desist from violating Section 4c(a)(1) and (2) of the Act, 7 U.S.C. § 6c(a)(1) and (2) (2012), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2015).
- B. Respondents shall pay a civil monetary penalty in the amount of five million dollars (\$5,000,000) (the “CMP Obligation”) within ten (10) days of the date of this Order. Respondents shall be jointly and severally liable for paying the CMP Obligation. If Respondents do not pay the CMP Obligation in full within ten (10) days of the date of entry of this Order, then post-judgment interest shall accrue on the CMP Obligation beginning on the date of entry of this Order and shall be determined by using the Treasury Bill rate prevailing on the date of entry of this Order pursuant to 28 U.S.C. § 1961 (2012). Respondents shall pay the CMP Obligation by electronic funds transfer, U.S. postal money order, certified check, bank cashier’s check, or bank money order. If payment is to be made other than by electronic funds transfer, then the payment shall be made payable to the Commodity Futures Trading Commission and sent to the address below:

Commodity Futures Trading Commission
Division of Enforcement
ATTN: Accounts Receivables
DOT/FAA/MMAC/AMZ-341
CFTC/CPSC/SEC
6500 S. MacArthur Blvd.
Oklahoma City, OK 73169
(405) 954-7262 office
(405) 954-1620 fax
nikki.gibson@faa.gov

If payment is to be made by electronic funds transfer, Respondents shall contact Nikki Gibson or her successor at the above address to receive payment instructions and shall fully comply with those instructions. Respondents shall accompany payment of the CMP


Obligation with a cover letter that identifies the paying Respondent and the name and docket number of this proceeding. The paying Respondent shall simultaneously transmit copies of the cover letter and the form of payment to the Chief Financial Officer, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, D.C. 20581.

- C. Respondents and their successors and assigns shall comply with the following conditions and undertakings set forth in the Offer:
1. Respondents agree that neither they nor any of their successors and assigns, agents or employees under their authority or control shall take any action or make any public statement denying, directly or indirectly, any findings or conclusions in this Order or creating, or tending to create, the impression that this Order is without a factual basis; provided, however, that nothing in this provision shall affect Respondents': (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to which the Commission is not a party. Respondents and their successors and assigns shall undertake all steps necessary to ensure that all of their agents and/or employees under their authority or control understand and comply with this agreement.
 2. Respondents understand and agree that any acceptance by the Commission of partial payment of Respondents' CMP Obligation shall not be deemed a waiver of their obligation to make further payments pursuant to this Order or a waiver of the Commission's right to seek to compel payment of any remaining balance.
 3. Respondents further agree that they shall comply with the following additional undertakings:
 - a. Respondents shall not enter into privately negotiated futures, options or combination transactions with one another on or through any U.S.-based futures exchange for a period of two years from the date of this Order;
 - b. Respondents shall institute, update and/or strengthen policies and procedures designed to detect, deter, discipline and correct any potential fictitious or noncompetitive trading in violation of Section 4c(a)(1) and (2) of the Act and Section 1.38(a) of the Regulations with regard to transactions made by Respondents on U.S. markets, including the type of violative conduct found by the Commission in this Order;

- c. Within 60 days of the issuance of this Order, Respondents shall conduct training addressing the ethics, compliance, and legal requirements of the Act and Regulations with regard to fictitious or noncompetitive trading in violation of Section 4c(a)(1) and (2) of the Act and Section 1.38(a) of the Regulations, to be given to professional staff, including all directors, officers, managers, portfolio managers, traders, associated persons, execution desk personnel, compliance personnel, and employees involved in any transactions made by Respondents on U.S. markets, including the type of violative conduct found by the Commission in this Order; and
- d. Respondents shall submit a confidential report to the Commission's Division of Enforcement within 120 days of the issuance of an Order. The report shall detail the steps taken to comply with this Order and the results of Respondents compliance with the above undertakings.

The provisions of this Order shall be effective as of this date.

By the Commission.



Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission

Dated: September 19, 2016