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Traders Can Stand Up to Investigations from Regulators and Exchanges

U.S. government regulators and self-regulatory organizations are ramping up investigations and enforcement actions against traders over allegations of market manipulation and spoofing. Traders should aggressively stand up to them - we look at some counteroffensive approaches to both types of entities that can drive more successful outcomes.

U.S. government regulators – including the Securities and Exchange Commission (SEC), Department of Justice (DOJ) and Commodity Futures Trading Commission (CFTC) – are intensifying enforcement actions on traders for market manipulation and spoofing, ratcheting up monetary demands for settlements and threats of criminal charges. At the same time, exchanges and self-regulatory organizations (SROs) are also stepping into the fray, with entities such as the New York Stock Exchange and Chicago Mercantile Exchange intent on policing trading activities.

Traders should use aggressive measures to manage enforcement risk within a broader strategy. There are counteroffensive approaches traders can take in response to government regulators and SROs that can avoid unnecessary escalation and drive more successful and cost-efficient outcomes.

Standing Up to Regulators and Exchanges

When facing a regulator, traders should consider the following strategies:

- 1. Testing the Regulator's Reach:** Regulators often overreach in their assertion of authority. One of the first steps for targets in certain cases is to challenge the legal basis of an enforcement action. This is especially pertinent for non-U.S. traders: for example, U.S. regulators must follow particular procedures to obtain overseas evidence. Even if a trader wants to appear cooperative, noting a jurisdictional issue can be a good negotiating tool to narrow the scope of a subpoena, for example.
- 2. Seizing Control of the Narrative:** While conventional wisdom may favor playing one's cards close to the vest, it can sometimes be advantageous to shape a regulator's views of a situation early in the process. This might consist of proactively responding to subpoenas with a letter or requesting a meeting to set out the trader's narrative.

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3. **Going On the Offensive:** Traders should look for opportunities to take a regulator head-on by challenging the enforcement process or increasing the stakes for the regulator. For example, traders can object on the grounds of a lack of fair notice that their trading activities were unlawful. They could also consider filing cost-shifting applications in response to overbroad government requests, increasing the burden on the regulator.

Similar strategies may be applicable against exchanges – for example, traders can benefit by presenting a counternarrative to the exchange. In addition, traders can take advantage of the unique way SROs function in the market, such as by:

1. **Leverage Downside Risks for Exchange Personnel:** Exchange personnel sometimes have personal knowledge regarding a trading firm's operations, potentially including the questioned conduct. Traders may be able to articulate that, for example, the trading activity relied on representations made by exchange personnel, putting pressure on the exchange that they may be in part responsible or have a conflict of interest.
2. **Challenging the Exchange's Hearing:** Exchanges often set the rules for their own hearings. Sometimes, this gives traders the chance to push back on fairness concerns, point to deficiencies in the hearing process or flag potential conflicts of interest. For example, an exchange's rules might not provide a mechanism to compel exchange personnel to testify or disclose relevant information despite their knowledge of the events that gave rise to the enforcement action. Even if these challenges may be ultimately unsuccessful, taking proactive action may serve as a stick to persuade an exchange that continued enforcement efforts increase its own risk.

In the past, trading firms' reflex to surrender to investigations from regulators and exchanges in the hopes of receiving some undefined "credit" for cooperation have delivered not quick relief but years of unrewarded intrusion. Some are now realizing that a strategy deploying counteroffensive and defensive measures can drive more successful outcomes. Traders have access to an arsenal of tools to fight against intrusive investigations from both regulators and exchanges.

About Kobre & Kim

Kobre & Kim is a conflict-free Am Law 200 law firm focused on disputes and investigations, often involving fraud and misconduct.

Our team of independent advocates in cross-border government enforcement investigations and actions:

- includes almost twenty former U.S. government lawyers based globally;
- has served as lead counsel in prominent enforcement actions including those involving market manipulation, bribery and corruption, antitrust and competition, economic sanctions, asset forfeiture, money laundering, extradition, fraud and other misconduct; and
- are able to either advocate directly or to work cooperatively with local counsel, in jurisdictions in the U.S., UK, EMEA, Asia, Latin America and key offshore financial centers.